

UNITED FIRE & CASUALTY CO

Form 10-K

March 01, 2010

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

☐ **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the fiscal year ended December 31, 2009**

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 001-34257

UNITED FIRE & CASUALTY COMPANY

(Exact name of registrant as specified in its charter)

Iowa

42-0644327

(State of Incorporation)

(IRS Employer Identification No.)

118 Second Avenue SE

PO Box 73909

Cedar Rapids, Iowa 52407-3909

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (319) 399-5700

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class

Name of each exchange on which registered

Common Stock, \$3.33 1/3 par value

The NASDAQ Stock Market LLC

Securities Registered Pursuant to Section 12(g) of the Act: None

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 whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). 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, 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 ☐ 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 ☒
The aggregate market value of voting stock held by nonaffiliates of the registrant as of June 30, 2009, was approximately \$344.9 million. For purposes of this calculation, all directors and executive officers of the registrant are considered affiliates. As of February 23, 2010, 26,381,564 shares of common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Form 10-K incorporates by reference certain information from the registrant's definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, for its annual stockholders meeting to be held on May 19, 2010.

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PART I.

ITEM 1. BUSINESS

FORWARD-LOOKING INFORMATION

It is important to note that our actual results could differ materially from those projected in the forward-looking statements. Information concerning factors that could cause actual results to differ materially from those in the forward-looking statements is contained in Part I, Item 1A, Risk Factors, and Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

GENERAL DESCRIPTION

The terms United Fire, United Fire Group, we, us, or our refer to United Fire & Casualty Company or United Fire & Casualty Company and its consolidated subsidiaries and affiliate, as the context requires. We are engaged in the business of writing property and casualty insurance and life insurance and selling annuities. United Fire & Casualty Company was incorporated in Iowa in January 1946. Our principal executive office is located at 118 Second Avenue SE, P.O. Box 73909, Cedar Rapids, Iowa 52407-3909. Telephone: 319-399-5700.

Employees

As of December 31, 2009, we employed 659 full-time employees and 14 part-time employees. We are not a party to any collective bargaining agreement.

Reportable Segments

We report our operations in two business segments: property and casualty insurance and life insurance. A table reflecting revenues, net income and assets attributable to our operating segments is included in Part II, Item 8, Note 11, Segment Information. All intercompany balances have been eliminated in consolidation.

Our property and casualty insurance segment includes United Fire & Casualty Company and the following companies, which are wholly owned by United Fire & Casualty Company, directly or indirectly: Addison Insurance Company, an Illinois property and casualty insurer; Lafayette Insurance Company, a Louisiana property and casualty insurer; United Fire & Indemnity Company, a Texas property and casualty insurer; American Indemnity Financial Corporation, a Delaware holding company; and Texas General Indemnity Company, a Colorado property and casualty insurer. United Fire Lloyds, a Texas property and casualty insurer, is an affiliate of and operationally and financially controlled by United Fire & Indemnity Company.

Most of our property and casualty insurance subsidiaries are members of an intercompany reinsurance pooling arrangement. Pooling arrangements permit the participating companies to rely on the capacity of the entire pool's capital and surplus, rather than being limited to policy exposures of a size commensurate with each participant's own surplus level. Under such arrangements, the members share substantially all of the insurance business that is written, and allocate the combined premiums, losses and expenses based on percentages defined in the arrangement.

Our life insurance segment consists of United Life Insurance Company, an Iowa life insurer and wholly owned subsidiary of United Fire & Casualty Company.

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Available Information

United Fire Group provides free and timely access to all company reports filed with the Securities and Exchange Commission (SEC) in the Investor Relations section of our website at www.unitedfiregroup.com. Select SEC Filings to view the list of filings, which includes:

Annual reports (Form 10-K)

Quarterly reports (Form 10-Q)

Current reports (Form 8-K)

Beneficial ownership reports (Forms 3, 4 and 5)

Amendments to reports filed or furnished pursuant to Section 13(a), 15(d) or 16(a) of the Exchange Act.

Such reports are made available as soon as reasonably practicable after they are filed with or furnished to the SEC.

Our Code of Ethics is also available at www.unitedfiregroup.com in the Investor Relations section. To view it, select Corporate Governance and then Code of Ethics.

Free paper copies of any materials that we file with the SEC can also be obtained by writing to Investor Relations, United Fire Group, P.O. Box 73909, Cedar Rapids, Iowa 52407-3909 or by visiting the SEC Public Reference Room, 450 Fifth Street NW, Washington, DC 20549. For information about the Public Reference Room, call the SEC at 1-800-SEC-0330.

The SEC maintains a website at www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

GEOGRAPHIC DISTRIBUTION

We market our products through our home office in Cedar Rapids, Iowa, and two regional locations: Westminster, Colorado, a suburb of Denver, and Galveston, Texas.

We are licensed as a property and casualty insurer in 43 states, primarily in the Midwest, West and South, plus the District of Columbia. We have 813 independent agencies representing us and our property and casualty insurance subsidiaries. The following table depicts the top five states for direct premiums written for our property and casualty insurance operations in 2009.

(In Thousands)	Direct Premiums Written	% to Total Direct Premiums Written
Texas	\$ 69,900	15.4%
Iowa	69,515	15.3
Louisiana	41,743	9.2
Missouri	41,185	9.1
Colorado	33,938	7.5
Direct Premiums Written ⁽¹⁾	\$ 256,281	56.5%

(1) The Statutory Financial Measures section of Part II, Item 7 defines data prepared in accordance with statutory

accounting
practices, which
is a
comprehensive
basis of
accounting other
than U.S.
GAAP.

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Our life insurance subsidiary is licensed in 28 states, primarily in the Midwest and West, and is represented by 933 independent agencies. The following table depicts the top five states for direct statutory premium volume for our life insurance operations in 2009.

(In Thousands)	Direct Statutory Premium Volume	% to Total Direct Statutory Premium Volume
Iowa	\$ 94,658	36.8%
Nebraska	33,103	12.9
Minnesota	23,128	9.0
Wisconsin	21,548	8.4
Illinois	17,720	6.9
Direct Statutory Premium Volume	\$ 190,157	74.0%

We staff our regional offices with underwriting, claims and marketing representatives and administrative technicians, all of whom provide support and assistance to the independent agencies. Also, home office staff technicians and specialists provide support to the subsidiaries, regional offices and independent agencies. We use management reports to monitor subsidiary and regional offices for overall results and conformity to our business policies.

COMPETITION**Property and Casualty Insurance Segment**

The property and casualty industry is highly competitive. We compete with numerous property and casualty insurance companies in the regional and national market, many of which are substantially larger and have considerably greater financial and other resources.

In addition, because our products are marketed exclusively through independent insurance agencies, most of which represent more than one company, we face competition within each agency. Our competitors include companies that market their products through agents, as well as companies that sell insurance directly to their customers.

Since we rely solely on independent agencies, we offer a competitive commissions program, as well as a rewarding profit-sharing plan, as incentives for agents to place high-quality property and casualty insurance business with us. We estimate property and casualty agencies will receive profit-sharing payments of \$5.7 million in 2010, based on business produced by the agencies in 2009.

Our competitive advantages include our commitment to:

Disciplined underwriting we empower our underwriters with the knowledge and tools needed to make good decisions for our company

Exceptional customer service our customers always have the option to speak with a real person

Superior loss control services our loss control representatives make multiple visits to businesses and jobsites to ensure safety, rather than just one visit

Fair and ethical claims handling we view claims as an opportunity to prove to our customers that they have chosen the right insurance company

Effective and efficient use technology we use technology to provide enhanced service, reinforcing the personal relationships we have with our customers, not replacing them.

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In 2009, for the second consecutive year, United Fire was recognized for the way we do business and the services we provide, being named a Top 10 Ease of Doing Business Performer in Deep Customer Connections Inc.'s (DCC) seventh annual Ease of Doing Business (EDB) survey. Over 8,700 independent agents and brokers assessed the performance of more than 250 property and casualty carriers as part of the survey. They rated the importance of 11 factors, ranging from underwriting responsiveness and handling claims promptly to acting with the agency's needs in mind. DCC specializes in helping property and casualty carriers achieve profitable growth by making it easy for their agents to work with them. DCC's EDB Index® is an industry benchmark of carriers' EDB performance.

Life Insurance Segment

We also encounter significant competition in all lines of our life and fixed annuity business from other life insurance companies and other providers of financial services. Since our products are marketed exclusively through independent life insurance agencies that typically represent more than one company, we face competition within our agencies. Competitors include companies that market their products through agents, as well as companies that sell directly to their customers.

To attract and maintain relationships with our independent life insurance agencies, we offer competitive commission rates and other sales incentives. Our life insurance segment achieves a competitive advantage by offering products that are simple and straightforward, by providing outstanding customer service, by being accessible to our agents and customers, and by using technology in a variety of ways to assist our agents and improve the delivery of service to our policyholders.

OPERATING SEGMENTS

Incorporated by reference from Note 11, Segment Information contained in Part II, Item 8, Financial Statements and Supplementary Data. Additionally, for a detailed discussion of our operating results by segment, refer to the Results of Operations section in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

REINSURANCE

Incorporated by reference from Note 5, Reinsurance contained in Part II, Item 8, Financial Statements and Supplementary Data.

RESERVES

Property and Casualty Insurance Segment

Property insurance indemnifies an insured with an interest in physical property for loss of, or damage to, such property or the loss of its income-producing abilities. Casualty insurance primarily covers liability for damage to property of, or injury to, a person or entity other than the insured. In most cases casualty insurance also obligates the insurance company to provide a defense for the insured in litigation arising out of events covered by the policy.

Reserves for losses and loss settlement expenses (loss reserves) are management's best estimates at a given point in time of what we expect to pay for claims that have been reported and those that have been incurred but not reported (IBNR), based on facts, circumstances and historical trends then known.

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The determination of reserves, particularly those relating to liability lines of insurance, reflects significant judgment factors. If, during the course of our regular monitoring of reserves, we determine that coverages previously written are incurring higher than expected losses, we will take action that may include, among others, increasing the related reserves. Any adjustments we make to reserves are reflected in operating results in the year in which we make those adjustments. As required by state law, we engage an independent actuary, Regnier Consulting Group, Inc., to render an opinion as to the adequacy of the statutory reserves we establish annually. The actuarial opinion is filed in those states where we are licensed. On a quarterly basis, Regnier Consulting Group, Inc. reviews our direct loss and loss settlement reserves for adequacy.

We do not discount loss reserves based on the time value of money. However, we consider inflation in the reserving process by reviewing cost trends, loss settlement expenses, historical reserving results and likely future economic conditions. There are no material differences between our statutory reserves and those established under U.S. generally accepted accounting principles (GAAP). Refer to the Critical Accounting Estimates section in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, for a more detailed discussion of our loss reserves.

The table on the following page illustrates the change in our estimate of reserves for loss and loss settlement expenses for our property and casualty companies for the years 1999 through 2008. The first section shows the amount of the liability, as originally reported, at the end of each calendar year in our Consolidated Financial Statements. These reserves represent the estimated amount of losses and loss settlement expenses for losses arising in that year and all prior years that are unpaid at the end of each year, including an estimate for our IBNR losses, net of applicable ceded reinsurance. The second section displays the cumulative amount of net losses and loss settlement expenses paid for each year with respect to that liability. The third section shows the reestimated amount of the previously recorded liability based on experience as of the end of each succeeding year. The estimate is increased or decreased as more information becomes known about the losses for individual years. The last section compares the latest reestimated amount with the original estimate. Conditions and trends that have affected development of loss reserves in the past may not necessarily exist in the future. Accordingly, it would not be appropriate to extrapolate future redundancies or deficiencies based on this table.

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ands)										
ed December 31	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
ility for loss and										
ment expenses	\$ 338,243	\$ 358,032	\$ 363,819	\$ 392,649	\$ 427,049	\$ 464,889	\$ 620,100	\$ 518,886	\$ 496,083	\$ 586,109
s and loss										
expenses	27,606	37,526	36,909	35,760	27,309	28,609	60,137	40,560	38,800	52,508
ty for loss and										
ment expenses	\$ 310,637	\$ 320,506	\$ 326,910	\$ 356,889	\$ 399,740	\$ 436,280	\$ 559,963	\$ 478,326	\$ 457,283	\$ 533,601
ve net paid as of:										
later	\$ 97,021	\$ 110,516	\$ 112,546	\$ 107,271	\$ 100,895	\$ 110,016	\$ 230,455	\$ 148,593	\$ 140,149	\$ 195,524
s later	154,886	166,097	172,538	172,158	167,384	166,592	321,110	235,975	265,361	
rs later	189,730	204,792	215,002	214,307	203,861	213,144	380,294	332,768		
s later	213,190	230,889	240,973	237,150	231,278	242,579	456,919			
later	231,838	245,677	252,969	253,026	250,787	264,015				
later	241,540	252,153	264,311	265,304	263,631					
rs later	245,145	259,621	273,153	273,066						
rs later	249,302	264,713	277,868							
s later	253,274	266,912								
later	254,674									
ty reestimated as										
ar	\$ 310,637	\$ 320,506	\$ 326,910	\$ 356,889	\$ 399,740	\$ 436,280	\$ 559,963	\$ 478,326	\$ 457,283	\$ 533,601
later	273,706	273,469	315,854	344,590	361,153	358,796	534,998	433,125	457,831	559,816
s later	261,217	290,872	323,354	340,502	331,693	330,137	508,774	453,474	502,177	
rs later	273,921	300,011	321,168	324,582	317,187	319,335	538,451	497,629		
s later	279,740	302,884	318,125	313,745	309,146	326,340	574,484			
later	279,653	298,428	309,033	308,304	316,227	327,626				
later	280,983	296,296	307,790	312,188	314,522					
rs later	279,892	293,579	311,367	314,680						
s later	276,815	297,844	312,433							
s later	281,346	297,022								
later	280,101									
dancy										
y)	\$ 30,536	\$ 23,484	\$ 14,477	\$ 42,209	\$ 85,218	\$ 108,654	\$ (14,521)	\$ (19,303)	\$ (44,894)	\$ (26,215)
imated liability	\$ 280,101	\$ 297,022	\$ 312,433	\$ 314,680	\$ 314,522	\$ 327,626	\$ 574,484	\$ 497,629	\$ 502,177	\$ 559,816
ed ceded loss and										
ment expenses	26,609	34,039	42,733	43,419	38,639	38,503	90,660	58,230	51,700	49,533
estimated liability	\$ 306,710	\$ 331,061	\$ 355,166	\$ 358,099	\$ 353,161	\$ 366,129	\$ 665,144	\$ 555,859	\$ 553,877	\$ 609,349

undancy
y)

\$ 31,533 \$ 26,971 \$ 8,653 \$ 34,550 \$ 73,888 \$ 98,760 \$ (45,044) \$ (36,973) \$ (57,794) \$ (23,240)

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Life Insurance Segment

We calculate the policy reserves reported in our Consolidated Financial Statements in accordance with GAAP. For our fixed annuities and universal life policies, we establish a benefit reserve at the time of policy issuance in an amount equal to the deposits received. Subsequently, we adjust the benefit reserve for any additional deposits, interest credited and partial or complete withdrawals as well as insurance and other expense charges. We base policy reserves for other life products on the projected contractual benefits and expenses and interest rates appropriate to those products. We base reserves for accident and health products, which are a minor portion of our reserves, on appropriate morbidity tables for the age and duration of the insured.

We determine reserves for statutory purposes based upon mortality rates and interest rates specified by Iowa state law. Our life insurance subsidiary's reserves meet or exceed the minimum statutory requirements. Griffith, Ballard & Company, an independent actuary, assists us in developing and analyzing our reserves on both a GAAP and statutory basis.

For further discussion of our life insurance segment's reserves, see Critical Accounting Estimates contained in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

INVESTMENTS

Incorporated by reference from Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations under the headings Investments and Critical Accounting Estimates; Part II, Item 7A,

Quantitative and Qualitative Disclosures about Market Risk; and Note 1, Significant Accounting Policies under the headings Investments and Securities Lending, Note 2, Summary of Investments, and Note 3, Fair Value of Financial Instruments, contained in Part II, Item 8, Financial Statements and Supplementary Data.

REGULATION

We are not aware of any currently proposed or recently enacted state or federal regulation that would have a material impact on our operations.

State Regulation

We are subject to extensive regulation, primarily at the state level. The method, extent and substance of such regulation varies by state, but generally has its source in statutes that establish standards and requirements for conducting the business of insurance and that delegate regulatory authority to a state regulatory agency. In general, such regulation is intended for the protection of those who purchase or use our insurance products, and not our stockholders. These rules have a substantial effect on our business and relate to a wide variety of matters including insurance company licensing and examination; agent and adjuster licensing; price setting; trade practices; policy forms; accounting methods; the nature and amount of investments; claims practices; participation in shared markets and guaranty funds; reserve adequacy; insurer solvency; transactions with affiliates; the payment of dividends; underwriting standards; and the collection, remittance and reporting of certain taxes and fees. We discuss below the state laws and regulations that have the most significant effect on our insurance operations and financial reporting are discussed below. We cannot predict whether any specific state or federal measures will be adopted to change the nature or scope of the regulation of the insurance business or what effect any particular measures might have on us.

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Insurance Holding Company Regulation

We are regulated as an insurance holding company system in the states of domicile of our property and casualty companies and life insurance subsidiary: Iowa (United Fire and United Life Insurance Company), Illinois (Addison Insurance Company), Louisiana (Lafayette Insurance Company), Texas (United Fire & Indemnity Company and United Fire Lloyds), and Colorado (Texas General Indemnity Company). These regulations require that we annually furnish financial and other information about the operations of the individual companies within our holding company system. Generally, the insurance codes of these states provide that notice to the state insurance commissioner is required before finalizing any transaction affecting the ownership or control of an insurer and before finalizing certain material transactions between an insurer and any person or entity in its holding company group. In addition, some of those transactions cannot be finalized without the commissioner's prior approval.

Stockholder Dividends

Our dividend-paying capacity, and that of our subsidiaries, is regulated by the laws of the applicable state of domicile. Under these laws, insurance companies must provide advance informational notice to the domicile state insurance regulatory authority prior to payment of any dividend or distribution to its stockholders. Prior approval from the state insurance regulatory authority must be obtained before payment of an extraordinary dividend as defined under the state's insurance code. In all cases, we may pay ordinary dividends only from our earned surplus. Refer to the Market Information section of Part II, Item 5, Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities, for additional information about the dividends we paid during 2009.

Price Regulation

Nearly all states have insurance laws requiring personal property and casualty insurers to file rate schedules, policy or coverage forms, and other information within the state's regulatory authority. In many cases, rate schedules, policy forms, or both, must be approved prior to use. While laws vary from state to state, their objectives are generally the same: an insurance rate cannot be excessive, inadequate or unfairly discriminatory. The speed with which we can change our rates in response to competition or in response to increasing costs depends, in part, on the willingness of state regulators to allow adequate rates for the business that we write.

Investment Regulation

Insurance companies are subject to various state regulations that require investment portfolio diversification and that limit the amount of investment in certain asset categories. Failure to comply with these rules leads to the treatment of nonconforming investments as nonadmitted assets for purposes of measuring statutory surplus. Further, in some instances, these rules require us to sell nonconforming investments.

Exiting Geographic Markets; Canceling and Nonrenewing Policies

Most states regulate our ability to exit a market. For example, states limit, to varying degrees, our ability to cancel and nonrenew policies. Some states prohibit us from withdrawing one or more types of insurance business from the state, except with state regulatory approval. Regulations that limit policy cancellation and nonrenewal may restrict our ability to exit unprofitable markets.

Insurance Guaranty Associations

Each state has insurance guaranty association laws. Membership in a state's insurance guaranty association is generally mandatory for insurers wishing to do business in the states. Under these laws, associations may assess their members for certain obligations that insolvent insurance companies have to their policyholders and claimants. Typically, states assess each solvent member in an amount related to that member's proportionate share of business written by all members within the state. Most state guaranty associations allow solvent insurers to recoup the assessments they are charged through future rate increases, surcharges or premium tax credits. However, there is no assurance that we will ultimately recover these assessments. We cannot predict the amount and timing of any future assessments or refunds under these laws.

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Shared Market and Joint Underwriting Plans

State insurance regulations require insurers to participate in assigned risk plans, reinsurance facilities and joint underwriting associations. These are mechanisms that generally provide applicants with various basic types of insurance coverage not otherwise available to them in voluntary markets. Such mechanisms are most commonly instituted for automobile and workers' compensation insurance, but many states also mandate participation in Fair Access to Insurance Requirements (FAIR) Plans or Windstorm Plans, which provide basic property coverage. Participation is based upon the amount of a company's voluntary market share in a particular state for the classes of insurance involved. Policies written through these mechanisms may require different underwriting standards and pose greater risk than those written through our voluntary application process.

Statutory Accounting

For public reporting, insurance companies prepare financial statements in accordance with GAAP. However, state laws require us to calculate and report certain data according to statutory accounting rules as defined in the National Association of Insurance Commissioners (NAIC) Accounting Practices and Procedures Manual. While not a substitute for any GAAP measure of performance, statutory data frequently is used by industry analysts and other recognized reporting sources to facilitate comparisons of the performance of insurance companies.

Insurance Reserves

State insurance laws require that insurance companies analyze the adequacy of their reserves annually. Our appointed actuaries must submit an opinion that our reserves are adequate for policy claims-paying obligations and related expenses.

Financial Solvency Ratios

The NAIC annually calculates 13 financial ratios to assist state insurance regulators in monitoring the financial condition of insurance companies. A usual range of results for each of these ratios is used by insurance regulators as a benchmark. Departure from the usual range on four or more of the ratios could lead to inquiries from individual state insurance departments as to certain aspects of a company's business. In addition to the financial ratios, states also require us to calculate a minimum capital requirement for each of our insurance companies based on individual company insurance risk factors. These risk-based capital results are used by state insurance regulators to identify companies that require regulatory attention or the initiation of regulatory action. At December 31, 2009, all of our insurance companies had capital well in excess of the required levels.

Federal Regulation

Although the federal government and its regulatory agencies generally do not directly regulate the business of insurance, federal initiatives often have an impact. Some of the current and proposed federal measures that may significantly affect our business are discussed below.

Corporate Governance Reform

In response to the recent financial crisis, Congress has proposed several legislative initiatives designed to strengthen corporate governance at public companies. These proposals contain several provisions that, if adopted, would affect the operation of all public companies and would require, among other things: (i) an annual nonbinding stockholder vote on executive compensation; (ii) the establishment of a risk management committee of the board of directors, composed entirely of independent directors, tasked with the periodic review of a company's risk management policies; (iii) that the chairman of the board of directors be an independent director; (iv) that all members of the compensation committee be independent; and (v) that all members of the board of directors be elected annually by majority vote of the stockholders.

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FINANCIAL STRENGTH RATING

Our financial strength, as measured by statutory accounting principles, is regularly reviewed by an independent rating agency that assigns a rating based upon criteria such as results of operations, capital resources and minimum policyholders' surplus requirements.

Our family of property and casualty insurers has received a group rating of A (Excellent) with a stable outlook from A.M. Best Company (A.M. Best). Within the group, all of our property and casualty insurers have an A (Excellent) rating, except one insurance subsidiary that is in a runoff status, which A.M. Best has designated as NR-3 (Rating Procedure Inapplicable). Our life insurance subsidiary has received an A- (Excellent) rating with a stable outlook from A.M. Best. According to A.M. Best, companies rated A and A- have an excellent ability to meet their ongoing obligations to policyholders.

An insurer's financial strength rating is one of the primary factors evaluated by those in the market to purchase insurance. A poor rating indicates that there is an increased likelihood that the insurer could become insolvent and therefore not able to fulfill its obligations under the insurance policies it issues. This rating can also affect an insurer's level of premium writings, the lines of business it can write and, for insurers like us that are also public registrants, the market value of its securities.

ITEM 1A. RISK FACTORS

RISK FACTORS

We provide the following discussion of risks and uncertainties relevant to our business. These are factors that we believe could cause our actual results to differ materially from expected and historical results. We could also be adversely affected by other factors in addition to those listed here. We have set forth additional information concerning factors that could cause actual results to differ materially from those in the forward-looking statements in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

Risks Relating to Our Business

The incidence, frequency and severity of catastrophe losses are unpredictable and may adversely affect the results of our operations, liquidity and financial condition.

Our property and casualty insurance operations expose us to claims arising from catastrophic events affecting multiple policyholders, which can be caused by various natural and man-made disasters, including, but not limited to, hurricanes, tornadoes, windstorms, hailstorms, fires, explosions, earthquakes, tropical storms and terrorist acts. Property damage resulting from catastrophes is the greatest risk of loss we face in the ordinary course of our business. We have exposure for catastrophe losses under both our commercial insurance policies and our personal insurance policies. In addition, our automobile and inland marine business exposes us to losses arising from floods and other perils.

Longer-term weather trends may be changing and new types of catastrophe losses may be developing due to climate change, a phenomenon that has been associated with extreme weather events linked to rising temperatures, including effects on global weather patterns, greenhouse gases, sea, land and air temperature, sea levels, rain and snow. The emerging science regarding climate change and its connection to extreme weather events is far from conclusive. If a connection to increased extreme weather events related to climate change is ultimately proven true, this could increase the frequency and severity of catastrophe losses we experience in both coastal and non-coastal areas.

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Because the occurrence and severity of catastrophes are inherently unpredictable and may vary significantly from year to year, historical results of operations may not be indicative of future results of operations. In addition, as with catastrophe losses generally, it can take a long time for us to determine our ultimate losses associated with a particular catastrophic event. As our claims experience for a particular catastrophe develops, we may be required to adjust our reserves to reflect our revised estimates of the total cost of claims. Catastrophes may also negatively affect our ability to write new business. Increases in the value and geographic concentration of insured property could impact claims severity for future catastrophic events. In addition, severity may be impacted after catastrophic events as the demand for resources such as building materials and labor to repair damaged structures may inflate costs, and the amount of salvage value received for damaged property may decline.

Our reserves for property and casualty insurance losses and costs related to settlement of property and casualty losses and our life reserves for future policy benefits may be inadequate, which would have an unfavorable impact on our financial results.

Our reserves for claims and future policy benefits may prove to be inadequate, which may result in future charges to earnings and/or a downgrade of our financial strength rating or the financial strength ratings of our insurance company subsidiaries.

We establish property and casualty loss reserves based on assumptions and estimates of damages and liabilities incurred. On a quarterly basis, Regnier Consulting Group, Inc., the independent actuary for our property and casualty segment, estimates property and casualty product reserves based on many assumptions to validate the reasonableness of our claims reserves.

Our property and casualty loss reserves are only estimates; we determine the amount of these loss reserves based on our best estimate and judgment of the losses and costs we will incur on existing insurance policies. Because of the uncertainties that surround estimating loss reserves, we cannot precisely determine the ultimate amounts of benefits and claims that we will pay or the timing of payment of benefits and claims. For a detailed discussion of our reserving process and the factors we consider in estimating reserves, refer to the Critical Accounting Estimates section in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

Actual losses and loss settlement expenses paid might exceed our reserves. If our loss reserves are insufficient, or if we believe our loss reserves are insufficient to cover our actual loss and loss settlement expenses, we will have to increase our loss reserves and incur charges to our earnings, which could indicate that premium levels were insufficient. These charges may be material.

Griffith, Ballard & Company, the independent actuary for our life insurance segment, calculates life product reserves based on our assumptions, including estimated premiums we will receive over the assumed life of the policy, the timing of the event covered by the insurance policy and the amount of benefits or claims to be paid. As such, deviations from one or more of these assumptions could result in a material adverse impact on our Consolidated Financial Statements.

The cyclical nature of the property and casualty insurance business may affect our financial performance.

The financial results of companies in the property and casualty insurance industry historically have been cyclical in nature, characterized by periods of severe price competition and excess underwriting capacity (commonly referred to as "soft" markets), followed by periods of high premium rates and shortages of underwriting capacity (commonly referred to as "hard" markets). We expect these cycles to continue. Premium rates for property and casualty insurance are influenced by factors that are outside of our control, including market and competitive conditions and regulatory issues. Soft market conditions could require us to reduce premiums, limit premium increases, or discontinue offering one or more of our insurance products in one or more states, resulting in a reduction in our premiums written and in our profit margins and revenues. The demand for property and casualty insurance can also vary significantly, rising as the overall level of economic activity increases and falling as that activity decreases. Fluctuations in demand and competition could produce underwriting results that would have a negative impact on the results of our operations and financial condition.

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We are subject to interest rate fluctuations and declines in the value of investments held in our investment portfolio due to various market factors that could negatively affect our profitability.

We are subject to the negative effects of interest rate fluctuations and to declines in the value of our investment portfolio due to changes in market valuations and changes in credit quality related to individual investments. Some of our interest-sensitive products, principally our fixed annuities, expose us to the risk that changes in interest rates will reduce our spread, which is the difference between the rates we are required to pay under these contracts and the rate of return we are able to earn on our investments intended to support our obligations under these contracts.

During periods when the interest rates paid on interest-sensitive insurance products are rising, we may not be able to reinvest our invested assets to achieve the higher rate of return necessary to compensate for the higher interest rates we must pay to keep these products competitive in the marketplace. Consequently, we may have to accept a lower spread and therefore lower profitability, or face a decline in sales of these products and a loss of related assets.

During periods of declining interest rates, we may be unable to achieve similar rates of return on our reinvested or maturing assets. Moreover, this risk may be exacerbated by borrowers prepaying fixed income securities, commercial mortgages, and mortgage-backed securities held in our investment portfolio in order to refinance at lower rates. Because we are only entitled to reset the interest rates on our annuities at limited, pre-established intervals, and because many of our annuity contracts have guaranteed interest rates, the profitability of these products could decrease or even become negative.

Due to the reinvestment risk described above, a decline in market interest rates available on investments could also reduce our return from investments of capital that do not support particular policy obligations, which could also have a material adverse effect on our results of operations. The adverse effect on us from fluctuations in interest rates may be exacerbated because we currently maintain, and intend to continue to maintain, a large portion (92.7 percent at December 31, 2009) of our investment portfolio in fixed income securities, particularly corporate bonds, including our portfolio of trading securities. The fair value of these investments generally increases or decreases in an inverse relationship with changes in interest rates. We classify the majority (99.0 percent, at December 31, 2009) of our fixed income securities as available-for-sale, including our portfolio of trading securities. We report the value of those investments at their current fair value. Accordingly, fluctuations in interest rates may result in fluctuations in the valuation of our fixed income investments, which would affect our stockholders' equity.

Fluctuations in interest rates may cause increased surrenders and withdrawals from our life insurance and annuity products. In periods of rising interest rates, surrenders and withdrawals of life insurance policies and annuity contracts, along with policy loans, may increase as policyholders seek to buy products with perceived higher returns. These surrenders and withdrawals may also require us to accelerate the amortization of deferred policy acquisition costs (DAC), which would increase our expenses in the current period.

The fair value of securities in our investment portfolio may also fluctuate depending on general economic and market conditions or events relating to a particular issuer of securities. Changes in the fair value of securities in our investment portfolio could result in realized or unrealized investment losses, thereby affecting our stockholders' equity. We are exposed to the chance that issuers of bonds that we hold will not be able to pay principal or interest when it is due. Defaults and other impairments may cause write-downs in the value of the bonds we hold. Pervasive deterioration in the credit quality of issuers, changes in interest rate levels and changes in interest rate spreads between types of investments could significantly affect the value of our invested assets and our earnings.

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Financial disruption or a prolonged economic downturn may materially and adversely affect our business operations.

Worldwide financial markets have recently experienced extraordinary disruption and volatility, resulting in heightened credit risk, reduced valuation of investments and decreased economic activity. Moreover, many companies are experiencing reduced liquidity and uncertainty as to their ability to raise capital. In the event that these conditions persist or result in a prolonged economic downturn, our results of operations, financial position and/or liquidity could be materially and adversely affected. In addition, as a result of recent financial events, we may face increased regulation. Many of the other risk factors discussed in this section identify risks that result from, or are exacerbated by, financial economic downturn. These include risks related to our investment portfolio, reinsurance arrangements, other credit exposures, emerging claims and coverage issues, the competitive environment, regulatory developments and the impact of rating agency actions.

The effects of emerging claim and coverage issues and class action litigation on our business are uncertain.

As industry practices and legal, judicial, social and other environmental conditions change, unexpected and unintended issues related to claims and coverage may emerge. These issues may adversely affect our business by either extending coverage beyond our underwriting intent or by increasing the number and/or size of claims. Examples of these issues include:

Judicial expansion of policy coverage and the impact of new theories of liability.

An increase of plaintiffs targeting property and casualty insurers, including us, in purported class action litigation regarding claims handling and other practices.

An increase in the variety, number and size of claims relating to liability losses, which often present complex coverage and damage valuation questions.

Adverse changes in loss cost trends, including inflationary pressure in medical cost and auto and home repair costs.

In addition, we have been the target of a number of class action lawsuits arising from Hurricane Katrina relating to allegations of improper claims settlement practices, misrepresentations in the scope of coverage and other matters. It is difficult to predict both the ultimate outcome of these lawsuits, and the impact, if any, they will have on our business and financial condition. However, rulings adverse to us in pending litigation arising from Hurricane Katrina could have a material adverse effect on our financial position, as well as on our results of operations.

We are exposed to credit risk in certain areas of our operations.

In addition to exposure to credit risk related to our investment portfolio and reinsurance recovery, we are exposed to credit risk in several other areas of our business operations, including credit risk relating to policyholders, independent agents and brokers.

In accordance with industry practice, when policyholders purchase insurance policies from us through independent agents and brokers, the premiums relating to those policies are often paid to the agents and brokers for payment to us. In most jurisdictions, the premiums will be deemed to have been paid to us whether or not actually received by us. Consequently, we assume a degree of credit risk associated with the amounts due from independent agents and brokers.

We are exposed to credit risk through our surety insurance operations, where we guarantee to a third party that our bonded principal will satisfy certain performance obligations (e.g., a construction contract) or certain financial obligations. If our policyholder defaults, we may suffer losses and be unable to be reimbursed by our policyholder. To a large degree, the credit risk we face is a function of the economy; accordingly, we face a greater risk during a period of economic downturn. While we attempt to manage these risks through underwriting and investment guidelines, collateral requirements and other oversight mechanisms, our efforts may not be successful. For example, collateral obtained may subsequently have little or no value. As a result, our exposure to credit risk could materially and adversely affect our results of operation and financial condition.

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We are subject to comprehensive laws and regulations that pose particular risks to our ability to earn profits.

We are subject to extensive supervision and regulation by the states in which we operate. Our ability to comply with these laws and regulations and obtain necessary and timely regulatory action is, and will continue to be, critical to our success and ability to earn profits.

Examples of regulations that pose particular risks to our ability to earn profits include the following:

Required licensing. We, and our insurance company subsidiaries, operate under licenses issued by various state insurance agencies. If a regulatory authority were to revoke an existing license or deny or delay granting a new license, our ability to continue to sell insurance or to enter or offer new insurance products in that market would be substantially impaired.

Regulation of insurance rates and approval of policy forms. The insurance laws of most states in which we operate require insurance companies to file insurance premium rate schedules and policy forms for review and approval. When our loss ratio compares favorably to that of the industry, state regulatory authorities may resist or delay our efforts to raise premium rates in the future, even if the property and casualty industry generally is not experiencing regulatory resistance to premium rate increases. If premium rate increases we deem necessary are not approved, we may not be able to respond to market developments and increased costs in that state. State regulatory authorities may even impose premium rate rollbacks or require us to pay premium refunds to policyholders, affecting our profitability. If insurance policy forms we seek to use are not approved by a state insurance agency, our ability to offer new products and grow our business in that state could be substantially impaired.

Restrictions on cancellation, nonrenewal or withdrawal. Many states have laws and regulations restricting an insurance company's ability to cease or significantly reduce its sales of certain types of insurance in that state, except pursuant to a plan that is approved by the state insurance department. These laws and regulations could limit our ability to exit or reduce our business in unprofitable markets or discontinue unprofitable products. For example, the State of Louisiana has a law prohibiting the nonrenewal of homeowners policies written for longer than three years except under certain circumstances, such as for nonpayment of premium or fraud committed by the insured.

Risk-based capital and capital adequacy requirements. We, and our insurance company subsidiaries and affiliate, are subject to risk-based capital requirements (RBC requirements) that require us to report our results of risk-based capital calculations to state insurance departments and the NAIC. Any failure to meet applicable RBC requirements or minimum statutory capital requirements could subject us or our subsidiaries and affiliate to further examination or corrective action by state regulators, including limitations on our writing of additional business, state supervision or liquidation.

Transactions between insurance companies and their affiliates. Transactions between us, our subsidiary insurance companies and our affiliate generally must be disclosed to, and in some cases approved by, state insurance agencies. State insurance agencies may refuse to approve or delay their approval of a transaction, which may impact our ability to innovate or operate efficiently.

Required participation in guaranty funds and assigned risk pools. Certain states have enacted laws that require a property and casualty insurer conducting business in that state to participate in assigned risk plans, reinsurance facilities, and joint underwriting associations where participating insurers are required to provide coverage for assigned risks. The number of risks assigned to us by these plans is based on our share of total written premium in the voluntary insurance market for that state. Pricing is controlled by the plan, often restricting our ability to charge the premium rate we might otherwise charge. Wherever possible, we utilize a designated servicing carrier to fulfill our obligations under these plans. Designated servicing carriers charge us fee to issue policies, adjust and settle claims and handle administrative reporting on our behalf. In these markets, we may be compelled to underwrite significant amounts of business at lower than desired premium rates, possibly leading to an unacceptable return on equity. While these facilities are generally designed so that the ultimate cost is borne by policyholders, the exposure to assessments and our ability to recoup these

assessments through adequate premium rate increases may not offset each other in our financial statements. Moreover, even if they do offset each other, they may not offset each other in our financial statements for the same fiscal period, due to the ultimate timing of the assessments and recoupments or premium rate increases. Additionally, certain states require insurers to participate in guaranty funds for impaired or insolvent insurance companies. These state funds periodically assess losses against all insurance companies doing business in the state. Our operating results and financial condition could be adversely affected by any of these factors.

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Restrictions on the amount, type, nature, quality and concentration of investments. The various states in which we operate have certain restrictions on the amount, type, nature, quality and concentration of our investments. Generally speaking, these regulations require us to be conservative in the nature and quality of our investments and restrict our ability to invest in riskier, but often higher yield investments. These restrictions may make it more difficult for us to obtain our desired investment results.

State and federal tax laws. Under current federal and state income tax law, our life insurance and annuity products receive favorable tax treatment. This favorable treatment may give these products a competitive advantage over other noninsurance products. Congress, from time to time, considers legislation that would reduce or eliminate the favorable policyholder tax treatment currently applicable to life insurance and annuities. Congress also considers proposals to reduce the taxation of certain products or investments that may compete with life insurance and annuities. Legislation that increases the taxation on insurance products or reduces the taxation on competing products could lessen the advantage or create a disadvantage for certain of our products, making them less competitive. Such proposals, if adopted, could have a material adverse effect on our financial position or ability to sell such products and could result in the surrender of some existing contracts and policies.

Periodic financial and market conduct examinations. We are subject to periodic financial and market conduct examinations by the insurance departments in the various states in which we operate. Generally, it is only those states in which we have a company incorporated that perform such examinations. Occasionally, however, we are examined by states in which we do not have a company incorporated. The costs of these examinations are borne by us and in any given year may contribute to our administrative expenses.

Terrorism Risk Insurance. The Terrorism Risk Insurance Act of 2002 and its successor, the Terrorism Risk Insurance Extension Act of 2005 (collectively, the Terrorism Acts) require the federal government and the insurance industry to share in insured losses up to \$100 billion per year resulting from future terrorist attacks within the United States. For further information about the Terrorism Acts, and their effect on our operations, refer to the information in the Results of Operations section in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

Compliance with these state laws and regulations requires us to incur administrative costs that decrease our profits. These laws and regulations may also prevent or limit our ability to underwrite and price risks accurately, obtain timely premium rate increases necessary to cover increased costs, discontinue unprofitable relationships or exit unprofitable markets and otherwise continue to operate our business profitably. In addition, our failure to comply with these laws and regulations could result in actions by state or federal regulators, including the imposition of fines and penalties or, in an extreme case, revocation of our ability to do business in one or more states. Finally, we could face individual, group and class action lawsuits by our policyholders and others for alleged violations of certain state laws and regulations. Each of these regulatory risks could have a negative effect on our profitability.

Unauthorized data access and other security breaches could have an adverse impact on our business and reputation.

Security breaches and other improper accessing of data in our facilities, networks or databases, or those of our vendors, could result in loss or theft of data and information or systems interruptions that may expose us to liability and have an adverse impact on our business. Moreover, any compromise of the security of our data could harm our reputation and business. There can be no assurances that we will be able to implement security measures adequate to prevent every security breach.

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A reduction in our financial strength ratings could adversely affect our business and financial condition.

Third-party rating agencies assess and rate the claims-paying ability of insurers and reinsurers based on criteria established by the agencies. Our property and casualty insurers have been assigned a financial strength rating of A (Excellent) from A.M. Best since 1994 (except for one insurance subsidiary that is in a runoff status, which A.M. Best has designated as NR-3 (Rating Procedure Inapplicable)). Our life insurance subsidiary has been assigned a financial strength rating of A- (Excellent) from A.M. Best since 1998. Our property and casualty companies are rated on a group basis. Financial strength ratings are used by policyholders, insurers, reinsurers and insurance and reinsurance intermediaries as an important means of assessing the financial strength of insurers and reinsurers. These ratings are not evaluations directed to potential purchasers of our common stock and are not recommendations to buy, sell or hold our common stock. These ratings are subject to change at any time and could be revised downward or revoked at the sole discretion of the rating agency. Downgrades in our financial strength ratings could adversely affect our ability to access the capital markets or could lead to increased borrowing costs in the future. Perceptions of our company by investors, producers, other businesses and consumers could also be significantly impaired.

We believe that the ratings assigned by A.M. Best are an important factor in marketing our products. Our ability to retain our existing business and to attract new business in our insurance operations depends largely on our ratings by this agency. Our failure to maintain our ratings, or any other adverse development with respect to our ratings, could cause our current and future independent agents and policyholders to choose to transact their business with more highly rated competitors. If A.M. Best downgrades our ratings or publicly indicates that our ratings are under review, it is likely that we will not be able to compete as effectively with our competitors and our ability to sell insurance policies could decline. If that happens, our premium revenue and earnings would decrease. For example, many of our agencies and policyholders have guidelines that require us to have an A.M. Best financial strength rating of A- or higher. A reduction of our A.M. Best ratings below A- would prevent us from issuing policies to a majority of our current policyholders or other potential policyholders with similar ratings requirements. In addition, a ratings downgrade for our property and casualty insurers by A.M. Best below A would constitute an event of default under our credit facility.

Market conditions may affect our access to and the cost of reinsurance and our reinsurers may not pay losses in a timely manner, or at all.

As part of our overall risk and capacity management strategy, we purchase reinsurance for significant amounts of the risk that we and our insurance company subsidiaries and affiliate underwrite. The availability and cost of reinsurance is subject to market conditions that are beyond our control. The availability and cost of the reinsurance we purchase may affect the level of our business and profitability. Although we purposely work with several reinsurance intermediaries and reinsurers, we may be unable to maintain our current reinsurance facilities or obtain other reinsurance facilities in adequate amounts and at favorable premium rates. Moreover, there may be a situation in which we have more than two catastrophic events within one policy year. Because our current catastrophe reinsurance program only allows for one automatic reinstatement at an additional reinstatement premium, we would be required to obtain a new catastrophe reinsurance policy to maintain our current level of catastrophe reinsurance coverage. Such coverage may be difficult to obtain, particularly if it is necessary to do so during hurricane season following the second catastrophe. If we are unable to renew our expiring facilities or to obtain new reinsurance facilities, either our net exposure to risk will increase or, if we are unwilling to bear an increase in net risk exposures, we will have to reduce the amount of risk we underwrite.

Although reinsurance makes the reinsurer liable to us to the extent the risk is transferred, it does not relieve us of our liability to our policyholders. Our ability to collect reinsurance recoverables may be subject to uncertainty. Our losses must meet the qualifying conditions of the reinsurance contract. Reinsurers must also have the financial capacity and willingness to make payments under the terms of a reinsurance treaty or contract. Particularly, following a major catastrophic event, our inability to collect a material recovery from a reinsurer on a timely basis, or at all, could have a material adverse effect on our liquidity, operating results and financial condition.

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Our geographic concentration in both our property and casualty insurance and life insurance segments ties our performance to the business, economic and regulatory conditions of certain states.

The following states provided 56.5 percent of the direct premium volume for the property and casualty insurance segment in 2009: Texas (15.4 percent), Iowa (15.3 percent), Louisiana (9.2 percent), Missouri (9.1 percent) and Colorado (7.5 percent). The following states provided 74.0 percent of the direct statutory premium volume for the life insurance segment in 2009: Iowa (36.8 percent), Nebraska (12.9 percent), Minnesota (9.0 percent), Wisconsin (8.4 percent) and Illinois (6.9 percent). Our revenues and profitability are subject to the prevailing regulatory, legal, economic, political, demographic, competitive, weather and other conditions in the principal states in which we do business. Changes in any of these conditions could make it less attractive for us to do business in such states and would have a more pronounced effect on us compared to companies that are more geographically diversified. In addition, our exposure to severe losses from localized natural perils, such as hurricanes or hailstorms, is increased in those areas where we have written a significant amount of property insurance policies.

We face significant competitive pressures in our business that could cause demand for our products to fall and reduce our revenue and profitability.

The insurance industry is highly competitive. In our property and casualty insurance business and in our life insurance business, we compete, and will continue to compete, with many major U.S. and non-U.S. insurers and smaller regional companies, as well as mutual companies, specialty insurance companies, underwriting agencies, and diversified financial services companies. Some of our competitors have far greater financial and marketing resources than we do. Our premium revenue and our profitability could decline if we lose business to competitors offering similar or better products at or below our prices. Our profitability could also be affected by the entry of new competitors into the market and the development of new products by new and existing competitors.

We price our insurance products based on estimated profit margins, and we would not be able to significantly reduce our current estimated profit margins in the near future. Some of our competitors may be larger and have more capital than we do, and may be able to withstand significant reductions in their profit margins. If our competitors decide to target our policyholder base by offering lower-priced insurance, we may not be able to respond competitively, which could reduce our revenue and our profitability.

Our business depends on the uninterrupted operations of our facilities, systems and business functions.

Our business depends on our employees' ability to perform necessary business functions, such as processing new and renewal policies and claims. We increasingly rely on technology and systems to accomplish these business functions in an efficient and uninterrupted fashion. Our inability to access our facilities or a failure of technology, telecommunications or other systems could significantly impair our ability to perform such functions on a timely basis or affect the accuracy of transactions. If sustained or repeated, such a business interruption or system failure could result in a deterioration of our ability to write and process new and renewal business, serve our agents and policyholders, pay claims in a timely manner, collect receivables or perform other necessary business functions. The continued threat of terrorism, both within the U. S. and abroad, and ongoing military and other actions and heightened security measures in response to these types of threats, may cause significant volatility and losses from declines in the equity markets and from interest rate changes in the U. S., Europe and elsewhere, and result in loss of life, property damage, disruptions to commerce and reduced economic activity. Some of the assets in our investment portfolio may be adversely affected by declines in the equity markets and reduced economic activity caused by the continued threat of terrorism. We seek to mitigate the potential impact of terrorism on our commercial mortgage portfolio by limiting geographical concentrations in key metropolitan areas and by requiring terrorism insurance to the extent that it is commercially available.

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In the event that a natural disaster or a terrorist act occurs, our company and employees could be directly adversely affected, depending on the nature of the event. We have an emergency preparedness plan that consists of the information and procedures required to enable rapid recovery from an occurrence, such as natural disaster or business disruption, which could potentially disable us for an extended period of time. This plan was tested during 2008, both by the Midwest flooding that affected our corporate headquarters in Cedar Rapids, Iowa, and by Hurricane Ike that affected our Gulf Coast regional office in Galveston, Texas.

Risks Relating to our Common Stock

As an insurance company, our ability to pay dividends is restricted by state law.

We are an insurance company domiciled in the State of Iowa and, as a result, we are subject to Iowa insurance laws restricting our ability to pay dividends to our stockholders, including laws establishing minimum solvency and liquidity standards and laws that prohibit us from paying dividends except from the earned profits arising from our business. Our ability to pay dividends also depends upon the statutory capital and surplus levels and earnings of our subsidiary insurance companies and the ability of our subsidiary insurance companies to pay dividends to us. Payments of dividends by our subsidiary insurance companies are restricted by state insurance laws similar to those laws that restrict our payment of dividends. As a result of these restrictions, at times we may not be able to pay dividends on our common stock, or we may be required to seek prior approval from the applicable regulatory authority before we can pay any such dividends. In addition, the payment of dividends by us is within the discretion of our Board of Directors and will depend on numerous factors, including our financial condition, our capital requirements and other factors that our Board of Directors considers relevant.

The price of our common stock may be volatile.

The trading price of our common stock may fluctuate substantially due to a variety of factors, some of which are beyond our control and may not be related to our operating performance. These fluctuations could be significant and could cause a loss in the amount invested in our shares of common stock. Factors that could cause fluctuations include, but are not limited to, the following:

Variations in our actual or anticipated operating results or changes in the expectations of financial market analysts with respect to our results.

Investor perceptions of the insurance industry in general and our company in particular.

Market conditions in the insurance industry and any significant volatility in the market.

Major catastrophic events.

Departure of our key personnel.

Certain provisions of our organizational documents, as well as applicable insurance laws, could impede an attempt to replace or remove our management, prevent the sale of our company or prevent or frustrate any attempt by stockholders to change the direction of our company, each of which could diminish the value of our common stock.

Our articles of incorporation and bylaws, as well as applicable laws governing corporations and insurance companies, contain provisions that could impede an attempt to replace or remove our management or prevent the sale of our company that, in either case, stockholders might consider being in their best interests. For example:

Our Board of Directors is divided into three classes. At any annual meeting of our stockholders, our stockholders have the right to appoint approximately one-third of the directors on our Board of Directors. Consequently, it will take at least two annual stockholder meetings to effect a change in control of our Board of Directors.

Our articles of incorporation limit the rights of stockholders to call special stockholder meetings.

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Our articles of incorporation set the minimum number of directors constituting the entire Board of Directors at nine and the maximum at 15, and they require approval of holders of two-thirds of all outstanding shares to amend these provisions.

Our articles of incorporation require the affirmative vote of two-thirds of all outstanding shares to approve any plan of merger, consolidation, or sale or exchange of all, or substantially all, of our assets.

Our Board of Directors may fill vacancies on the Board of Directors.

Our Board of Directors has the authority, without further approval of our stockholders, to issue shares of preferred stock having such rights, preferences and privileges as the Board of Directors may determine.

Section 490.1110 of the Iowa Business Corporation Act imposes restrictions on mergers and other business combinations between us and any holder of 10.0 percent or more of our common stock.

Section 490.624A of the Iowa Business Corporation Act authorizes the terms and conditions of stock rights or options issued by us to include restrictions or conditions that preclude or limit the exercise, transfer, or receipt of such rights or options by a person, or group of persons, owning or offering to acquire a specified number or percentage of the outstanding common shares or other securities of the corporation.

Further, the insurance laws of Iowa and the states in which our subsidiary insurance companies are domiciled prohibit any person from acquiring direct or indirect control of us or our insurance company subsidiaries, generally defined as owning or having the power to vote 10.0 percent or more of our outstanding voting stock, without the prior written approval of state regulators.

These provisions of our articles of incorporation and bylaws, and these state laws governing corporations and insurance companies, may discourage potential acquisition proposals. These provisions and state laws may also delay, deter or prevent a change of control of our company, in particular through unsolicited transactions that some or all of our stockholders might consider to be desirable. As a result, efforts by our stockholders to change the direction or our company's management may be unsuccessful, and the existence of such provisions may adversely affect market prices for our common stock if they are viewed as discouraging takeover attempts.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

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ITEM 2. PROPERTIES

We own three buildings: a five-story office building, a two-story office building and an eight-story office building in which a portion of the first floor (approximately 5.7 percent of the building's square footage) is leased to tenants, and related parking facilities in Cedar Rapids, Iowa, that we use as our corporate headquarters. All three buildings are connected by a skywalk system. The first floors and basements of our three owned buildings in Cedar Rapids, Iowa underwent extensive reconstruction due to flooding that occurred in June 2008. We completed renovation of these buildings during 2009.

In November 2009, we completed the construction of a 250-space parking ramp, which is located adjacent to our corporate headquarters, for use by the company. The parking ramp replaced a paved parking lot of which we own approximately 70 percent of the land, while the remaining portion of the land will continue to be leased from the owner.

Our regional locations in Westminster, Colorado, and Galveston, Texas, and our claims office in Metairie, Louisiana, conduct operations in leased office space. While our employees were displaced from our Galveston, Texas office due to Hurricane Ike, which occurred in September 2008, we temporarily leased office space in a suburb of Houston, Texas for our Gulf Coast Regional Office to conduct business. This lease expired on September 30, 2009.

The following table shows a brief description of our owned and leased office space. We believe our current facilities are adequate to meet our needs with additional space available for future expansion, if necessary, at each of our leased and owned facilities.

Location	Utilized by	Owned or Leased	Lease Expiration Date
Corporate Headquarters			
Cedar Rapids, Iowa (118 Second Avenue SE)	Corporate Administration, Property and Casualty Segment	Owned	N/A
Cedar Rapids, Iowa (119 Second Avenue SE)	Corporate Administration, Life Insurance Segment	Owned	N/A
Cedar Rapids, Iowa (109 Second Street SE)	Property and Casualty Segment	Owned	N/A
Denver Regional Office Westminster, Colorado	Property and Casualty Segment	Leased	June 30, 2015
Gulf Coast Regional Office Galveston, Texas	Property and Casualty Segment	Leased	November 30, 2014
Gulf Coast Regional Office Temporary office in a suburb of Houston, Texas	Property and Casualty Segment	Leased	September 30, 2009
New Orleans Claims Office Metairie, Louisiana	Property and Casualty Segment	Leased	September 30, 2012

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ITEM 3. LEGAL PROCEEDINGS

Incorporated by reference from Note 1, Significant Accounting Policies under the heading Contingent Liabilities contained in Part II, Item 8, Financial Statements and Supplementary Data.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of the stockholders during the fourth quarter of 2009.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Common Stock Holders

United Fire's common stock is traded on The NASDAQ Stock Market LLC (NASDAQ) under the symbol UFCS. On February 1, 2010, there were 894 holders of record of United Fire common stock. The number of record holders does not reflect stockholders who beneficially own common stock in nominee or street name, but does include participants in our employee stock ownership plan.

See Security Ownership of Certain Beneficial Owners, Security Ownership of Management and Securities Authorized for Issuance under Equity Compensation Plans, in Part III, Item 12 of this Form 10-K, which incorporates by reference our definitive Proxy Statement for our annual meeting of stockholders to be held on May 19, 2010. The Proxy Statement will be filed with the SEC within 120 days after the end of our fiscal year (the 2010 Proxy Statement) and is incorporated herein by reference.

Dividends

Our practice has been to pay quarterly cash dividends, which we have paid every quarter since March 1968. The table in the following section shows the quarterly cash dividends declared in 2009 and 2008. Payments of any future dividends and the amounts of such dividends, however, will depend upon factors such as net income, financial condition, capital requirements, and general business conditions.

State law permits the payment of dividends only from statutory accumulated earned profits arising from business operations. Furthermore, under Iowa law we may pay dividends only if after giving effect to the payment we are either able to pay our debts as they become due in the normal course of business or our total assets would be equal to or more than the sum of our total liabilities. Our subsidiaries are also subject to similar state law restrictions on dividends. Additional information about these restrictions is incorporated by reference from Note 7, Statutory Reporting, Capital Requirements and Dividends and Retained Earnings Restrictions contained in Part II, Item 8, Financial Statements and Supplementary Data.

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Market Information

The following table sets forth the high and low trading price for our common stock for the calendar periods indicated. These quotations reflect interdealer prices without retail markups, markdowns, or commissions and may not necessarily represent actual transactions.

	Share Price		Cash
	High	Low	Dividends Declared
2009			
Quarter Ended:			
March 31	\$ 31.31	\$ 15.72	\$ 0.15
June 30	24.75	16.47	0.15
September 30	21.66	16.39	0.15
December 31	21.30	16.50	0.15
2008			
Quarter Ended:			
March 31	\$ 39.27	\$ 27.86	\$ 0.15
June 30	39.19	26.93	0.15
September 30	36.07	25.25	0.15
December 31	31.60	13.09	0.15

Issuer Purchases of Equity Securities

Under our share repurchase program, first announced in August 2007, we may purchase common stock from time to time on the open market or through privately negotiated transactions. The amount and timing of any purchases will be at our discretion and will depend upon a number of factors, including the share price, economic and general market conditions, and corporate and regulatory requirements. We will generally consider repurchasing company stock on the open market if (i) the trading price on NASDAQ drops below 130 percent of its book value, (ii) sufficient excess capital is available to purchase the stock, and (iii) we are optimistic about future market trends and the performance of our company. Our share repurchase program may be modified or discontinued at any time. At its meeting in August 2009, the board of directors extended our share repurchase program for an additional two years. It is currently set to expire in August 2011.

The following table provides information with respect to purchases of shares of common stock made by or on our behalf or by any affiliated purchaser, as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934, during the three-month period ended December 31, 2009.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as a Part of Publicly Announced Plans or Programs	Maximum Number of Shares that may be Purchased Under the Plans or Programs
10/1/09-10/31/09		\$		575,575
11/1/09-11/30/09	59,421	16.88	59,421	516,154
12/1/09-12/31/09				516,154

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United Fire & Casualty Company Common Stock Performance Graph

The following graph compares the cumulative total stockholder return on our common stock for the last five fiscal years with the cumulative total return of the Russell 2000 Index, the SNL Insurance Company Index and the SNL Property & Casualty Insurance Index, assuming an investment of \$100 in each of the above at their closing prices on December 31, 2004, and reinvestment of dividends.

The following table shows the data used in the Total Return Performance graph above.

Index	Period Ending					
	12/31/04	12/31/05	12/31/06	12/31/07	12/31/08	12/31/09
United Fire & Casualty Company	\$ 100.00	\$ 121.48	\$ 107.53	\$ 90.14	\$ 98.24	\$ 59.58
Russell 2000	100.00	104.55	123.76	121.82	80.66	102.58
SNL Insurance P&C	100.00	109.31	127.42	137.59	106.50	115.13
SNL Insurance	100.00	116.98	128.56	129.37	69.07	79.18

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ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth certain selected financial data from our Consolidated Financial Statements. We derived the financial data from the Consolidated Financial Statements of United Fire and its subsidiaries and affiliate. The data should be read in conjunction with Part II, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations and Part II, Item 8 Financial Statements and Supplementary Data.

(In Thousands, Except Per Share Data)

Years Ended December 31	2009	2008	2007	2006	2005
Consolidated Balance Sheet Data:					
Total cash and investments	\$ 2,542,693	\$ 2,205,355	\$ 2,399,141	\$ 2,388,387	\$ 2,254,421
Total assets	2,902,544	2,687,130	2,760,554	2,776,067	2,721,924
Future policy benefits and losses, claims and loss settlement expenses					
Property and casualty insurance ⁽¹⁾	606,045	586,109	496,083	518,886	620,100
Life insurance	1,321,600	1,167,665	1,184,977	1,233,342	1,285,635
Unearned premiums	206,010	216,966	224,530	231,377	222,267
Total liabilities	2,229,809	2,045,389	2,009,057	2,095,259	2,221,712
Net unrealized gains, after tax ⁽²⁾	82,491	25,543	85,579	93,519	86,440
Repurchase of United Fire common stock	1,545	14,817	16,078		
Total stockholders' equity ⁽³⁾	672,735	641,741	751,497	680,808	500,212
Book value per share	25.35	24.10	27.63	24.62	21.20
Consolidated Income Statement Data:					
Revenues					
Net premiums written ⁽⁴⁾	467,427	496,897	501,849	509,669	487,627
Net premiums earned	478,498	503,375	505,763	503,122	495,516
Investment income, net of investment expenses ⁽⁵⁾	106,075	107,577	122,439	121,981	118,847
Realized investment gains (losses) ⁽⁶⁾	(13,179)	(10,383)	9,670	9,965	4,540
Other income	799	880	654	532	702
Consolidated revenues	572,193	601,449	638,526	635,600	619,605
Losses and loss settlement expenses ⁽⁷⁾	382,494	406,640	260,714	292,789	392,228
Amortization of deferred policy acquisition costs	114,893	129,158	136,805	126,898	115,473
Other underwriting expenses ⁽⁸⁾	39,298	28,252	22,918	21,525	32,955
Net income (loss) ⁽⁹⁾	(10,441)	(13,064)	111,392	88,085	9,044
Property and Casualty Insurance Segment Data:					
Net premiums written ⁽⁴⁾	424,827	459,571	470,402	476,402	453,683
Net premiums earned	435,677	465,581	473,134	467,031	456,147
Net income (loss)	(17,677)	(15,156)	98,225	73,970	(4,598)

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Combined ratio ⁽⁴⁾	115.2%	113.9%	81.3%	87.9%	111.3%
Life Insurance Segment Data:					
Net premiums earned	42,821	37,794	32,629	36,091	39,369
Net income	7,236	2,092	13,167	14,115	13,642
Earnings Per Share Data:					
Preferred stock dividends and accretions					4,106
Basic earnings (loss) per common share ⁽¹⁰⁾	(0.39)	(0.48)	4.04	3.37	0.22
Diluted earnings (loss) per common share	(0.39)	(0.48)	4.03	3.36	0.22
Other Supplemental Data:					
Cash dividends declared per common share	0.60	0.60	0.555	0.495	0.48

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- (1) Property and casualty reserves may be affected by both internal and external events, such as changes in claims handling procedures, judicial or legislative actions, inflation, and catastrophes. The fluctuations in our reserves over the past five years primarily relate to the hurricanes (Katrina, Rita, Ike and Gustav) we experienced in 2005 and 2008, and the litigation that has resulted from Hurricane Katrina. For further discussion of Hurricane Katrina, refer to our Results of Operations contained in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 1, Significant Accounting Policies under the heading Contingent Liabilities contained in Part II, Item 8, Financial Statements and Supplementary Data.
- (2) Net unrealized gains, after tax were impacted in 2008 due to the volatility in the financial markets. The severe downturn in the financial

markets resulted in a significant decrease to our net unrealized appreciation in 2008, while in 2009 our unrealized appreciation returned to levels similar to prior years. It is widely believed that the economic downturn we faced in recent years appears to be over, however the economic indicators illustrate that the recovery will be a long, slow process.

(3) In recent years our stockholders' equity has fluctuated due to the impact the economic conditions and financial market volatility have had on our net unrealized gains, underwriting loss and net investment income, which are components of our net income (loss). Additionally, we recognized in equity, for 2006 through 2009, the net change in the underfunded status of our employee benefit plans.

(4) Please refer to the Statutory Financial Measures section of Part II, Item 7 for further explanation of this measure.

(5)

The decline in 2009 and 2008 was due to lower market interest rates earned on our investment portfolio, which affected our short-term investments and cash and cash equivalents; agency bonds that were called during 2009, the proceeds of which we reinvested at a lower interest rate than was previously available in prior years; the reduction or discontinuation of dividend payments by some of our equity securities that previously had paid regular dividends; and the changes in the value of certain investments in limited liability partnerships.

- (6) Realized investment gains and losses are fundamental to our results of operations over the long term, and the occurrence and timing of realized gains and losses may cause our earnings to fluctuate substantially. GAAP requires us to recognize gains and losses from certain changes in fair values of securities without the actual sale of those securities. The realized investment losses in 2009 and 2008 were primarily due to pre-tax other-than-temporary

investment (OTTI)
charges incurred on
our fixed maturity
securities and equity
securities. We
recorded OTTI
charges of
\$18.3 million in 2009
and \$9.9 million in
2008. The OTTI
charges that occurred
in 2009 and 2008
represent 0.8 percent
and 0.5 percent of our
investment portfolio,
respectively.

(7) Loss and loss
settlement expenses
include reserve
changes that may
occur for both the
property and casualty
segment and the life
insurance segment.
The fluctuations in
this line are primarily
caused by the
property and casualty
segment.

(8) Two factors caused
most of the
fluctuation in other
underwriting
expenses: the level of
deferrable
underwriting
expenses, which
correlates to our level
of written premiums,
and changes in the
expense for our
employee benefit
plans.

(9) Our net losses in
2009 and 2008 were
due to lower revenues
from premiums
earned, a decrease in

net investment
income, realized
losses, higher
expenses from losses,
and other
underwriting
expenses. Our lower
level of income in
2005 was primarily
due to the level of
losses experienced
due to Hurricane
Katrina. For further
discussion of net
income (loss) refer to
our Results of
Operations contained
in Part II, Item 7,
Management's
Discussion and
Analysis of Financial
Condition and Results
of Operations.

- (10) Our basic earnings
(loss) per common
share is calculated by
dividing our net
income (loss) by
weighted average
common shares
outstanding at the end
of the period.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

This report may contain forward-looking statements about our operations, anticipated performance and other similar matters. The Private Securities Litigation Reform Act of 1995 provides a safe harbor under the Securities Act of 1933 and the Securities Exchange Act of 1934 for forward-looking statements. The forward-looking statements are not historical facts and involve risks and uncertainties that could cause actual results to differ materially from those expected and/or projected. Such forward-looking statements are based on current expectations, estimates, forecasts and projections about our company, the industry in which we operate, and beliefs and assumptions made by management. Words such as expect(s), anticipate(s), intend(s), plan(s), believe(s), continue(s), seek(s), e goal(s), target(s), forecast(s), project(s), predict(s), should, could, may, will continue, might, ho words and terms of similar meaning or expression in connection with a discussion of future operating, financial performance or financial condition, are intended to identify forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed in such forward-looking statements. Among the factors that could cause our actual outcomes and results to differ are:

The adequacy of our loss and loss settlement reserves established for Hurricane Katrina, which are based on management estimates.

The resolution of regulatory issues and litigation pertaining to and arising out of Hurricane Katrina.

The frequency and severity of claims, including those related to catastrophe losses, and the impact those claims have on our loss reserve adequacy.

Developments in the domestic and global financial markets that could affect our investment portfolio and financing plans.

The valuation of invested assets.

The calculation and recovery of deferred policy acquisition costs (DAC).

The valuation of pension and other postretirement benefit obligations.

The absolute and relative performance of our products or services.

Our relationship with our agents.

Our relationship with our reinsurers.

The financial strength rating of our reinsurers.

The increased costs and risk associated with the security of our data.

Changes in industry trends and significant industry developments.

Additional government and NASDAQ policies or regulations relating to corporate governance, and the cost to comply.

These are representative of the risks, uncertainties and assumptions that could cause actual outcomes and results to differ materially from what is expressed in forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report or as of the date they are made. Except as required under the federal securities laws and the rules and regulations of the SEC, we do not have any intention or obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

Additional information concerning factors that could cause actual results to differ materially from those in the forward-looking statements is contained in Part I, Item 1A Risk Factors of this document.

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INTRODUCTION

The purpose of Management's Discussion and Analysis is to provide an understanding of our results of operations and consolidated financial position. Our Management's Discussion and Analysis should be read in conjunction with Part II, Item 6, Selected Financial Data and Part II, Item 8, Financial Statements and Supplementary Data.

We begin Management's Discussion and Analysis with an overview of our company and our financial highlights and then follow with detailed discussions on our results of operations; investments; liquidity; capital resources; enterprise risk management; and critical accounting estimates. When we provide information on a statutory basis, we label it as such; otherwise all other data is presented in accordance with GAAP.

OVERVIEW

We operate property and casualty and life insurance businesses, marketing our products through independent agents. Although we maintain a broad geographic presence that includes most of the United States, more than half of our property and casualty business is generated in Texas, Iowa, Louisiana, Missouri and Colorado. Approximately three-fourths of our life insurance business is generated in Iowa, Nebraska, Minnesota, Wisconsin, and Illinois.

We conduct our operations through two distinct segments: property and casualty insurance and life insurance. We manage these segments separately because they generally do not share the same customer base, and they each have different pricing and expense structures. We evaluate each of our segment's profits based upon operating and investment results. Segment profit or loss described in the following sections of Management's Discussion and Analysis is reported on a pre-tax basis. Additional segment information is presented in Part II, Item 8, Note 11

Segment Information to the Consolidated Financial Statements.

Our revenue is primarily composed of premiums and investment income. Major categories of expenses include losses and loss settlement expenses, changes in reserves for future policy benefits, operating expenses and interest on policyholders' accounts. Through disciplined underwriting and strong agency relationships, we have traditionally emphasized writing good business at an adequate price, preferring quality to volume. Our goal of consistent profitability is supported by these business strategies.

Our premium written is cyclical in nature and is influenced by many factors, including price competition, economic conditions, interest rates, weather-related events and other catastrophes including natural disasters (e.g., hurricanes and tornados) and man-made disasters, state regulations, court decisions and changes in the law.

Over the past three years, our commercial lines of business have accounted for over 90.0 percent of premium revenue. We anticipate that our current composition of commercial lines and personal lines business will not change materially during the coming year.

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FINANCIAL HIGHLIGHTS**Consolidated Results of Operations**

				% Change	
(In Thousands)				2009	2008
Years ended December 31	2009	2008	2007	vs. 2008	vs. 2007
Revenues					
Net premiums earned	\$ 478,498	\$ 503,375	\$ 505,763	-4.9%	-0.5%
Investment income, net	106,075	107,577	122,439	-1.4	-12.1
Realized investment gains (losses)	(13,179)	(10,383)	9,670	-26.9	-207.4
Other income	799	880	654	-9.2	34.6
Total Revenues	\$ 572,193	\$ 601,449	\$ 638,526	-4.9%	-5.8%
Benefits, Losses and Expenses					
Loss and loss settlement expenses	\$ 382,494	\$ 406,640	\$ 260,714	-5.9%	56.0%
Increase in liability for future policy benefits	23,897	23,156	15,666	3.2	47.8
Amortization of deferred policy acquisition costs	114,893	129,158	136,805	-11.0	-5.6
Other underwriting expenses	39,298	28,252	22,918	39.1	23.3
Disaster charges and other related expenses, net of recoveries	(1,335)	7,202		-118.5	N/A
Interest on policy holders' accounts	41,652	40,177	43,089	3.7	-6.8
Total Benefits, Losses and Expenses	\$ 600,899	\$ 634,585	\$ 479,192	-5.3%	32.4%
Income (loss) before income taxes	(28,706)	(33,136)	159,334	13.4	-120.8
Federal income tax expense (benefit)	(18,265)	(20,072)	47,942	9.0	-141.9
Net Income (Loss)	\$ (10,441)	\$ (13,064)	\$ 111,392	20.1%	-111.7%
Basic earnings (loss) per share	\$ (0.39)	\$ (0.48)	\$ 4.04	18.8%	-111.9%
Diluted earnings (loss) per share	\$ (0.39)	\$ (0.48)	\$ 4.03	18.8	-111.9

The following is a summary of our financial performance over the last three years and the factors that have affected our performance.

Consolidated Results of Operations

Net income declined from \$111.4 million in 2007 to net losses of \$13.1 million in 2008 and \$10.4 million in 2009, as a result of (i) year over year reductions in net premiums earned due to continued competition and the weak economy and (ii) an increase in loss and loss settlement expenses that stemmed from an increase in our case reserves on prior year losses, which was partially due to an increase in late reported claims and an increase in IBNR reserves.

Our premium writings decreased 5.9 percent for 2009, due to continued competition and the weak economy, which has led to a decline in both the residential housing market (especially in our western states) and in government-funded projects. This reduced the volume of business of the commercial and residential contractors that we insure and bond. Also contributing to the reduction in net premiums written was the nonrenewal of accounts that no longer meet our underwriting or pricing guidelines. As pricing in the industry continues to decrease, we avoid accounts that have become too underpriced for the risk. Annuity deposits increased to \$176.2 million for 2009, from \$161.1 million and \$161.5 in 2008 and 2007, respectively. Annuity deposits are not recorded as a component of net premiums written or net premiums earned; however, they do generate investment income.

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During 2009, our other liability line had a significant increase in IBNR reserves, due to trends toward larger jury awards in this line and continuing construction defect claims and loss expenses.

Though the insurance industry experienced low levels of catastrophe losses in 2009 compared with 2008, we had an average historical level of catastrophe loss activity. Our catastrophes losses in 2009 totaled \$22.4 million compared to \$76.1 million in 2008. Hurricane activity was nearly nonexistent, but we had an active season of Midwestern storms. Catastrophe losses, without Hurricane Katrina, contributed 5.1 percent to our 2009 combined ratio, which is in-line with our historic annual average. In 2007, we experienced lower than average catastrophe losses, which totaled \$14.1 million.

Adverse development from Hurricane Katrina resulted in losses of \$38.0 million in 2009 compared to \$26.6 million (including a \$10.8 million judgment, net of reinsurance) for 2008 and \$6.3 million for 2007. We appealed this judgment in 2008, which we lost in 2009.

Our combined ratio was 115.2 percent for 2009, indicating an underwriting loss, compared to 113.9 percent and 81.3 percent for 2008 and 2007, respectively. In 2009, we incurred additional loss and loss settlement expenses related to Hurricane Katrina claims litigation, while our premium writings were affected by the struggling economy and the competitiveness of the market. An increase of 1.9 percentage points in our expense ratio contributed to our combined ratio, as we were not able to defer underwriting expenses (primarily agent commissions and employee salaries) at the same level in 2009 as we were able to in 2008 due to lower net premiums written.

Consolidated Financial Condition

Our annuity sales and a reduction in withdrawals contributed to a net cash inflow related to our annuity business of \$96.0 million in 2009 compared to net cash outflows of \$73.0 million and \$92.8 million in 2008 and 2007, respectively. The reduction in annuity withdrawals is indicative of the change in economic conditions and the inclination of consumers to choose products with less risk and guaranteed returns. For 2009, we repurchased 92,721 shares of our common stock at an average cost of \$16.61. As of December 31, 2009, 516,154 shares of common stock remained authorized for repurchase under our share repurchase program, which expires in August 2011.

The carrying value of our investment portfolio fluctuated due to the volatility in the financial markets, ending 2009 with net unrealized gains, after tax, of \$82.5 million compared to \$25.5 million and \$85.6 million for the years ended 2008 and 2007, respectively.

Our financial strength continued, as our stockholders' equity increased in 2009 to \$672.7 million from \$641.7 million in 2008. Our equity in 2007 was \$751.5 million, which was primarily the result of record earnings in that year.

Despite our results in 2009, our book value per share increased by \$1.25 to \$25.35 from \$24.10 in 2008. Book value per share in 2007 was \$27.63. The change in 2009 is attributable to an increase in our net unrealized gains, after tax, which reflects the rising market values of our equity security holdings and an increase in the fair value of our fixed maturity securities as interest rates decreased.

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Commentary on the Economy

The weak economy has significantly affected our business in 2009 and 2008 as follows:

Premium writings decreased in both the residential housing market in our western states and in government-funded projects, which reduced the volume of business of the commercial and residential contractors that we insure and bond.

Our policy retention rate in both the personal and commercial lines of business was approximately 80.0 percent in 2009, which was a slight decrease from 2008, as our underwriters continue to focus on writing good business at an adequate price, preferring quality to volume. Despite continued competition, particularly on medium and large commercial accounts, we have been able to renew a select number of accounts at a higher rate/premium level in 2009 compared to 2008.

The insurance marketplace remained competitive in our commercial lines of business in 2009. We experienced a modest decrease (less than 1 percent) in commercial lines premium level in the fourth quarter of 2009, reflecting a continuation of a trend of gradual decreases in premium level for some lines of business dating back to 2004. On personal lines business, we averaged low- to mid-single-digit percentage increases in premium level for our homeowner and personal automobile lines of business in 2009.

Unprecedented volatility in the financial markets caused our portfolio values to fluctuate with 2009 experiencing an improvement over 2008.

Investment income has been impacted by lower market interest rates, a decline in the value of our other long-term investments, and the reduction or discontinuation of dividend payments by some of our equity securities that previously had paid regular dividends.

Other-than-temporary impairment (OTTI) charges totaled \$18.3 million for 2009 compared to \$9.9 million and \$.1 million in 2008 and 2007, respectively.

It is widely believed that the economic downturn we faced in recent years appears to be over, however the economic indicators illustrate that the recovery will be a long, slow process. We are encouraged that as the economy improves, the market may be more conducive to better premium rate levels as well as more opportunities to write good business, but may or may not affect the trend in claims, specifically in our other liability line of business. As the economy recovers, it is also possible that interest rates may increase, which will increase net investment income, but could result in lower values of our fixed maturity securities. A combination of these trends may affect our net income going forward, but we cannot predict the timing or related impact, if any.

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RESULTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2009, 2008 AND 2007**Property and Casualty Insurance Segment****Property & Casualty Segment Results of Operations**

(In Thousands)

				% Change	
				2009	2008
				vs.	vs.
Years ended December 31	2009	2008	2007	2008	2007
Net premiums written ⁽¹⁾	\$ 424,827	\$ 459,571	\$ 470,402	-7.6%	-2.3%
Net premiums earned	\$ 435,677	\$ 465,581	\$ 473,134	-6.4	-1.6
Loss and loss settlement expenses	365,721	393,349	245,845	-7.0	60.0
Amortization of deferred policy acquisition costs	105,606	117,590	123,420	-10.2	-4.7
Other underwriting expenses	30,553	19,146	15,378	59.6	24.5
Underwriting income (loss)	\$ (66,203)	\$ (64,504)	\$ 88,491	-2.6%	-172.9%
Investment income, net	31,542	33,452	43,363	-5.7%	-22.9%
Realized investment gains (losses)	(6,815)	1,879	7,099	-462.7	-73.5
Other income (loss)	194	(55)	59	N/A	N/A
Disaster charges and other related expenses, net of recoveries	(1,335)	7,202		-118.5	N/A
Income (loss) before income taxes	\$ (39,947)	\$ (36,430)	\$ 139,012	-9.7%	-126.2%

(1) The Statutory Financial Measures section of this report defines data prepared in accordance with statutory accounting practices, which is a comprehensive basis of accounting other than U.S. GAAP.

				Increase (Decrease) in Ratios	
				2009	2008
				vs.	vs. 2007
Years ended December 31	2009	2008	2007	2008	
GAAP combined ratio:					

Net loss ratio (without catastrophes and Hurricane Katrina development)	70.1%	65.9%	49.0%	6.4%	34.5%
Hurricane Katrina litigation effect on net loss ratio	8.7	2.3	1.3	278.3	76.9
Other catastrophes effect on net loss ratio	5.1	16.3	1.7	-68.7	858.8
Net loss ratio	83.9%	84.5%	52.0%	-0.7%	62.5%
Expense ratio ⁽¹⁾	31.3	29.4	29.3	6.5	0.3
Combined ratio ⁽²⁾	115.2%	113.9%	81.3%	1.1%	40.1%

Statutory combined ratio:

Net loss ratio (without catastrophes and Hurricane Katrina development)	70.1%	66.0%	49.4%	6.2%	33.6%
Hurricane Katrina litigation effect on net loss ratio	8.7	2.3	1.3	278.3	76.9
Other catastrophes effect on net loss ratio	5.1	16.3	1.7	-68.7	858.8
Net loss ratio	83.9%	84.6%	52.4%	-0.8%	61.5%
Expense ratio ⁽¹⁾	30.3	28.8	29.7	5.2	-3.0
Combined ratio ⁽²⁾	114.2%	113.4%	82.1%	0.7%	38.1%

Industry statutory combined ratio: ⁽³⁾

Net loss ratio	59.9%	65.2%	55.8%	-8.1%	16.8%
Expense ratio ⁽¹⁾	40.7	39.9	39.7	2.0	0.5
Combined ratio ⁽²⁾	100.6%	105.1%	95.5%	-4.3%	10.1%
Combined ratio (without catastrophes) ⁽²⁾	97.4%	100.0%	94.0%	-2.6%	6.4%

(1) Includes policyholder dividends.

(2) The Statutory Financial Measures section of this report defines data prepared in accordance with statutory accounting practices, which is a comprehensive basis of

accounting other
than U.S.
GAAP.

(3) A.M. Best
Company
estimate.

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Our property and casualty insurance segment reported a pre-tax loss of \$39.9 million and \$36.4 million in 2009 and 2008, respectively, compared to pre-tax income of \$139.0 million in 2007. The deterioration in our 2009 results, compared to 2008, was due in part to a decline in our net premiums written, which directly affects net premiums earned. Our premium writings have been affected by continued competition and the weak economy, which has led to a decline both in the residential housing market in our western states and in government-funded projects. This reduced the volume of business of the commercial and residential contractors that we insure and bond. Additionally, we incurred OTTI charges of \$9.8 million, \$38.0 million in adverse development from Hurricane Katrina and an increase in IBNR reserves in 2009, all of which impacted our pre-tax earnings.

The deterioration in our 2008 results, as compared to 2007 was due to the significant number of catastrophe losses we experienced in 2008. The financial impact from these catastrophes was largely realized on our commercial property line of business. Also contributing to the decline was an increase in the severity of non-catastrophe losses and the impact of competitive market conditions on pricing.

Premiums

The following table shows our premiums written and earned for 2009, 2008 and 2007.

(In Thousands)				% Change	
	2009	2008	2007	2009 vs. 2008	2008 vs. 2007
Years ended December 31					
Direct premiums written	\$ 454,046	\$ 484,038	\$ 494,541	-6.2%	-2.1%
Assumed premiums written	7,820	12,660	16,907	-38.2%	-25.1%
Ceded premiums written	(37,039)	(37,127)	(41,046)	-0.2%	-9.5%
Net premiums written ⁽¹⁾	424,827	459,571	470,402	-7.6%	-2.3%
Net premiums earned	435,677	465,581	473,134	-6.4%	-1.6%

(1) The Statutory Financial Measures section of this report defines data prepared in accordance with statutory accounting practices, which is a comprehensive basis of accounting other than U.S. GAAP.

Net Premiums Written

Direct premiums written is the total policy premiums, net of cancellations, associated with policies issued and underwritten by our property and casualty insurance segment. Assumed premiums written is the total premiums associated with the insurance risk transferred to us by other insurance and reinsurance companies pursuant to reinsurance contracts. Ceded premiums written is the portion of direct premiums written that we cede to our reinsurers under our reinsurance contracts. Net premiums earned are recognized over the life of a policy and differ from net

premiums written, which are recognized on the effective date of the policy.

Direct Premiums Written

Direct premiums written decreased in 2009 due to continued competition and the weak economy, as explained in the previous section. Also contributing to the reduction in direct premiums written in 2009, was the nonrenewal of accounts that no longer meet our underwriting or pricing guidelines. As pricing in the industry continues to decrease, we avoid accounts that have become too underpriced for the risk.

The insurance marketplace remained competitive in our commercial lines of business in 2009. We experienced a less than 1.0 percent decrease in our commercial lines premium level in the fourth quarter of 2009, reflecting a continuation of a trend of gradual decreases in premium level for some lines of business dating back to the third quarter of 2004. In our personal lines business, we averaged low- to mid-single-digit percentage increases in premium level for our homeowner and personal auto lines of business in late 2009.

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Our policy retention rate in both the personal and commercial lines of business was approximately 80.0 percent in 2009, which was a slight decrease from 2008, as our underwriters continue to focus on writing good business at an adequate price, preferring quality to volume. Despite continued competition, particularly on medium and large commercial accounts, we were able to renew a select number of accounts at a higher rate/premium level in 2009 as compared to 2008.

In 2008, we continued to experience the effects of soft market conditions within the insurance industry. These conditions led to downward pressure on premium rates, particularly for mid-size to large commercial accounts. At the same time, we experienced an unexpected increase in loss severity during 2008 compared to prior years, while frequency of reported losses remained relatively stable between years, particularly in accounts under \$100,000.

Assumed Premiums Written

We experienced a decrease in assumed premiums written in 2009, as we terminated one of our assumed reinsurance contracts and lowered participation on another contract. In 2008, the decrease in assumed premiums written was due to the lower level of active assumed contracts we had as compared to prior years. Also contributing to the decline in premiums written for 2009, 2008 and 2007 was some of our assumed business that had been in run-off since late 2006, which concluded in early 2009. In 2010, we entered into three new assumed contracts, which we anticipate will increase our assumed premiums written.

Ceded Premiums Written

Direct and assumed premiums written are reduced by the ceded premiums that we pay to reinsurers. Pricing of ceded reinsurance did not increase materially in 2009, 2008 or 2007. The reduction in ceded premiums written in 2009, 2008 and 2007 was due to the lower level of direct premiums written in each of those years as well as our reduced exposure in Southern Louisiana, which also had an effect on the premiums we pay for our property catastrophe reinsurance treaty.

Catastrophe Losses

Catastrophes losses are inherent risks of the property and casualty insurance business. These catastrophic events and natural disasters include, without limitation, hurricanes, tornadoes, earthquakes, hailstorms, wildfires, high winds and winter storms. Such events result in insured losses that may be a material factor in our results of operations and consolidated financial position. Additionally, since the level of insured losses that may occur in any one year cannot be accurately predicted, these losses contribute to fluctuations in our year-to-year results of operations and consolidated financial position. Some types of catastrophes are more likely to occur at certain times within the year than others, which adds an element of seasonality to our property and casualty insurance claims. The occurrence and severity of catastrophic events are difficult to accurately predict in any year. However, some geographic locations are more susceptible to these events than others. We have endeavored to control our direct insurance exposures in certain regions that are prone to naturally occurring catastrophic events through a combination of geographic diversification, restrictions on the amount and location of new business production in such regions, and reinsurance. The process of estimating and establishing reserves for catastrophe losses is inherently uncertain and the actual ultimate cost of a claim, net of reinsurance recoveries, may vary materially from the estimated amount reserved.

Hurricane Katrina

Hurricane Katrina made landfall in New Orleans, Louisiana, on August 29, 2005, causing an estimated \$80 billion in damages. Over 95.0 percent of our policyholders in the New Orleans area suffered damage from Hurricane Katrina, with over 11,000 claims reported; we have concluded 96.7 percent of those claims. Our loss and loss settlement expenses inception to date (net of reinsurance) attributable to Hurricane Katrina totaled \$288.9 million as of December 31, 2009, of which \$38.0 million was incurred in 2009. The loss and loss settlement expenses incurred in 2009 includes an IBNR reserve increase for Hurricane Katrina claims litigation of \$16.2 million, primarily due to the continuing unfavorable legal environment related to Hurricane Katrina in Louisiana. In 2009, we continued to settle unresolved litigation related to Hurricane Katrina, concluding approximately 50 percent of the claims that were in litigation as of December 31, 2008. Our 2009 combined ratio was impacted 8.7 percent by Hurricane Katrina loss development.

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In 2008 and 2007, adverse development from Hurricane Katrina resulted in losses of \$26.6 million (including a \$10.8 million judgment, net of reinsurance, that was under appeal in 2008, which we lost on appeal in 2009) and \$6.3 million, respectively.

Since the occurrence of Hurricane Katrina in 2005, we have focused on reducing our risk exposure in Southern Louisiana by decreasing the number of insured properties, raising rates and purchasing additional reinsurance coverage. As of December 31, 2009, our current exposure level in Southern Louisiana is satisfactory, however, we will continue to monitor the situation closely and make additional adjustments as needed.

In January 2010, we ceased renewing policies or writing new business in the state of Louisiana through Lafayette Insurance Company. As a result, policyholders will be unable to litigate most issues in the Louisiana state court system, where we have experienced results that are inconsistent and unpredictable. We will continue to provide personal and commercial insurance coverage in Louisiana under United Fire & Casualty Company and our subsidiary, United Fire & Indemnity Company. Policyholders under these policies will be required to litigate in Federal courts, instead of Louisiana courts. All current Lafayette Insurance Company policyholders in Louisiana will be offered the opportunity to renew their policy in 2010 under United Fire & Indemnity Company, unless the policyholder has not paid their premium or the policy is being nonrenewed for a specific underwriting reason, such as failure to comply with loss control recommendations.

Other Catastrophes

In 2009, our pre-tax catastrophe losses without adverse development from Hurricane Katrina were \$22.4 million. In comparison our 2008 and 2007 pre-tax catastrophe losses were \$76.1 million and \$14.1 million, respectively. In 2008 and 2007, the portion of these losses attributable to adverse development from Hurricane Katrina was \$15.8 million (which excludes the \$10.8 million judgment, net of reinsurance) for 2008 and \$6.3 million, respectively. Our 2009 losses were the result of 26 new catastrophes, with our largest single loss coming from a Midwest storm that caused wind and hail damage and resulted in pre-tax losses totaling \$3.6 million. In 2008, we experienced our second highest year for catastrophe losses in the past decade, with losses from 34 new catastrophe events. Our largest losses during 2008 were related to Hurricane Ike (\$20.2 million) and Hurricane Gustav (\$15.8 million).

Catastrophe Reinsurance

Our 2009 core and catastrophe reinsurance programs remained relatively unchanged from our 2008 programs. Neither terms and conditions nor pricing were materially different. In 2009, we did not utilize our property catastrophe excess of loss treaty. In 2008, we exceeded our catastrophe retention of \$20.0 million with Hurricane Ike, and recorded \$2.4 million in ceded losses recoverable from that catastrophe.

Our planned reduction in Southern Louisiana that began after Hurricane Katrina has reduced our estimated 100-year maximum probable loss by over 58.0 percent as of December 31, 2009. To maintain profitability of our remaining Southern Louisiana business, we have employed portfolio optimizing techniques (i.e., proximity to the coast, type of construction, the reduction of geographic risk concentration and higher deductibles) to reduce the impact of any one future catastrophe. As an example of the effectiveness of our risk-reduction efforts, we estimate that we incurred \$12.8 million less in losses related to Hurricane Gustav in 2008 than we would have if we had not undertaken these measures.

In evaluating our catastrophe reinsurance coverage for 2005, we utilized two industry accepted models to estimate our exposure, and then purchased catastrophe reinsurance coverage that exceeded the estimated level. Hurricane Katrina resulted in a level of damage that the models, the industry, and we could not foresee. Consequently, we did not give consideration for such an event, which resulted in a level of reinsurance coverage that did not adequately protect us from the devastation of Hurricane Katrina. In addition to strengthening our underwriting guidelines and reducing our exposure in Southern Louisiana after Hurricane Katrina, we also evaluated and modified our catastrophe reinsurance coverage to lessen the impact of future catastrophes by increasing our property catastrophe reinsurance limits from \$125.0 million in 2005 to \$200.0 million beginning in 2007.

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We use many reinsurers, both domestic and foreign, which helps us to avoid concentrations of credit risk associated with our reinsurance. All reinsurers must meet the following minimum criteria: capital and surplus of at least \$250.0 million and an A.M. Best rating of at least A- or an S&P rating of at least A-. If a reinsurer is rated by both rating agencies, then both ratings must be at least an A-. The table below represents the primary reinsurers we utilize and their financial strength ratings as of December 31, 2009.

Name of Reinsurer	AM Best	S&P Rating
Arch Re	A	A
FM Global	A+	
Hannover Re ^{(1) (2)}	A	AA-
Lloyds Syndicates	A	A+
Odyssey Re ⁽²⁾	A	A-
Paris Re ⁽²⁾	A-	A+
Partner Re ^{(1) (2)}	A+	AA-
Platinum Re ⁽¹⁾	A	A
QBE Insurance Ltd ⁽¹⁾	A	A+
R&V Versicherung AG ⁽²⁾	N/A	A+
Renaissance	A+	AA-
Tokio Millennium	A+	AA

(1) Primary insurers participating on the property and casualty excess of loss programs.

(2) Primary insurers participating on the surety excess of loss program.

For 2010, the pricing for our core reinsurance program, which excludes our property catastrophe treaty, decreased 6.6 percent due to market conditions and a small reduction in coastal exposure in Southern Louisiana. Some of the key changes to our 2010 core program include: incorporating the umbrella coverage into our casualty excess of loss treaty, which prior to 2010 was a separate treaty; increasing the property excess of loss treaty to \$15.0 million from \$12.0 million; increasing our casualty per occurrence limit from \$20.0 million to \$40.0 million; expanding some of our aggregate limits; and renewing the \$2.0 million stated retention limit on our casualty and property excess of loss treaties.

Refer to Part II, Item 8, Note 5, Reinsurance for further discussion of our reinsurance programs.

Terrorism Coverage

The Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA) was signed into law on December 27, 2007. TRIPRA coverage includes most direct commercial lines of business, including coverage for losses from nuclear, biological and chemical exposures if coverage was afforded by an insurer, with exclusions for commercial automobile insurance, burglary and theft insurance, surety, professional liability insurance and farm owners multiple peril insurance. Under TRIPRA, each insurer has a deductible amount, which is 20.0 percent of the prior year's direct commercial lines earned premiums for the applicable lines of business, and retention of 15.0 percent above the

deductible. No insurer that has met its deductible shall be liable for the payment of any portion of that amount that exceeds the annual \$100.0 trillion aggregate loss cap specified in TRIPRA. TRIPRA provides marketplace stability. As a result, coverage for terrorist events in both the insurance and reinsurance markets is often available. The amount of aggregate losses necessary for an act of terrorism to be certified by the U.S. Secretary of Treasury, the Secretary of State and the Attorney General was \$100.0 million for 2009 and remains the same for 2010. Our TRIPRA deductible was \$64.8 million for 2009 and our TRIPRA deductible will be \$60.2 million for 2010. Our core and catastrophe reinsurance treaties provide limited coverage for terrorism exposure excluding nuclear, biological and chemical related claims.

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Non-Catastrophe Losses and Reserve Development

Workers' compensation and other liability are considered to be long-tail lines of business due to the length of time that may elapse before claims are finally settled. Therefore, we may not know our final development on individual claims for many years. Our estimates for losses, particularly in these long-tail lines, are dependent upon many factors, such as the legal environment, inflation and medical costs. We consider all of these factors, as well as others, in estimating our loss reserves. As conditions or trends with respect to these factors change, we change our estimate for loss reserves accordingly. Refer to "Critical Accounting Estimates" in this section for a more detailed discussion of our property and casualty segment's loss and loss settlement expenses and reserves.

2009 Results

In 2009, we increased our case reserves on prior year losses partially due to an increase in late reported claims. In addition, we have focused on establishing reserves for reported claims more quickly. In the fourth quarter 2009, we increased IBNR reserves for claims that occurred in prior years. Our other liability line had a significant increase in IBNR reserves, due to trends toward larger jury awards in this line and continuing construction defect claims and loss expenses. Overall, claims frequency decreased, which is a trend we have seen for several quarters. Claims severity has flattened for a majority of lines, with a slight increase in certain liability lines, specifically automobile and other liability as compared to 2008.

Overall, we experienced a net deficiency in our prior year reserves of \$26.2 million for 2009. The primary components of this deficiency was the deterioration in our other liability lines of business, which resulted in a deficiency in these lines of \$21.8 million, and adverse development from Hurricane Katrina claims and litigation totaling \$38.0 million, which resulted in a deficiency in the fire and allied lines of business of \$16.9 million.

2008 Results

Late in 2008, we began a corporate-wide audit of our reported large claim losses to analyze the increase in severity that we experienced in 2008. While we were satisfied with the results of the audit, our review resulted in the modification of certain underwriting guidelines. Examples of such modifications include an increase in the number of commercial accounts serviced by our loss control unit, the development of a new safety class for insureds, a decline in certain classes of commercial business that are no longer profitable and the introduction of some pricing increases. We also increased our case reserves on prior year losses, which resulted in a net deficiency of \$.5 million for 2008. The primary cause of our net deficiency in 2008 was the \$26.6 million in adverse development for Hurricane Katrina. The Hurricane Katrina-related losses contributed to a deficiency in the fire and allied lines of business of \$12.2 million.

Also contributing to our net deficiency in prior year reserves was an increase in general liability losses, which includes both other and products liability lines. Claims for construction defect losses are included in the products liability line of business. Incurred losses from construction defect claims for prior years were \$7.7 million in 2008. These losses contributed to a deficiency in the other liability and products liability lines of business totaling \$5.8 million. Other changes in loss development included prior year reserve redundancies in the following lines of business: commercial auto liability (\$3.2 million), workers' compensation (\$7.2 million) and assumed reinsurance (\$5.2 million).

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2007 Results

In 2007, we incurred losses and loss settlement expenses of \$245.8 million, of which \$291.0 million were from claims that occurred in 2007. We had favorable development from prior years' claims of \$45.2 million. The redundancy was realized in each of our lines of business, with the exception of homeowners, which was attributable to adverse development from Hurricane Katrina.

Reserve Development

The following table illustrates the primary components of the net redundancy (deficiency) we experienced in our reserves for 2009, 2008 and 2007.

(In Thousands)

Years ended December 31	2009	2008	2007
Savings from:			
Salvage and subrogation	\$ 5,968	\$ 7,099	\$ 11,637
Estimated alternative dispute resolution	12,957	7,352	8,847
Workers' compensation medical bill review	3,516	3,477	4,113
Other	(10,680)	8,152	29,322
Net redundancy excluding Hurricane Katrina	11,761	26,080	53,919
Adverse development from Hurricane Katrina	(37,976)	(26,628)	(8,718)
Net redundancy (deficiency)	\$ (26,215)	\$ (548)	\$ 45,201

Salvage is the sale of damaged goods, for which the insured has been indemnified and for which the insured has transferred title to the insurance company. Salvage reduces the cost incurred for property losses. Subrogation also reduces the costs incurred for a loss by seeking payment from other parties involved in the loss and/or from the other parties' insurance company. Alternative dispute resolution facilitates settlements and reduces defense and legal costs through processes such as mediation and arbitration. Workers' compensation medical bill review is a system designed to detect duplicate billings, unrelated and unauthorized charges and coding discrepancies. It also ensures that we are billed for medical services according to the fee schedule designated by each state in which we have claims.

Our other redundancy (deficiency) is attributable to both the payment of claims in amounts other than the amounts reserved and changes in reserves due to additional information on individual claims that we received after the reserves for those claims had been established. The additional information we consider is unique to each claim. Such information may include facts that reveal we have no coverage obligation for a particular claim, changes in applicable laws that reduce or increase our liability or coverage exposure on a particular claim, facts that implicate other parties as being liable on a particular claim and favorable or unfavorable court rulings that changes our liability for a particular claim. Also, additional information relating to severity is unique to each claim. For example, we may learn during the course of a claim that bodily injuries may be less or more severe than originally believed or that damage to a structure is merely cosmetic instead of structural.

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Net Loss Ratios by Line

The following table depicts our net loss ratio for 2009, 2008 and 2007.

Years ended December 31	2009			2008			2007		
	Net Losses and Loss Settlement			Net Losses and Loss Settlement			Net Losses and Loss Settlement		
	Net	Settlement	Net	Net	Settlement	Net	Net	Settlement	Net
(In Thousands)	Premiums Earned	Expenses Incurred	Loss Ratio	Premiums Earned	Expenses Incurred	Loss Ratio	Premiums Earned	Expenses Incurred	Loss Ratio
Commercial lines:									
Other liability	\$ 119,587	\$ 119,200	99.7%	\$ 134,429	\$ 93,000	69.2%	\$ 136,704	\$ 55,354	40.5%
Fire and allied lines	102,265	100,436	98.2	109,217	134,060	122.7	117,494	65,773	56.0
Automobile	97,948	75,123	76.7	101,229	72,384	71.5	99,004	63,509	64.1
Workers compensation	51,992	41,283	79.4	52,792	41,434	78.5	48,359	32,408	67.0
Fidelity and surety	21,354	1,838	8.6	22,244	4,105	18.5	21,848	2,121	9.7
Miscellaneous	854	214	25.1	858	438	51.0	851	413	48.5
Total commercial lines	\$ 394,000	\$ 338,094	85.8%	\$ 420,769	\$ 345,421	82.1%	\$ 424,260	\$ 219,578	51.8%
Personal lines:									
Fire and allied lines	\$ 22,317	\$ 12,254	54.9%	\$ 21,353	\$ 34,195	160.1%	\$ 21,117	\$ 12,434	58.9%
Automobile	13,053	10,725	82.2	12,603	11,701	92.8	13,764	8,561	62.2
Miscellaneous	365	662	181.4	326	472	N/A	311	353	N/A
Total personal lines	\$ 35,735	\$ 23,641	66.2%	\$ 34,282	\$ 46,368	135.3%	\$ 35,192	\$ 21,348	60.7%
Reinsurance assumed	\$ 5,942	\$ 3,986	67.1%	\$ 10,530	\$ 1,560	14.8%	\$ 13,682	\$ 4,919	36.0%
Total	\$ 435,677	\$ 365,721	83.9%	\$ 465,581	\$ 393,349	84.5%	\$ 473,134	\$ 245,845	52.0%

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Commercial Lines

The net loss ratio in our commercial lines of business was 85.8 percent in 2009, 82.1 percent in 2008 and 51.8 percent in 2007. Several factors contributed to the deterioration of our loss ratio in 2009 and 2008.

Our other liability losses and loss settlement expenses incurred increased to \$119.2 million in 2009, compared to \$93.0 million in 2008 and \$55.4 million in 2007. In 2009, the deterioration was attributable to an increase in IBNR reserves and a slight increase in severity from trends such as larger jury awards and continuing construction defect claims and loss settlement expenses. Incurred losses from construction defect claims totaled \$6.0 million in 2009 as compared to \$11.0 million and \$5.4 million in 2008 and 2007, respectively.

Our profitability in the commercial lines of business has been impacted by competition, in each of the three years. In 2009 we experienced a modest decrease in premium level, reflecting the continuation of a trend of gradual decreases in premium level for some lines of business dating back to the third quarter of 2004.

An additional factor in the deterioration of our 2008 loss ratio was the significant impact catastrophe losses had on the commercial lines of business. The pre-tax impact totaled \$54.5 million, which was an increase of \$41.8 million over 2007 catastrophes. In 2008, we experienced our second highest year for catastrophe losses in the past decade. A portion of these losses was attributable to a \$10.8 million judgment, net of reinsurance, for Hurricane Katrina litigation that was under appeal in 2008, which we lost on appeal in 2009.

Commercial Fire and Allied Lines

Commercial fire and allied lines include fire, allied lines, commercial multiple peril and inland marine. The insurance covers losses to an insured's property, including its contents, from weather, fire, theft or other causes. We provide this coverage through a variety of business policies. The net loss ratio for our commercial fire and allied lines was 98.2 percent in 2009, 122.7 percent in 2008 and 56.0 percent in 2007. The improvement in these lines for 2009 as compared to 2008 was primarily due to a decrease in loss and loss settlement expenses in this line due to lower catastrophe losses and a leveling off of severity. Without considering catastrophe losses, frequency has not changed significantly over the past three years.

The deterioration in 2008 was primarily driven by catastrophe losses, which increased by nearly \$50.6 million in 2008 over 2007. Net losses from Hurricanes Gustav and Ike contributed \$3.6 million and \$19.0 million, respectively, to the commercial lines property losses in 2008. We also had an increase in commercial fire losses, with incurred losses from these claims increasing from \$20.3 million in 2007 to \$27.3 million in 2008. The number of claims reported decreased slightly, but the severity of commercial fire losses increased.

We continue to take measures to address our increase in incurred losses in the commercial fire and allied lines of business by implementing a number of underwriting initiatives that we anticipate will improve our loss experience.

Our 2009 underwriting initiatives included:

- Continued expansion of the loss control function in our Gulf Coast and Denver regions. Our service account program, which provides at least annual loss control visits, was implemented for larger and/or more complex accounts.

- Continued expansion of the use of pre-surveys prior to quoting larger new business accounts.

- Change in our underwriting guidelines to address issues noted in large loss audits.

- Reducing our risk exposure in Southern Louisiana by decreasing the number of insured properties and increasing our premium rates.

- Implementation of CATography Underwriter, a new property underwriting tool that integrates hazard data for many perils, catastrophe modeling, interactive color-coded exposure mapping, and aerial photography into an intuitive dashboard screen, providing a complete overview of the risk landscape at a geocode or street address level.

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Premiums earned in these lines have decreased from \$117.5 million in 2007 to \$109.2 million in 2008 to \$102.3 million in 2009. Our premium writings have been affected by continued competition and the weak economy, which has led to a decline in both the residential housing market in our western states and in government-funded projects. This reduced the volume of business of the commercial and residential contractors that we insure. Also contributing to the reduction in direct premiums written is the nonrenewal of accounts that no longer meet our underwriting or pricing guidelines. As pricing in the industry continues to decrease, we avoid accounts that have become too underpriced for the risk.

In addition, since the occurrence of Hurricane Katrina in 2005, we have focused on reducing our risk exposure in Southern Louisiana by, among other things, decreasing the number of insured properties and raising rates, which has led to a decline in premiums earned over the past three years.

Other Liability

Other liability is business insurance covering bodily injury and property damage arising from general business operations, accidents on the insured's premises and products manufactured or sold. We reported a net loss ratio in this line of 99.7 percent in 2009, 69.2 percent in 2008 and 40.5 percent in 2007.

The other liability line experienced a lower level of premiums earned in 2009, as compared to 2008, due to the effect competition and the weak economy had on residential and commercial construction. Our other liability losses and loss settlement expenses incurred increased to \$119.2 million in 2009, compared to \$93.0 million in 2008 and \$55.4 million in 2007. For 2009, the deterioration was attributable to an increase in IBNR reserves and a slight increase in severity from trends such as larger jury awards and increases in construction defect claims and loss settlement expenses. Incurred losses from construction defect claims totaled \$6.0 million in 2009 as compared to \$11.0 million and \$5.4 million in 2008 and 2007, respectively.

Construction Defect Losses

Losses from construction defect claims decreased in 2009 to \$6.0 million compared to \$11.0 million and \$5.4 million in 2008 and 2007, respectively. At December 31, 2009, we established \$15.2 million in construction defect loss and loss settlement expense reserves, excluding IBNR reserves, which consisted of 234 claims, compared with \$16.0 million, excluding IBNR reserves, consisting of 243 claims, at December 31, 2008.

Construction defect claims generally relate to allegedly defective work performed in the construction of structures such as apartments, condominiums, single family dwellings or other housing, as well as the sale of defective building materials. Such claims seek recovery due to damage caused by alleged deficient construction techniques or workmanship. The reporting of such claims can be quite delayed due to an extended statute of limitations, sometimes up to ten years. Court decisions have expanded insurers' exposure to construction defect claims as well. Defense costs are also a part of the insured expenses covered by liability policies and can be significant, sometimes greater than the cost of the actual paid claims.

A majority of our exposure to construction defect claims has been in Colorado and surrounding states. We historically have insured small-to-medium sized contractors in this geographic area. In an effort to limit the number of future claims from multi-unit buildings, we have implemented new policy exclusions limiting sub-contractor coverage on any building project with more than 12 units or on single family homes in any subdivision where the contractor is working on more than 15 homes. We have changed our underwriting guidelines to add a professional liability exclusion when a contractor prepares its own design work or blue prints. In 2009, we implemented the multi-family exclusion and tract home building limitation form in additional regions.

Other Liability Losses – Other Than Construction Defect

Within our other liability lines of business (other than construction defect), frequency increased slightly in 2009 as compared to 2008, with losses incurred on 4,936 claims in 2009 compared to 4,817 in 2008 and 4,523 in 2007. In 2009, our average direct losses incurred per other liability claim (other than construction defect) were \$23,699 per claim compared to \$28,727 per claim in 2008 and \$16,444 per claim in 2007.

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Because of the long-tail nature of liability claims, significant periods of time, ranging up to several years, may elapse between the occurrence of the loss, the reporting of the loss to us and the settlement of the claim. In both 2009 and 2008, over 37.0 percent of our other liability losses incurred (other than construction defect) resulted from losses that occurred in prior years. For 2009, the prior years that were most significantly impacted were 1997 and 2004 through 2008. For 2008, the prior years that were most significantly impacted were 2001 and 2003 through 2007.

The deterioration in the net loss ratio in 2007 was primarily related to an increase in severity as compared to the prior year. We had several large liability losses in 2007, but did not detect a trend related to the cause or geographic locations of the losses.

In recent years, we began to use our loss control department more extensively in an attempt to return this line of business to a higher level of profitability. For example, our loss control department has representatives make multiple annual visits to businesses and jobsites to ensure safety, rather than just one. We are also nonrenewing accounts that no longer meet our underwriting or pricing guidelines. As pricing in the industry continues to decrease, we avoid accounts that have become too underpriced for the risk.

Commercial Automobile

Our commercial automobile insurance covers physical damage to an insured's vehicle, as well as liabilities to third parties. Automobile physical damage insurance covers loss or damage to vehicles from collision, vandalism, fire, theft, flood or other causes. Automobile liability insurance covers bodily injury, damage to property resulting from automobile accidents caused by the insured, uninsured or underinsured motorists and the legal costs of defending the insured against lawsuits. Generally, our company policy is to write standard automobile insurance. Our net loss ratio in commercial automobile was 76.7 percent in 2009, 71.5 percent in 2008 and 64.1 percent in 2007.

In 2009, our premium writings were affected by continued competition and the weak economy, which contributed to the \$3.3 million decrease in premiums earned as compared to 2008. In 2009, we experienced a slight decrease in our policy counts, which resulted in a decrease in premiums earned, compared to 2008, when an increase in policy counts resulted in an increase in premiums earned. Losses and loss settlement expenses increased in each of the past three years, rising from \$63.5 million in 2007 to \$72.4 million in 2008 and \$75.1 million in 2009. We attribute the increase in 2009 to a slight increase in claims severity, while the increase in 2008 was attributable to the growth of the number of policies that we had written.

Workers Compensation

Our net loss ratio in the workers' compensation line of business was 79.4 percent in 2009, 78.5 percent in 2008 and 67.0 percent in 2007. We consider our workers' compensation business to be a companion product; we rarely write stand-alone workers' compensation policies. Our workers' compensation insurance covers primarily small- to mid-size accounts.

In 2009, both the nonrenewal of accounts that no longer meet our underwriting or pricing guidelines and avoiding accounts that have become too underpriced for the risk have contributed to the reduction in premiums earned in this line. In 2008 and 2007, we wrote more workers' compensation business, as we worked to retain business with current policyholders that required workers' compensation insurance coverage.

We believe that our underwriting expertise, loss control service and medical review programs will enable us to be profitable in the workers' compensation line of business. The challenges faced by workers' compensation insurance providers to attain profitability include the regulatory climates in some states that make it difficult to obtain appropriate premium rate increases and inflationary medical costs. Despite these pricing issues, we continue to believe that we can improve profitability in the workers' compensation line of business. Consequently, we have introduced predictive modeling analytics into our workers' compensation underwriting process. In addition, we are going to increase our utilization of our loss control unit in the analysis of current risks, with the intent of increasing the quality of our workers' compensation book of business.

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The deterioration in the loss and loss settlement expenses in 2009 and 2008 is reflective of the increased premium writings we undertook in recent years and the risk associated with this long-tail line. The improvement in results in 2007 was due to lower severity, a slight decrease in our frequency and improvements in our medical review programs.

Fidelity and Surety

Our surety products guarantee performance and payment by our bonded principals. Our contract bonds protect owners from failure to perform on the part of our principals. In addition, our surety bonds protect material suppliers and subcontractors from nonpayment by our contractors. When surety losses occur, our loss is determined by estimating the cost to complete the remaining work and to pay the contractor's unpaid bills, offset by contract funds due to the contractor, reinsurance and the value of any collateral to which we may have access. The net loss ratio in this line was 8.6 percent in 2009, 18.5 percent in 2008 and 9.7 percent in 2007.

Beginning in 2008, a downturn in general economic conditions decreased demand for our surety products, as construction activity declined. This contributed to flat growth in premiums earned in 2008 and the slight decline in 2009.

The improvement in our loss and loss settlement expense for 2009 was the result of a slight decrease in claims frequency and related loss settlement expenses. The increase in the loss ratio in 2008 was due to an increase in loss settlement expenses. Since 2007, there have been no new claims that exceeded our \$1.5 million reinsurance retention level.

Personal Lines

Our personal lines consist primarily of fire and allied lines (including homeowners) and automobile lines. The net loss ratio was 66.2 percent in 2009, 135.3 percent in 2008 and 60.7 percent in 2007.

In late 2009, we averaged low- to mid-single-digit percentage increases in premium level for our homeowner and personal auto lines of business. In 2008 and 2007, premium pricing decreased only in our personal auto line of business. In 2009, policy counts for homeowners, automobile and umbrella increased, as compared to 2008 where policy counts decreased in fire and allied lines (including homeowners) and automobile. In 2008, the premium reduction we experienced in the homeowners lines of business due to loss of business was more than offset by the significant increases in premium pricing in hurricane-exposed regions.

The deterioration in 2008 was primarily the result of catastrophe losses totaling \$21.6 million, compared to \$1.4 million in 2007, as we experienced a significant level of catastrophe losses as compared to the prior year.

Assumed Reinsurance

Our assumed reinsurance line of business loss ratio was 67.1 percent in 2009, compared to 14.8 percent and 36.0 percent in 2008 and 2007, respectively. The deterioration in 2009 was due to losses on current contracts related to Hurricanes Gustav and Ike, as well as environmental and asbestos losses on runoff business.

In 2009, we terminated one of our assumed reinsurance contracts and lowered participation on another. In 2008, the decrease in assumed premiums earned was due to the lower level of active assumed contracts we had as compared to prior years. In 2010, we entered into three new assumed contracts, which we anticipate will increase our assumed premiums writings.

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In 2009, loss and loss settlement expenses were \$4.0 million compared to \$1.6 million in 2008; \$9 million of the 2009 losses were attributable to Hurricanes Gustav and Ike. The remaining losses incurred were primarily from business that was in runoff. The favorable loss experience in 2008 is attributable to a low level of catastrophe losses as well as favorable claims development on runoff business. In 2007, the improvement in losses and loss settlement expenses incurred resulted from a number of older runoff businesses where we were able to reduce reserves to zero. We continue to have exposure, primarily with respect to environmental and asbestos coverage related to the runoff of some business, as well as exposure to catastrophe losses for the small number of assumed reinsurance contracts that we have continued to underwrite.

Other Underwriting Expenses

Our underwriting expense ratios, which are a percentage of other underwriting expenses over premiums earned, were 31.3 percent, 29.4 percent and 29.3 percent for 2009, 2008 and 2007, respectively. In 2009 we were unable to defer underwriting expenses (primarily agent commissions and employee salaries) at the same level as we were able to in 2008, due to lower premium writings resulting from continued competition and the weak economy, thus leading to the increase in our expense ratio.

In 2008, our commission expense decreased due to lower profit-sharing commissions payable to our agents. This decrease was offset by an increase in the ratio of fixed underwriting expenses to premiums earned.

Life Insurance Segment**Life Insurance Segment Results of Operations**

(In Thousands)

				% Change	
				2009	2008
Years ended December 31	2009	2008	2007	vs. 2008	vs. 2007
Revenues					
Net premiums written ⁽¹⁾	\$ 42,600	\$ 37,326	\$ 31,447	14.1%	18.7%
Net premiums earned	\$ 42,821	\$ 37,794	\$ 32,629	13.3%	15.8%
Investment income, net	74,533	74,125	79,076	0.6	-6.3
Realized investment gains (losses)	(6,364)	(12,262)	2,571	48.1	-576.9
Other income	605	935	595	-35.3	57.1
Total Revenues	\$ 111,595	\$ 100,592	\$ 114,871	10.9%	-12.4%
Benefits, Losses and Expenses					
Loss and loss settlement expenses	\$ 16,773	\$ 13,291	\$ 14,869	26.2%	-10.6%
Increase in liability for future policy benefits	23,897	23,156	15,666	3.2	47.8
Amortization of deferred policy acquisition costs	9,287	11,568	13,385	-19.7	-13.6
Other underwriting expenses	8,745	9,106	7,540	-4.0	20.8
Interest on policyholders' accounts	41,652	40,177	43,089	3.7	-6.8
Total Benefits, Losses and Expenses	\$ 100,354	\$ 97,298	\$ 94,549	3.1%	2.9%
Income Before Income Taxes	\$ 11,241	\$ 3,294	\$ 20,322	241.3%	-83.8%

(1) The Statutory
Financial
Measures

section of this
report defines
data prepared in
accordance with
statutory
accounting
practices, which
is a
comprehensive
basis of
accounting other
than U.S.
GAAP.

Our life insurance segment produced pre-tax income of \$11.2 million in 2009, compared to \$3.3 million in 2008 and \$20.3 million in 2007. In both 2009 and 2008, our pre-tax income was lower due to realized investment losses we experienced from OTTI charges in our portfolio of fixed maturity and equity securities. In 2009, 2008 and 2007, OTTI charges recorded totaled \$8.5 million, \$8.9 million and \$.1 million, respectively.

Net premiums earned increased in 2009 as compared to 2008 as well as in 2008 as compared to 2007. The increase in net premium earned in both 2009 and 2008 is attributable to increased sales of single premium whole life products and to our increased marketing efforts.

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Net investment income in both 2009 and 2008 was lower than in 2007, which is a reflection of lower market interest rates. Consolidated investment results are discussed in more detail later in this section under the caption Investments. United Life Insurance Company underwrites all of our life insurance business. Our principal life insurance products are deferred and immediate annuities, universal life products and traditional life (primarily single premium whole life insurance) products. We also underwrite and market other traditional products, including term life insurance and whole life insurance. Deferred and immediate annuities (84.1 percent), traditional life products (9.9 percent), universal life products (5.2 percent), and other life products (0.8 percent) comprised our 2009 life insurance premium revenues, as determined on the basis of statutory accounting practices. We do not write variable annuities or variable insurance products.

The fixed annuity deposits that we collect are not reported as net premiums written or earned under GAAP. Instead, we invest annuity deposits and record them as a liability against future policy benefits. The revenue that is generated from fixed annuity products consists of policy surrender charges and investment income. The difference between the yield we earn on our investment portfolio and the interest we credit on our fixed annuities is known as the investment spread. The investment spread is a major driver of the profitability for all of our annuity products.

Our annuity deposits increased 9.4 percent in 2009 compared to a decrease of 0.2 percent in 2008 and an increase of 11.1 percent in 2007. Annuity deposit levels increased from 2008 to 2009, primarily due to consumers choosing products with less risk and guaranteed returns.

In 2009, we experienced an increase in interest on policyholders' accounts, which is reflective of the increase in annuity deposits and the lowest level of surrenders and withdrawals experienced since 2005. In both 2008 and 2007, interest on policyholders' accounts decreased, as surrenders and withdrawals exceeded deposits, due to our annuitants seeking alternative options for their money.

The decrease in amortization of DAC in 2009 was due to modest changes in amortization schedules implemented for the universal life and deferred annuity lines, as compared to more significant changes in 2008. The 2008 changes were implemented because of lower than expected investment returns, reflecting large realized capital losses, as well as an adjustment in anticipated lapse rates, based upon recent experience. The impact of the changes each year resulted in a decrease of \$3.1 million in DAC amortization charges in 2009 as compared to 2008. Offsetting this decrease was an increase in regular amortization charges in the traditional life line due to the growth of the business, increasing amortization charges by \$.8 million in 2009 as compared to 2008.

Refer to Critical Accounting Estimates in this section for a more detailed discussion of our life segment's deferred policy acquisition costs.

Federal Income Taxes

We reported a federal income tax benefit of \$18.3 million and \$20.1 million in 2009 and 2008, respectively, resulting from a taxable loss in our property and casualty insurance operations. Our effective federal income tax rate was 30.1 percent for 2007. Our effective federal tax rate varied from the generally applicable federal income tax expense rate of 35.0 percent, due primarily to our portfolio of tax-exempt securities.

As of December 31, 2009, we have a net operating loss (NOL) carryforward of \$17.2 million, all of which is due to our purchase of American Indemnity Financial Corporation in 1999. Such net operating losses are currently available to offset future taxable income of our property and casualty companies. NOLs totaling \$.8 million and \$5.5 million expire in 2010 and 2011, respectively.

Due to our determination that we may not be able to fully realize the benefits of American Indemnity Financial Corporation's NOLs, we have recorded a valuation allowance against the NOLs. At December 31, 2009, this valuation allowance totaled \$5.6 million and remained unchanged from December 31, 2007. The valuation allowance was reduced by \$.5 million in 2007 due to utilization of the NOLs. Based on a yearly review we determine whether the benefit of the NOLs can be realized, and, if so, the decrease in the valuation allowance is recorded as a reduction to current federal income tax expense. In future years, decreases to the valuation allowance, if applicable, will continue to be recognized as a reduction to current federal income tax expense.

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INVESTMENTS

Investment Environment

During both 2009 and 2008, we saw extraordinary volatility and deterioration in the financial markets. This deterioration impacted our investment income results for 2009. It is widely believed that the economic downturn we faced in recent years appears to be over, however the economic indicators illustrate that the recovery will be a long, slow process. We will carefully watch the national and global economies and financial markets and monitor and modify our investment portfolio to reflect changes in market conditions in order to match our liabilities and maximize our investment return.

Investment Philosophy

We invest the property and casualty insurance segment's assets to meet our liquidity needs and maximize our after-tax returns while maintaining appropriate risk diversification. We invest the life insurance segment's assets primarily in investment-grade fixed maturities in order to meet our liquidity needs, maximize our investment return and achieve a matching of assets to liabilities.

We comply with state insurance laws that prescribe the kind, quality and concentration of investments that may be made by insurance companies. We determine the mix of our investment portfolio based upon these state laws, our liquidity needs, our tax position and general market conditions. We also consider the timing of our obligations, so we have cash available to pay our obligations when they become due. We make any necessary modifications to our investment portfolio as changing conditions warrant. We manage all but a small portion of our investment portfolio internally.

With respect to our fixed maturity securities, our general investment philosophy is to purchase financial instruments with the expectation that we will hold them to their maturity. However, close management of our available-for-sale portfolio is considered necessary to maintain an approximate matching of assets to liabilities and to adjust the portfolio to respond to changing financial market conditions and tax considerations.

Investment Portfolio

Our invested assets at December 31, 2009 totaled \$2.352 billion, compared to \$2.095 billion at December 31, 2008. At December 31, 2009, fixed maturity securities comprised 92.3 percent of our investment portfolio, while equity securities accounted for 5.6 percent of the value of our portfolio. Because the primary purpose of the investment portfolio is to fund future claims payments, we utilize a conservative investment philosophy, investing in a diversified portfolio of high quality, intermediate-term taxable corporate bonds, taxable U.S. government bonds and tax-exempt U.S. municipal bonds.

Composition

We develop our investment strategies based on a number of factors, including estimated duration of reserve liabilities, short- and long-term liquidity needs, projected tax status, general economic conditions, expected rates of inflation and regulatory requirements. We manage our portfolio based on investment guidelines approved by management, which comply with applicable statutory regulations.

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The composition of our investment portfolio at December 31, 2009, is presented in the following table.

	Property & Casualty Insurance Segment		Life Insurance Segment		Total	
(In Thousands)		Percent of Total		Percent of Total		Percent of Total
Fixed maturities ⁽¹⁾	\$ 766,274	83.6%	\$ 1,401,722	97.5%	\$ 2,167,996	92.3%
Equity securities	117,741	12.9	14,977	1.0	132,718	5.6
Trading securities	12,613	1.4			12,613	0.5
Mortgage loans			7,328	0.5	7,328	0.3
Policy loans			7,947	0.6	7,947	0.3
Other long-term investments	13,344	1.5	2,536	0.2	15,880	0.7
Short-term investments	5,083	0.6	2,276	0.2	7,359	0.3
Total	\$ 915,055	100.0%	\$ 1,436,786	100.0%	\$ 2,351,841	100.0%

(1) Available-for-sale
fixed maturities
are carried at fair
value.
Held-to-maturity
fixed maturities
are carried at
amortized cost.

At December 31, 2009, \$2,158.4 million, or 99.6 percent, of our fixed maturities were classified as available-for-sale, compared with \$1,898.6 million, or 99.2 percent, at December 31, 2008. We classify our remaining fixed maturities as held-to-maturity or trading. We record held-to-maturity securities at amortized cost. We record trading securities, primarily convertible redeemable preferred debt securities, at fair value, with any changes in fair value recognized in earnings.

Credit Quality

The following table is a breakdown of our fixed maturity securities for our available-for-sale, held-to-maturity and trading security portfolios, by credit rating, at December 31, 2009 and 2008, respectively. Information contained in the table is based upon issue credit ratings provided by Moody's unless the rating is unavailable, and then it is obtained from Standard & Poor's:

(In Thousands)	December 31, 2009		December 31, 2008	
	Carrying Value	% of Total	Carrying Value	% of Total
Rating				
AAA	\$ 207,199	9.5%	\$ 254,753	13.3%
AA	397,380	18.2	390,726	20.3
A	562,795	25.8	534,074	27.8
Baa/BBB	869,465	39.9	623,527	32.4
Other/Not Rated	143,770	6.6	118,721	6.2
	\$ 2,180,609	100.0%	\$ 1,921,801	100.0%

Our total carrying value of AAA rated fixed maturity securities decreased in 2009 as compared to 2008 because AAA agency bonds that we owned were called during 2009. Both our AA and Baa/BBB fixed maturity securities increased due to purchases in 2009, as we sought a higher yield in our fixed maturity portfolio. Downgrades in corporate bonds and other securities during 2009 also shifted the composition of our investment portfolio, increasing our A and Other/Not Rated fixed maturity securities and contributing to the increase of our Baa/BBB fixed maturity securities. The securities in our fixed maturity portfolio at December 31, 2009, continued to be affected by downgrades of our municipal bond holdings that occurred during 2008 and 2009.

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Third-Party Guarantees

We base our investment decisions on the credit characteristics of individual securities; however, within our municipal bond portfolio are a number of securities whose ratings were enhanced by third-party insurance for the payment of principal and interest in the event of an issuer default. A downgrade in the credit ratings of the insurers of these securities in 2009 and 2008 has resulted in a corresponding downgrade in the ratings of the securities. Of the insured municipal securities in our investment portfolio, 95.1 percent and 95.3 percent were rated single A or above, and 70.0 percent and 68.9 percent were rated AA or above at December 31, 2009 and 2008, respectively, without the benefit of insurance. Due to the underlying financial strength of the issuers of the securities, we believe that the loss of insurance would not have a material impact on our operations, financial position, or liquidity.

We reviewed our investment portfolio pertaining to securities guaranteed by third parties, with both direct and indirect exposure. We have no direct exposure in any of the guarantors that guarantee our investments. Our largest indirect exposure with a single guarantor totaled \$129.7 million or 31.5 percent of our insured municipal securities for December 31, 2009 as compared to \$133.5 million or 31.7 percent for December 31, 2008. Our five largest indirect exposures to financial guarantors accounted for 79.6 percent and 79.0 percent of our insured municipal securities at December 31, 2009 and 2008, respectively.

Duration

Our investment portfolio is comprised primarily of fixed maturity securities whose fair value is susceptible to market risk, specifically interest rate changes. Duration is a measurement used to quantify our inherent interest rate risk and analyze our ability to match our invested assets to our claims liabilities. If our invested assets and claims liabilities have similar durations, then any change in interest rates will have an equal and opposite effect on our investments and claims liabilities. Mismatches in the duration of assets and liabilities can cause significant fluctuations in our results of operations. The primary purpose for matching invested assets and claims liabilities is liquidity. With appropriate matching, our investments will mature when cash is needed, preventing the need to liquidate other assets prematurely.

Group

The weighted average duration of our fixed maturity available-for-sale, held-to-maturity and trading portfolios, at December 31, 2009 is 6.0 years compared to 6.3 years at December 31, 2008.

Property and Casualty Insurance Segment

For our property and casualty insurance segment, the weighted average duration of our fixed maturity available-for-sale, held-to-maturity and trading portfolios, at December 31, 2009 is 7.3 years compared to 7.7 years at December 31, 2008.

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The amortized cost and fair value of held-to-maturity, available-for-sale and trading securities at December 31, 2009, by contractual maturity, are shown in the following table. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities and collateralized mortgage obligations may be subject to prepayment risk and are therefore not categorized by contractual maturity.

(In Thousands)	Held-To-Maturity		Available-For-Sale		Trading	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
December 31, 2009						
Due in one year or less	\$ 255	\$ 259	\$ 15,325	\$ 15,631	\$	\$
Due after one year through five years	6,636	6,613	114,234	120,008	5,657	6,101
Due after five years through 10 years	655	694	525,760	548,873		
Due after 10 years			70,428	74,210	6,067	6,512
Mortgage-backed securities	4	4	2	2		
	\$ 7,550	\$ 7,570	\$ 725,749	\$ 758,724	\$ 11,724	\$ 12,613

Life Insurance Segment

For our life insurance segment, the weighted average duration of our fixed maturity available-for-sale, held-to-maturity and trading portfolios, at December 31, 2009 and 2008 is 4.3 years.

The amortized cost and fair value of held-to-maturity, available-for-sale and trading securities at December 31, 2009, by contractual maturity, are shown in the following table. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities and collateralized mortgage obligations may be subject to prepayment risk and are therefore not categorized by contractual maturity.

(In Thousands)	Held-To-Maturity		Available-For-Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
December 31, 2009				
Due in one year or less	\$	\$	\$ 141,733	\$ 143,860
Due after one year through five years	570	571	943,980	991,351
Due after five years through 10 years			181,616	181,752
Due after 10 years			65,203	63,752
Mortgage-backed securities	530	603		
Collateralized mortgage obligations	955	976	17,452	18,952
	\$ 2,055	\$ 2,150	\$ 1,349,984	\$ 1,399,667

Net Investment Income

We invest the premiums received from our policyholders and annuitants in order to generate investment income, which is an important component of our revenues and profitability. The ability to increase investment income is affected by factors that are beyond our control and which may adversely impact investment income. These factors include: volatility in the financial markets, economic growth, inflation, interest rates, world political conditions, terrorism attacks or threats, adverse events affecting other companies in our industry or the industries in which we invest and other unpredictable national or world events.

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Our investment results are summarized in the following table.

(In Thousands) As of and for the years ended December 31	2009	2008	2007	% Change	
				2009 vs. 2008	2008 vs. 2007
Investment income, net	\$ 106,075	\$ 107,577	\$ 122,439	-1.4%	-12.1%
Realized investment gains (losses)					
Other-than-temporary impairment charges	\$ (18,307)	\$ (9,904)	\$ (105)	-84.8%	N/A
Other realized investment gains (losses)	5,128	(479)	9,775	N/A	N/A
Total realized investment gains (losses)	\$ (13,179)	\$ (10,383)	\$ 9,670	-26.9%	-207.4%
Net unrealized gains, after tax	\$ 82,491	\$ 25,543	\$ 85,579	222.9%	-70.2%

In 2009, our net investment income (pre-tax) declined \$1.5 million to \$106.1 million as compared to the same period in 2008. The decline was due to the following factors: lower market interest rates earned on our investment portfolio, which also affected the returns on our short-term investments and cash and cash equivalents; agency bonds that were called during 2009, the proceeds of which we reinvested at lower interest rates than the called bonds carried; and the reduction or discontinuation of dividend payments by some of our equity securities that previously had paid regular dividends.

Also contributing to the decline were changes in the value of certain investments in limited liability partnerships, which we account for under the equity method of accounting. Our largest investment is in a partnership fund that invests in U.S. subregional banks. We continue to hold our investments in limited liability partnerships, as it is anticipated that the performance of these holdings will improve as the industry recovers.

In 2008, our net investment income declined \$14.9 million to \$107.6 million. This decrease is attributable to lower market interest rates in 2008 than in 2007; mostly on our short-term and fixed maturity securities, which dropped an average of 203 basis points in 2008. This decrease is also attributable to the net cash outflows from our annuity business, which decreased our invested assets by \$73.0 million in 2008 and \$92.8 million in 2007. Further contributing to this decline was a loss in investment income of \$4.5 million due to the performance of our investments in certain limited liability partnership holdings.

The following table summarizes the components of net investment income:

(In Thousands)				
Years Ended December 31	2009	2008	2007	
Investment income				
Interest on fixed maturities	\$ 106,023	\$ 100,755	\$ 103,632	
Dividends on equity securities	3,950	5,749	6,190	
Loss on other long-term investments (1)	(1,133)	(4,442)	(954)	
Interest on mortgage loans	587	851	1,712	
Interest on short-term investments	558	3,127	2,634	
Interest on cash and cash equivalents	1,094	4,710	12,327	
Other	1,253	1,588	1,208	
Total investment income	\$ 112,332	\$ 112,338	\$ 126,749	
Less investment expenses	6,257	4,761	4,310	
Investment income, net	\$ 106,075	\$ 107,577	\$ 122,439	

- (1) Includes an adjustment for the changes in value of our holdings in limited liability partnership funds, which are accounted for under the equity method of accounting.

In 2009, 94.4 percent of our gross investment income originated from interest on fixed maturities, compared to 89.7 and 81.8 percent in 2008 and 2007, respectively.

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The following table details our yield on average invested assets for 2009, 2008 and 2007, which is based on our invested assets (including money market accounts) at the beginning and end of the year divided by net investment income (after the deduction of investment expenses and excluding realized gains and losses).

(In Thousands)	Average Invested Assets	Investment Income, Net	Annualized Yield on Average Invested Assets
Years ended December 31			
2009	\$ 2,307,260	\$ 106,075	4.6%
2008	2,211,780	107,577	4.9%
2007	2,219,510	122,439	5.5%

Securities Lending

We participate in a securities lending program administered by The Northern Trust Company (Northern Trust), which generates investment income and provides discounts on other investment fees we are charged by Northern Trust. Pursuant to the lending agreement, certain of our fixed maturity securities are loaned to other institutions for short periods of time. Borrowers of these securities must deposit collateral, which is generally in the form of cash, with Northern Trust, as our agent, that is equal to at least 102% of the market value of the loaned securities plus accrued interest. The value of the loaned securities is marked to market daily by Northern Trust at an aggregate level per borrower. As the market value of the loaned securities fluctuates, the borrower either deposits additional collateral or Northern Trust refunds collateral to the borrower in order to maintain the collateral level at 102%. We retain the right to terminate the loan at any time, whereupon the borrower must return the loaned securities to Northern Trust. If the borrower defaults and does not return the securities, Northern Trust will use the deposited collateral to purchase equivalent securities for us. However, we would receive the deposited collateral in place of the borrowed securities if Northern Trust is unable to purchase equivalent securities. Our participation in the securities lending program generated investment income of \$139,000 in 2009 and \$89,000 in 2008. There were no securities on loan under the program at December 31, 2009 and 2008. We resumed our participation in the securities lending program in January 2010.

Realized Investment Gains and Losses

In 2009, we reported realized investment losses of \$13.2 million, compared to losses of \$10.4 million and gains of \$9.7 million in 2008 and 2007, respectively. The following table summarizes the components of our realized investment gains or losses:

(In Thousands)	2009	2008	2007
Years Ended December 31			
Realized investment gains (losses)			
Fixed maturities	\$ (4,117)	\$ (11,728)	\$ 2,078
Equity securities	(11,362)	1,427	6,020
Trading securities	1,965	(82)	1,572
Other long-term investments	332		
Short-term investments	3		
Total realized investment gains (losses)	\$ (13,179)	\$ (10,383)	\$ 9,670

The realized investment losses in 2009 and 2008 were primarily due to pre-tax OTTI charges on our fixed maturity securities and equity securities. We recorded \$18.3 million in investment write-downs in 2009 compared to \$9.9 million and \$.1 million in 2008 and 2007, respectively. The write-downs that occurred in 2009 and 2008 represent 0.8 percent and 0.5 percent of our investment portfolio, respectively. In 2007, our realized investment gains were due primarily to cash received as a result of transactions that impacted companies whose securities we held.

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The following table summarizes the composition of our OTTI charges:

(In Thousands)				
Years Ended December 31	2009	2008	2007	
Other-than-temporary-impairment charges (pre-tax)				
Fixed maturities	\$ 5,759	\$ 8,597	\$ 105	
Equity securities	12,548	1,307		
Total other-than-temporary-impairment charges	\$ 18,307	\$ 9,904	\$ 105	

Net Unrealized Gains and Losses

As of December 31, 2009, net unrealized gains, after tax, totaled \$82.5 million, compared to \$25.5 million and \$85.6 million as of December 31, 2008 and 2007, respectively. In 2009, an improvement in the equity markets and a decrease in market interest rates led to an increase in the carrying value of our fixed maturity and equity securities, which improved our net unrealized gains. In 2008 and 2007, depressed bond and stock prices, particularly for our holdings of investments in financial institutions, contributed to the decrease in net unrealized gains. We have and will continue to closely monitor market conditions and evaluate the long-term impact of the market volatility experienced in recent years on all of our investment holdings.

Changes in unrealized gains on available-for-sale securities do not affect net income (loss) and earnings (loss) per share but do impact comprehensive income (loss), stockholders' equity and book value per share. We believe that our unrealized losses on available-for-sale securities at December 31, 2009 are temporary based upon both our current analysis of the issuers of the securities that we hold and on current market conditions. It is possible that we could recognize impairment losses in future periods on securities that we own at December 31, 2009, if future events and information cause us to determine that a decline in value is other-than-temporary. However, we endeavor to invest in high quality assets to provide protection from future credit quality issues and corresponding impairment write-downs. The following table summarizes the change in our net unrealized appreciation:

(In Thousands)				
Years Ended December 31	2009	2008	2007	
Net changes in unrealized investment appreciation				
Available-for-sale fixed maturity securities	\$ 126,555	\$ (70,516)	\$ 5,547	
Equity securities	24,673	(58,130)	(13,985)	
Short-term investments			56	
Deferred policy acquisition costs	(63,425)	36,284	(3,831)	
Income tax effect	(30,855)	32,326	4,273	
Change in net unrealized appreciation	\$ 56,948	\$ (60,036)	\$ (7,940)	

Refer to Critical Accounting Estimates in this section for a detailed discussion of our policy for recording OTTI charges.

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LIQUIDITY AND CAPITAL RESOURCES**Liquidity**

Liquidity measures our ability to generate sufficient cash flows to meet our short- and long-term cash obligations. Our cash inflows are primarily a result of premiums, annuity deposits, reinsurance recoveries, sales or maturities of investments, and investment income. Historically, we have generated substantial cash inflows from operations. It is our policy to invest the cash generated from operations in securities with maturities that correlate to the anticipated timing of payments for losses and loss settlement expenses of the underlying insurance policies. The majority of our assets are invested in available-for-sale fixed maturity securities.

Our cash outflows are a result of losses and loss settlement expenses for property and casualty claims; payment of policyholder benefits under life insurance contracts; annuity withdrawals; payment of commissions, premium taxes, income taxes, operating expenses, dividends; and investment purchases. Cash outflows may be variable because of the uncertainty regarding settlement dates for losses. In addition, the timing and amount of individual catastrophe losses are inherently unpredictable and could increase our liquidity requirements.

In the insurance industry there generally is a time delay between when premiums are collected and when insurance claims or policyholder benefits are paid. During periods of positive operating cash flows, we are able to invest a portion of our operating cash flows to fund future insurance claims and policyholder benefit payments. During periods of negative operating cash flows, such as during a decline in premium revenues, we may need to sell investments to fund payments to claimants and policyholders. Additionally, if we experience several significant catastrophes over a relatively short period of time, or if we experience an extraordinary catastrophe, it is possible that investments may have to be sold before their maturity dates to fund payments, which could either result in investment gains or losses. Our cash flows from operations were sufficient to meet our liquidity needs in 2009, 2008 and 2007.

We invest funds required for short-term cash needs primarily in money market accounts, which are classified as cash equivalents. At December 31, 2009, our cash and cash equivalents included \$96.2 million related to these money market accounts, compared with \$70.7 million at December 31, 2008.

If our operating and investing cash flows are not sufficient to support our operations, we may also borrow up to \$50.0 million on a bank line of credit. Under the terms of our credit agreement, interest on outstanding notes is payable at the lender's prevailing prime rate, minus 1.0 percent. We did not utilize our line of credit during 2009 or 2008, other than to secure letters of credit utilized in our reinsurance operations. As of December 31, 2009, none of our line of credit was allocated for that purpose compared to \$.2 million as of December 31, 2008.

The following table displays a summary of cash sources and uses in 2009, 2008 and 2007.

Cash Flow Summary (In Thousands)	Years Ended December 31,		
	2009	2008	2007
Cash provided by (used in):			
Operating activities	\$ 100,408	\$ 43,904	\$ 105,780
Investing activities	(130,089)	(107,255)	(16,332)
Financing activities	110,950	(79,632)	(91,928)
Net increase (decrease) in cash and cash equivalents	\$ 81,269	\$ (142,983)	\$ (2,480)

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Operating Activities

Net cash flows provided by operating activities totaled \$100.4 million in 2009, compared to \$43.9 million in 2008 and \$105.8 million in 2007, respectively. Significant sources of operating cash flows are derived from underwriting operations and net investment income. Cash flows for 2009 reflect an increase in loss payments; a reduction in other assets of \$29.0 million for the conclusion of certain litigation related to Hurricane Katrina; and a reduction in reinsurance recoveries due to the collection of payments during the year and the improvement in our catastrophe experience in 2009 as compared to 2008.

Net cash flows in 2008 were reduced primarily due to the increase in claims incurred, (including the impact of higher catastrophe losses). In addition, in 2008 we were required to make a cash deposit of \$29.0 million in connection with certain litigation related to Hurricane Katrina.

Investing Activities

Net cash flows used in investment activities totaled \$130.1 million in 2009, compared to \$107.3 million in 2008 and \$16.3 million in 2007. The availability of more cash from financing activities in 2009, primarily due to the higher level of annuity deposits, allowed us to invest at a level similar to 2008.

In 2009, we continued to purchase a higher level of corporate fixed maturities rather than other investment vehicles such as short-term investments, which were less profitable due to the lower market interest rates. In 2008, we substantially increased our purchases of corporate fixed maturity securities, as the interest rates on these securities increased during 2008.

Financing Activities

Net cash flows provided by financing activities totaled \$111.0 million in 2009, compared to net cash used of \$79.6 million and \$91.9 million in 2008 and 2007, respectively. Net cash flows from financing activities improved significantly in 2009, primarily due to the life insurance segment's annuity and universal life contract deposits exceeding withdrawals. We began to experience a slowdown in the amount of withdrawals in 2008, which is indicative of the change in economic conditions and the inclination of consumers to choose products with less risk and guaranteed returns. This slowdown continued into 2009, with 2009 experiencing the largest reduction of withdrawals since 2005.

Net cash flows from financing activities were impacted by a combination of factors in 2008 and 2007. Cash outflows associated with our life insurance segment's annuity portfolio had increased from historical levels in connection with the increased level of surrenders and withdrawals experienced in recent years. Net cash used in these activities totaled \$48.8 million and \$61.7 million for 2008 and 2007, respectively. The increase in withdrawals is described in the earlier Life Insurance Segment section.

During 2009, 2008 and 2007, pursuant to authorization by our Board of Directors, we repurchased 92,721, 580,792 and 497,500 shares of common stock respectively, which used cash totaling \$1.5 million in 2009, \$14.8 million in 2008 and \$16.1 million in 2007. Dividend payments to our common stockholders totaled \$16.0 million in 2009, compared with \$16.2 million in 2008 and \$15.3 million in 2007.

CAPITAL RESOURCES

Stockholders' Equity

Stockholders' equity increased from \$641.7 million at December 31, 2008, to \$672.7 million at December 31, 2009, an increase of 4.8 percent. The increase in stockholders' equity between years is primarily due to an increase in net unrealized appreciation on investments of \$56.9 million, after-tax. This was somewhat offset by a net loss of \$10.4 million; dividends paid of \$16.0 million; repurchase of common stock of \$1.5 million; and the change in underfunded status of our employee benefit plans of \$.2 million, net of tax. The book value per share of our common stock was \$25.35 at December 31, 2009, compared with \$24.10 at December 31, 2008.

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Contractual Obligations and Commitments

The following table shows our contractual obligations and commitments, including our estimated payments due by period, at December 31, 2009.

(In Thousands)		Payments Due By Period				
		Total	Less Than One Year	One to Three Years	Three to Five Years	More Than Five Years
Contractual Obligations						
Future policy benefit reserves ⁽¹⁾	\$ 1,866,277	\$ 200,388	\$ 419,028	\$ 402,799	\$ 844,062	
Loss and loss settlement expense reserves	606,045	221,304	193,244	90,907	100,590	
Operating leases	16,623	4,077	6,733	4,801	1,012	
Total	\$ 2,488,945	\$ 425,769	\$ 619,005	\$ 498,507	\$ 945,664	

(1) This projection of our obligation for future policy benefits considers only actual future cash outflows. The future policy benefit reserves presented on the consolidated balance sheet is the net present value of the benefits to be paid, less the net present value of future net premiums.

Future Policy Benefits

Future payments to be made to policyholders and beneficiaries must be actuarially estimated and are not determinable from the contract. The projected payments are based on our current assumptions for mortality, morbidity and policy lapse, but are not discounted with respect to interest. Additionally, the projected payments are based on the assumption that the holders of our annuities and life insurance policies will withdraw their account balances from our company upon the expiration of their contracts. Policies must remain in-force for the policyholder or beneficiary to receive the benefit under the policy. Depending on the terms of a particular policy, future premiums from the policyholder may be required for the policy to remain in-force. The future policy benefit reserves for the life insurance segment reported on the Consolidated Balance Sheets are generally based on the historical assumptions for mortality and policy lapse rates and are on a discounted basis. Accordingly, the amounts presented above for future policy benefit reserves significantly exceeds the amount of future policy benefit reserves reported on our Consolidated Balance Sheets at December 31, 2009.

Loss and Loss Settlement Expense Reserves

The amounts presented are estimates of the dollar amounts and time periods in which we expect to pay out our gross loss and loss settlement expense reserves. These amounts are estimates based upon historical payment patterns and may not represent actual future payments because the timing of future payments may vary from the stated contractual obligation. Refer to Critical Accounting Estimates: Loss and Loss Settlement Expenses Property and Casualty Insurance Segment in this section for further discussion.

Operating Leases

Our operating lease obligations are for the rental of office space, vehicles, computer equipment and office equipment.

Off-Balance Sheet Arrangements

Pursuant to an agreement with one of our limited liability partnership holdings, we are contractually committed to make capital contributions up to \$15.0 million, upon request by the partnership, through December 31, 2017. As of December 31, 2009, our remaining potential contractual obligation was \$13.1 million.

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ENTERPRISE RISK MANAGEMENT

Enterprise risk management (ERM) is a methodology that helps an organization assess and manage its overall exposure to risk. ERM begins as a capital preservation process that helps insurers identify, quantify and manage risks from all sources that exist throughout the corporation, including risks arising from investments, underwriting, and operations. ERM considers the accumulation and diversification of risk and utilizes a company's past experience to help evaluate future business plans and manage risk.

We employ a multi-disciplinary approach to risk identification and evaluation from claims to underwriting to financial to investments. Members of our ERM committee include our Chief Executive Officer, Chief Financial Officer, Executive Vice President, Vice President of Claims, Vice President of Corporate Underwriting, Chief Investment Officer and Vice President/Chief Operating Officer of our life insurance subsidiary (United Life Insurance Company), as well as United Life Insurance Company's independent actuary. During 2009, this committee met on a quarterly basis with two members of our Board of Directors to oversee our risk management process and to implement risk management strategies. At the November 2009 meeting of our Board of Directors, the directors established a Risk Management Committee consisting of four directors. Going forward, this committee will meet on a quarterly basis and will continue meeting jointly with the ERM committee.

During its meetings, the ERM committee discusses the risks that our company faces, as well as the controls that are in place to mitigate those risks. These are not new ideas management has actively and successfully managed risks throughout our company's history. Collectively, the committee has identified two broad categories of risk faced by our company insurance risk and operational risk. Types of insurance risks generally include, but are not limited to, those risks associated with catastrophes, geographical concentrations of property insured, business mix, underwriting practices, loss reserving practices, policy pricing, and the actions of our competitors. Types of operational risks we face generally include, but are not limited to, those risks associated with business continuity planning, information technology, executive succession planning, regulatory and legal compliance, diversification and quality of investments and the application of accounting policies and procedures.

ERM issues are discussed both during our quarterly meetings of the Board of Directors and at our semi-annual managers meetings. At these meetings, directors and managers are updated on ERM issues and the ongoing efforts of the ERM committee. The work of our ERM committee has led to the development of new tools designed to aid in the evaluation and mitigation of underwriting risks.

In 2009, we established a Business Continuity group that enables us to be better prepared in the event of another disaster similar to the floods we experienced in 2008. The Business Continuity group evaluated our risks that are specific to natural perils such as flooding, while our ERM Committee evaluated other risks we have such as cyber events, and directors and officers liability.

One of the most significant risks in our business is our exposure to catastrophic events. Although catastrophes are inherently unpredictable, we use various analyses and methods, including computer modeling techniques, to analyze catastrophic events and the risks associated with them. We use these analyses and methods to make underwriting and reinsurance decisions designed to manage our exposure to losses associated with catastrophic events.

As part of our risk management process, we use third-party proprietary computer modeling of windstorm/hail, hurricane and earthquake events, to aid in estimating the likelihood that the loss from a single event occurring in a one-year timeframe will equal or exceed a particular amount.

Catastrophe modeling requires a significant amount of judgment and a number of assumptions and relies upon inputs based on experience, science, engineering and history. We utilize various tools and techniques to evaluate our catastrophe exposures including utilizing multiple catastrophe models, analysis of realistic disaster scenarios, evaluation of total insured values and exposure aggregates. Such models may fail to account for risks that are outside of the range of normal probability or that are otherwise unforeseeable. Consequently, catastrophe modeling estimates are subject to significant uncertainty. In addition, more than one such event could occur in any period.

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There are no industry-standard methodologies or assumptions for projecting catastrophe exposure. Accordingly, catastrophe estimates provided by different insurers may not be comparable.

CRITICAL ACCOUNTING ESTIMATES

Critical accounting estimates are defined as those that are representative of significant judgments and uncertainties and that potentially may result in materially different results under different assumptions and conditions. We base our discussion and analysis of our results of operations and financial condition on the amounts reported in our Consolidated Financial Statements, which we have prepared in accordance with GAAP. As we prepare these Consolidated Financial Statements, we must make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for the reporting period. We evaluate our estimates on an ongoing basis. We base our estimates on historical experience and on other assumptions that we believe to be reasonable under the circumstances. Actual results could differ from those estimates. We believe that our most critical accounting estimates are as follows.

Investment Valuation

Upon acquisition, we classify investments in marketable securities as held-to-maturity, available-for-sale, or trading. We record investments in held-to-maturity fixed maturities at amortized cost. We record available-for-sale fixed maturity securities, trading securities and equity securities at fair value. Other long-term investments are recorded on the equity method of accounting. We record mortgage loans at amortized cost and policy loans at the outstanding loan amount due from policyholders.

In general, investment securities are exposed to various risks, such as interest rate risk, credit risk, and overall market volatility risk. Therefore, it is reasonably possible that changes in the fair value of our investment securities reported at fair value will occur in the near term and such changes could materially affect the amounts reported in the Consolidated Financial Statements. Also, it is reasonably possible that changes in the carrying values of our limited liability partnerships could occur in the future and such changes could materially affect our results of operations and financial condition on the amounts reported in our Consolidated Financial Statements.

Determining Fair Value

We value our available-for-sale fixed maturities, trading securities, equity securities, short-term investments and money market accounts at fair value in accordance with the applicable FASB guidance on fair value measurements and disclosures. We exclude unrealized appreciation or depreciation on investments carried at fair value, with the exception of trading securities, from net income and report it, net of applicable deferred income taxes, as a component of accumulated other comprehensive income in stockholders' equity.

Financial instruments recorded at fair value are categorized in the fair value hierarchy as follows:

Level 1: Valuations are based on unadjusted quoted prices in active markets for identical financial instruments.

Level 2: Valuations are based on quoted prices, other than quoted prices included in Level 1, in markets that are not active or on inputs that are observable either directly or indirectly for the full term of the financial instrument.

Level 3: Valuations are based on pricing or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement of the financial instrument. Such inputs may reflect management's own assumptions about the assumptions a market participant would use in pricing the financial instrument.

To determine the fair value of the majority of our investments, we utilize prices obtained from independent, nationally recognized pricing services. We obtain one price for each security. When the pricing services cannot provide a determination of fair value for a specific security, we obtain non-binding price quotes from broker-dealers that we have had several years' experience with and who have demonstrated knowledge of the subject security. We request and utilize one broker quote per security.

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We validate the prices obtained from pricing services and brokers prior to their use for reporting purposes by evaluating their reasonableness on a monthly basis. Our validation process includes a review for unusual fluctuations. In our opinion, the pricing obtained at December 31, 2009, was reasonable.

In order to determine the proper classification in the fair value hierarchy for each security where the price is obtained from an independent pricing service, we obtain and evaluate the vendors' pricing procedures and inputs used to price the security, which include unadjusted quoted market prices for identical securities, such as a New York Stock Exchange closing price and quoted prices for identical securities in markets that are not active. For fixed maturity securities, an evaluation of interest rates and yield curves observable at commonly quoted intervals, volatility, prepayment speeds, and credit risks and default rates may also be performed. We have determined that these processes and inputs result in fair values and classifications consistent with the applicable FASB guidance on fair value measurements.

We review our fair value hierarchy categorizations on a quarterly basis, at which time the classification of certain financial instruments may change if the input observations have changed. The following table presents the categorization for our financial instruments measured at fair value on a recurring basis in our Consolidated Balance Sheets at December 31, 2009:

(In Thousands)	Fair Value Measurements			
	December 31, 2009	Level 1	Level 2	Level 3
Assets of December 31, 2009:				
Available-for-sale fixed maturities	\$ 2,158,391	\$	\$ 2,127,932	\$ 30,459
Equity securities	132,718	132,428	290	
Trading securities	12,613	1,519	11,094	
Short-term investments	7,359	1,100	6,005	254
Money market accounts	96,163	96,163		
Total assets as of December 31, 2009	\$ 2,407,244	\$ 231,210	\$ 2,145,321	\$ 30,713

The fair value of securities that are categorized as Level 1 is based on quoted market prices that are readily and regularly available.

The fair value of securities that are categorized as Level 2 is determined by management in reliance on market values obtained from independent pricing services and brokers. Such estimated fair values do not necessarily represent the values for which these securities could have been sold at the reporting date. Our independent pricing services and brokers obtain prices from reputable pricing vendors in the marketplace. They continually monitor and review the external pricing sources, while actively participating to resolve any pricing issues that may arise.

The securities categorized as Level 3 include holdings in certain private placement fixed maturity and equity securities and certain impaired securities for which there is not an active market. The fair value of our Level 3 impaired securities was determined primarily based upon management's assumptions regarding the timing and amount of future cash inflows.

If a security has been written down or the issuer is in bankruptcy, management relies in part on outside opinions from rating agencies, our lien position on the security, general economic conditions and management's expertise to determine fair value. We have the ability and the positive intent to hold securities until such time that we are able to recover all or a portion of our original investment. If a security does not have a market at the balance sheet date, management will estimate the security's fair value based on other securities in the market. Management will continue to monitor securities after the balance sheet date to confirm that their estimated fair value is reasonable.

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The following table provides a summary of the changes in fair value of our Level 3 securities for 2009:

(In Thousands)	Available-for-sale fixed maturities	Equity securities	Short-term investments	Total
Balance at January 1, 2009	\$ 6,254	\$ 1,851	\$	\$ 8,105
Realized gains ⁽¹⁾	(1)			(1)
Unrealized gains ⁽¹⁾	331			331
Purchases and disposals	65		254	319
Transfers in	26,010			26,010
Transfers out	(2,200)	(1,851)		(4,051)
Balance at December 31, 2009	\$ 30,459	\$	\$ 254	\$ 30,713

(1) Realized gains are recorded as a component of current operations whereas unrealized gains are recorded as a component of comprehensive income.

The amount reported in the previous table as transfers in consisted of \$22.7 million in available-for-sale fixed maturities that were primarily private placement securities that had no observable price available at December 31, 2009, and \$3.3 million of available-for-sale fixed maturities that were subsequently reclassified, as a disposal, to other long-term investments due to bankruptcy reorganization. The \$4.1 million in transfers out resulted from available-for-sale fixed maturities and equity securities that previously had no observable price at December 31, 2008, but for which observable prices were available at December 31, 2009.

The following table presents the composition of our Level 3 securities at December 31, 2009:

(In Thousands)	Level Three	% of Total Fair Value	Total from Balance Sheet	% of Level Three
Available-For-Sale Fixed Maturities				
Bonds				
Collateralized mortgage obligation	\$	%	\$ 18,952	%
Mortgage-backed securities			2	
All other government:				
US Treasury			35,650	
Agency			70,625	
States, municipalities and political subdivisions:				
General obligations			390,378	
Special revenue	1,110	3.6	227,362	0.5
All foreign bonds:				
Canadian			58,826	

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Other foreign	1,394	4.6	82,414	1.7
Public utilities:				
Electric	70	0.2	224,004	
Natural gas			57,806	
Other			3,778	
Corporate bonds:				
Bank, trust, and insurance	14,028	46.1	289,209	4.8
Transportation			32,187	
Energy			152,339	
Technology			89,172	
Basic industry	4,806	15.7	109,567	4.4
Credit cyclicals	2,848	9.4	72,585	3.9
Other	6,203	20.4	243,535	2.5
Total Available-For-Sale Fixed Maturities	\$ 30,459	100.0%	\$ 2,158,391	1.4%
Short-Term Investments	\$ 254	100.0%	\$ 7,359	3.5%

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For further discussion on fair value measurements and disclosures refer to Note 3. Fair Value of Financial Instruments contained in Part II, Item 8, Financial Statements and Supplementary Data.

Other-Than-Temporary Impairment Charges

We continually monitor the difference between our cost basis and the estimated fair value of our investments. Our accounting policy for impairment recognition requires OTTI charges to be recorded when we determine that it is more likely than not that we will be unable to collect all amounts due according to the contractual terms of the fixed maturity security or that the anticipated recovery in fair value of the equity security will not occur in a reasonable amount of time. Impairment charges on investments are recorded based on the fair value of the investments at the measurement date. Factors considered in evaluating whether a decline in value is other-than-temporary include: the length of time and the extent to which fair value has been less than cost; the financial condition and near-term prospects of the issuer; our intention to hold the investment; and the likelihood that we will be required to sell the investment. As of December 31, 2009, we had a number of securities where fair value was less than our cost. The total unrealized depreciation on these securities totaled \$14.7 million at December 31, 2009, compared with \$82.6 million at December 31, 2008. At December 31, 2009, the largest unrealized loss, after tax, on any single fixed maturity or equity security was \$1.7 million. Our rationale for not recording OTTI charges on these securities is discussed in Part II, Item 8, Note 2, Summary of Investments.

Deferred Policy Acquisition Costs Property and Casualty Insurance Segment

We record an asset for DAC, such as commissions, premium taxes and other variable costs incurred in connection with the writing of our property and casualty lines of business.

The following table summarizes DAC for December 31, 2009 and 2008.

(In Thousands)	Years Ended December 31,	
	2009	2008
Deferred policy acquisition costs at beginning of the year	\$ 52,222	\$ 58,291
Current deferred costs	98,946	111,521
Current amortization	(105,606)	(117,590)
Deferred policy acquisition costs at end of year	\$ 45,562	\$ 52,222

This asset is amortized over the life of the policies written, generally one year. We assess the recoverability of DAC on a quarterly basis by line of business. This assessment is performed by comparing recorded unearned premium to the sum of unamortized DAC and estimates of expected losses and loss settlement expenses. If the sum of these costs exceeds the amount of recorded unearned premium, (i.e., the line of business is expected to generate an operating loss) the excess is recognized as an offset against the asset established for DAC. This offset is referred to as a premium deficiency charge. If the amount of the premium deficiency charge is greater than the unamortized deferred policy acquisition cost asset, a liability will be recorded for the excess.

To calculate the premium deficiency charge, we estimate expected losses and loss settlement expenses by using an assumed loss and loss settlement expense ratio which approximates that of the recent past. This is the only assumption we utilize in our calculation. Changes in this assumption can have a significant impact on the amount of premium deficiency charge calculated. We do not consider anticipated investment income in determining the recoverability of deferred costs.

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The following table illustrates the hypothetical impact on the premium deficiency charge recorded at December 31, 2009 of reasonably likely changes in the assumed loss and loss settlement expense ratio utilized for purposes of this calculation. The entire impact of these changes would be recognized through income as other underwriting expenses. The base amount indicated below is the actual premium deficiency charge recorded as of December 31, 2009.

Sensitivity Analysis Impact of Changes in Assumed**Loss and Loss Settlement Expense Ratios**

(In Thousands)	-10%	-5%	Base	+5%	+10%
Premium deficiency charge estimated	2,951	3,747	3,014	8,272	14,477

Actual future results could differ materially from our current estimates, requiring adjustments to the recorded deferred policy acquisition cost asset. Such adjustments are recorded through operations in the period the adjustments are identified. Due to changes in the estimated recoverability of DAC, the premium deficiency charge calculated at December 31, 2009 increased \$1.8 million from the premium deficiency charge calculated at December 31, 2008 and \$1.2 million from the charge calculated at December 31, 2007. An increase in the premium deficiency charge results in the deferral of comparatively less underwriting costs period over period, resulting in a relatively smaller deferred acquisition cost asset. The changes in the estimated recoverability of DAC are attributable to deterioration in our underwriting experience in the past two years.

Deferred Policy Acquisition Costs Life Insurance Segment

Costs that vary with and relate to the acquisition of life insurance and annuity business are deferred and recorded as DAC asset. Such costs consist principally of commissions and policy issue expenses.

The following table summarizes DAC for December 31, 2009 and 2008. The majority of the DAC asset relates to our universal life and annuity contracts, hereafter referred to as non-traditional business.

(In Thousands)	Years Ended December 31,	
	2009	2008
Deferred policy acquisition costs at beginning of the year	\$ 106,043	\$ 70,707
Current deferred costs	13,612	10,620
Current amortization	(9,287)	(11,568)
Ending unamortized deferred policy acquisition costs	\$ 110,368	\$ 69,759
Change in shadow deferred policy acquisition costs	(63,425)	36,284
Deferred policy acquisition costs at end of year	\$ 46,943	\$ 106,043

We defer and amortize policy acquisition costs, with interest, on traditional life insurance policies, over the anticipated premium-paying period in proportion to the present value of expected gross premium. The present value of expected premiums is based upon the premium requirement of each policy and assumptions for mortality, morbidity, persistency and investment returns at policy issuance. These assumptions are not revised after policy issuance unless the deferred acquisition cost balance is deemed to be unrecoverable from future expected profits. Absent a premium deficiency, variability in amortization after policy issuance is caused only by variability in premium volumes.

We defer policy acquisition costs related to non-traditional business and amortize these costs in proportion to the present value of estimated expected gross profits. The components of gross profit include investment spread, mortality and expense margins and surrender charges. Of these factors, we anticipate that investment returns, expenses and persistency are reasonably likely to significantly impact the rate of deferred acquisition cost amortization.

We periodically review estimates of expected profitability and evaluate the need to unlock or revise the amortization of the deferred policy acquisition cost asset. The primary assumptions utilized when estimating future profitability relate to interest rate spread, mortality experience and policy lapse experience. The table below illustrates the impact that a reasonably likely change in our assumptions used to estimate expected gross profits would have on the deferred

policy acquisition cost asset for our non-traditional business recorded as of December 31, 2009. The entire impact of the changes illustrated would be recognized through operations as an increase or decrease to amortization expense.

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Sensitivity Analysis Impact of changes in assumptions

(In Thousands)

Changes in assumptions	-10%	+10%
Interest rate spread assumption	\$ (1,725)	\$ 1,592
Mortality experience assumption	2,503	(2,694)
Policy lapse experience assumption	2,397	(2,247)

A material change in these assumptions could have a negative or positive effect on our reported deferred policy acquisition cost asset, earnings and stockholders' equity.

The DAC in connection with our non-traditional business are adjusted with respect to estimated expected gross profits as a result of changes in the net unrealized gains or losses on available-for-sale fixed maturity securities allocated to support the block of fixed annuities and universal life policies. That is, because we carry available-for-sale fixed maturity securities at fair value, we make an adjustment to DAC equal to the change in amortization that would have been recorded if we had sold such securities at their stated fair value and reinvested the proceeds at current yields. We include the change in this adjustment, which is called "shadow DAC," net of tax, as a component of accumulated other comprehensive income. At December 31, 2009, "shadow DAC" decreased our DAC asset by \$35.1 million, compared with "shadow DAC" that increased our DAC asset by \$28.3 million at December 31, 2008.

Loss and Loss Settlement Expenses Property and Casualty Insurance Segment

Reserves for losses and loss settlement expenses are reported using our best estimate of ultimate liability for claims that occurred prior to the end of any given accounting period but have not yet been paid. Before credit for reinsurance recoverables, these reserves were \$606.0 million and \$586.1 million at December 31, 2009 and 2008, respectively.

We purchase reinsurance to mitigate the impact of large losses and catastrophic events. Loss and loss settlement reserves ceded to reinsurers were \$33.8 million for 2009 and \$52.5 million for 2008. Our reserves by line of business as of December 31, 2009, were as follows.

(In Thousands)	Case Basis	IBNR	Loss Settlement Expense	Total Reserves
Commercial lines:				
Fire and allied lines	\$ 41,761	\$ 22,464	\$ 5,131	\$ 69,356
Other liability	114,455	47,612	91,786	253,853
Automobile	65,499	13,356	14,791	93,646
Workers' compensation	107,789	5,840	18,035	131,664
Fidelity and surety	5,094	370	977	6,441
Miscellaneous	421	113	67	601
Total commercial lines	\$ 335,019	\$ 89,755	\$ 130,787	\$ 555,561
Personal lines:				
Automobile	\$ 6,964	\$ 388	\$ 1,145	\$ 8,497
Fire and allied lines	9,766	3,988	1,531	15,285
Miscellaneous	1,063	96	99	1,258
Total personal lines	\$ 17,793	\$ 4,472	\$ 2,775	\$ 25,040
Reinsurance	7,331	18,000	113	25,444
Total	\$ 360,143	\$ 112,227	\$ 133,675	\$ 606,045

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Case-Basis Reserves

For each of our lines of business, with respect to reported claims, we establish reserves on a case-by-case basis. Our experienced claims personnel estimate these case-based reserves using adjusting guidelines established by management. Our goal is to set the case-based reserves at the ultimate expected loss amount as soon as possible after information about the claim becomes available.

Estimating case reserves is subjective and complex and requires us to make estimates about the future payout of claims, which is inherently uncertain. When we establish and adjust reserves, we do so based on our knowledge of the circumstances and facts of the claim. Upon notice of a claim, we establish a factor reserve based on the claim information reported to us at that time. Subsequently, we conduct an investigation of each reported claim, which allows us to more fully understand the factors contributing to the loss and our potential exposure. This investigation may extend over a long period of time. As our investigation of a claim develops, and as our claims personnel identify trends in claims activity, we may refine and adjust our estimates of case reserves. To evaluate and refine our overall reserving process, we track and monitor all claims until they are settled and paid in full, with all salvage and subrogation claims being resolved.

Most of our insurance policies are written on an occurrence basis which provides coverage if a loss occurs in the policy period, even if the insured reports the loss many years later. For example, some general liability claims are reported 10 years or more after the policy period, and the workers' compensation coverage provided by our policies pays unlimited medical benefits for the duration of the claimant's injury up to the lifetime of the claimant. In addition, final settlement of certain claims can be delayed for years or decades due to litigation or other reasons. Reserves for these claims require us to estimate future costs, including the effect of judicial actions, litigation trends and medical cost inflation, among others. Reserve development can occur over time as conditions and circumstances change in years after the policy was issued.

Our loss reserves include amounts related to both short-tail and long-tail lines of business. Tail refers to the time period between the occurrence of a loss and the ultimate settlement of the claim. A short-tail insurance product is one where ultimate losses are known and settled comparatively quickly; ultimate losses under a long-tail insurance product are sometimes not known and settled for many years. The longer the time span between the incidence of a loss and the settlement of the claim, the more the ultimate settlement amount can vary from the reserves initially established.

Accordingly, long-tail insurance products can have significant implications on the reserving process.

Our short-tail lines of business include fire and allied lines, homeowners, commercial property, auto physical damage and inland marine. The amounts of the case-based reserves that we establish for claims in these lines depend upon various factors, such as individual claim facts (including type of coverage and severity of loss), company historical loss experience and trends in general economic conditions (including changes in replacement costs, medical costs and inflation).

For short-tail lines of business, the estimation of case-basis loss reserves is less complex than for long-tail lines because claims are generally reported and settled shortly after the loss occurs and because the claims relate to tangible property. Because of the relatively short time from claim occurrence to settlement, actual losses typically do not vary greatly from reserve estimates.

Our long-tail lines of business include workers' compensation and other liability. In addition, certain product lines such as personal and commercial auto, commercial multi-peril and surety include some long-tail coverages and some short-tail coverages. For many liability claims, significant periods of time, ranging up to several years, may elapse between the occurrence of the loss, the reporting of the loss to us and the settlement of the claim. As a result, loss experience in the more recent accident years for the long-tail liability classes has limited statistical credibility in our reserving process because a relatively small proportion of losses in these accident years are reported claims and an even smaller proportion are paid losses. In addition, long-tail liability claims are more susceptible to litigation and can be significantly affected by changing contract interpretations and the legal environment. Consequently, the estimation of loss reserves for long-tail classes is more complex and subject to a higher degree of variability than for short-tail classes.

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The amounts of the case-based reserves that we establish for claims in long-tail lines depends upon various factors, including individual claim facts (including type of coverage, severity of loss and underlying policy limits), company historical loss experience, changes in underwriting practice, legislative enactments, judicial decisions, legal developments in the awarding of damages, changes in political attitudes and trends in general economic conditions, including inflation. As with the short-tail lines of business, we review and make changes to long-tail case-based reserves based on our review of continually evolving facts as they become available to us during the claims settlement process. Our adjustments to case-based reserves are reflected in the financial statements in the period that new information arises about the claim. Examples of facts that become known that could cause us to change our case-based reserves include, but are not limited to: evidence that loss severity is different than previously assessed, new claimants who have presented claims and the assessment that no coverage exists.

IBNR Reserves

IBNR reserves are estimated liabilities, which we establish because claims are not always reported promptly upon occurrence and because the assessment of existing known claims may change over time with the development of new facts, circumstances and conditions, which may include litigation.

For both our short-tail and long-tail lines of business, we establish our reserves for IBNR claims by applying a factor to our current pool of in-force premium, as well as evaluating our IBNR to exposure units. This factor has been developed through a historical analysis of company experience as to what level of IBNR reserve should be established to achieve an adequate IBNR reserve relative to our existing loss exposure base. Unique circumstances or trends which are evident as of the end of a given period may require us to refine our IBNR reserve calculation. This methodology for establishing our IBNR reserve has consistently resulted in aggregate reserve levels that management believes are reasonable in comparison to the reserve estimates prepared by Regnier Consulting Group, Inc., an independent actuary which we utilize in our reserving process.

For our short-tail lines of business, IBNR reserves constitute a small portion of the overall reserves. This is because claims are generally reported and settled shortly after the loss occurs. In our long-tail lines of business, IBNR reserves constitute a relatively higher proportion of total reserves, because, for many liability claims, significant periods of time may elapse between the initial occurrence of the loss, the reporting of the loss to us and the ultimate settlement of the claim.

Loss Settlement Expense Reserves

Loss settlement expense reserves include amounts ultimately allocable to individual claims, as well as amounts required for the general overhead of the claims handling operation that are not specifically allocable to individual claims. We do not establish loss settlement expense reserves on a claim-by-claim basis. Instead, we examine the ratio of loss settlement expenses paid to losses paid over the most recent three-year period, by line. We use these factors and apply them to open reserves, including IBNR reserves. We develop these factors annually, each December and use them throughout the year, unless development patterns or emerging trends warrant adjustments to the factors. Generally, the loss settlement expense reserves for long-tail lines are a greater portion of the overall reserves, as there are often substantial legal fees and other costs associated with the complex liability claims that are associated with long-tail lines. Because short-tail lines settle much more quickly and the costs are easier to determine, loss settlement expense reserves for short-tail claims constitute a smaller portion of the total reserves.

Reinsurance Reserves

The estimation of assumed and ceded reinsurance loss and loss settlement expense reserves is subject to the same factors as the estimation of loss and loss settlement expense reserves. In addition to those factors, which give rise to inherent uncertainties in establishing loss and loss settlement expense reserves, there exists a delay in our receipt of reported claims for assumed business due to the procedure of having claims first reported through one or more intermediary insurers or reinsurers.

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Key Assumptions

In establishing an estimate of loss and loss settlement reserves, management uses a number of key assumptions. They are as follows:

To the best of our knowledge, there are no new latent trends that would impact our case-basis reserves;

Our case-basis reserves reflect the most up-to-date information available about the unique circumstances of each claim;

No new judicial decisions or regulatory actions will increase our case-basis obligations;

The historical patterns of claim frequency and claim severity utilized within our IBNR reserve calculation, without considering unusual events, are consistent and will continue to be consistent; and

The company's historical ratio of loss settlement expenses (LAE) paid to losses paid is consistent and will continue to be consistent.

Our key assumptions are subject to change as actual claims occur and as we gain additional information about the variables that underlie our assumptions. Accordingly, management reviews and updates these assumptions periodically to ensure that the assumptions continue to be valid. If necessary, management makes changes not only in the estimates derived from the use of these assumptions, but also in the assumptions themselves. Due to the inherent uncertainty in the loss reserving process, management believes that there is a reasonable chance that modification to key assumptions could individually, or in aggregate, result in reserve levels that are misstated either above or below the actual amount for which the related claims will eventually settle.

As an example, if our reserve for loss and loss settlement expenses of \$606.0 million as of December 31, 2009, is 10 percent inadequate, we would experience a reduction in future earnings of up to \$6.1 million, pre-tax. This reduction could be recorded in one year or multiple years, depending on when we identify the deficiency. The deficiency would also affect our financial position in that our equity would be reduced by an amount equivalent to the reduction in net income. Any deficiency is recognized in the reserve for loss and loss settlement expenses and, accordingly, it usually does not have a material effect on our liquidity because the claims have not been paid. Conversely, if our estimates of ultimate unpaid loss and loss settlement expense liabilities prove to be redundant, our future earnings and financial position would be improved.

We are unable to reasonably quantify the impact of changes in our key assumptions utilized to establish individual case-basis reserves on our total reported reserve because the impact of these changes would be unique to each specific case-basis reserve established. However, based on historical experience, we believe that aggregate case-basis reserve volatility levels of five percent and ten percent can be attributed to the ultimate development of our case-basis reserves. The table below details the impact of this development volatility on our reported case-basis reserves. The impact to pre-tax earnings would be a decrease if the reserves were to be adjusted upwards. The impact to pre-tax earnings would be an increase if the reserves were to be adjusted downwards.

(In Thousands)

Change in level of case-basis reserve development	5%	10%
Impact on reported case-basis reserves	\$ 16,415	\$ 32,829

Due to the formula-based nature of our IBNR and loss settlement expense reserve calculations, changes in the key assumptions utilized to generate these reserves can result in a quantifiable impact on our reported results. It is not possible to isolate and measure the potential impact of just one of these factors, and future loss trends could be partially impacted by all factors concurrently. Nevertheless, it is meaningful to view the sensitivity of the reserves to potential changes in these variables. To demonstrate the sensitivity of reserves to changes in significant assumptions, the following example is presented. The amounts reflect the pre-tax impact on earnings from a hypothetical percentage change in the calculation of IBNR and loss settlement expense reserves. The impact to pre-tax earnings

would be a decrease if the reserves were to be adjusted upwards. The impact to pre-tax earnings would be an increase if the reserves were to be adjusted downwards. We believe that the changes presented are reasonably likely based upon an analysis of our historical IBNR and loss settlement expense reserve experience.

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(In Thousands)

Change in claim frequency and claim severity assumptions	5%	10%
Impact due to change in IBNR reserving assumptions	\$ 5,595	\$ 11,190

(In Thousands)

Change in LAE paid to losses paid ratio	1%	2%
Impact due to change in LAE reserving assumptions	\$ 1,321	\$ 2,642

In 2009, we did not change the key assumptions on which we based our reserving calculations. In estimating our 2009 loss and loss settlement expense reserves, we did not anticipate future events or conditions that were inconsistent with past development patterns.

Certain of our lines of business are subject to the potential for greater loss and loss settlement expense development than others. These lines with greater potential for development are discussed below.

Other Liability Reserves

Other liability is considered a long-tail line of business, as it can take a relatively long period of time to settle claims from prior accident years. This is partly due to the lag time between the date when a loss or event occurs that triggers coverage and the date when the claim is actually reported. Defense costs are also a part of the insured expenses covered by liability policies and can be significant, sometimes greater than the cost of the actual paid claims. For the majority of our products, defense costs are outside of the policy limit, meaning that the amounts paid for defense costs are not subtracted from the available policy limit.

Factors that can cause reserve uncertainty in estimating reserves in this line include: reporting lag; the number of parties involved in the underlying tort action; whether the event triggering coverage is confined to only one time period or is spread over multiple time periods; the potential dollars involved (in the individual claim actions); whether such claims were reasonably foreseeable and intended to be covered at the time the contracts were written (i.e., coverage disputes); and the potential for mass claim actions.

Claims with longer reporting lags may result in greater inherent risk. This is especially true for alleged claims with a latency feature, particularly where courts have ruled that coverage is spread over multiple policy years, hence involving multiple defendants (and their insurers and reinsurers) and multiple policies (thereby increasing the potential dollars involved and the underlying settlement complexity). Claims with long latencies also increase the potential lag between writing a policy in a certain market and the recognition that such policy has potential mass tort and/or latent claim exposure.

Our reserve for other liability claims at December 31, 2009, is \$253.9 million and consists of 5,363 claims, compared with \$214.7 million, consisting of 4,878 claims at December 31, 2008. Of the \$253.9 million total reserve for other liability claims, \$71.9 million is identified as defense costs and \$19.9 million is identified as general overhead required in the settlement of claims. If our reserve for other liability loss and loss settlement expenses is overstated or understated by 10 percent, the potential impact to our Consolidated Financial Statements would be approximately \$25.4 million, before federal income taxes.

Included in the other liability line of business are gross reserves for construction defect losses and settlement expenses. Construction defect is a liability allegation relating to defective work performed in the construction of structures such as commercial buildings, apartments, condominiums, single family dwellings or other housing, as well as the sale of defective building materials. These claims seek recovery due to damage caused by alleged deficient construction techniques or workmanship. At December 31, 2009, we established \$15.2 million in construction defect loss and loss settlement expense reserves, excluding IBNR reserves, which consisted of 234 claims, compared with \$16.0 million, excluding IBNR reserves, consisting of 243 claims, at December 31, 2008. The reporting of such claims can be delayed, as the statute of limitations can be up to 10 years. Also, recent court decisions have expanded insurers' exposure to construction defect claims. As a result, claims may be reported more than 10 years after a project has been completed, as litigation can proceed for several years before an insurance company is identified as a potential contributor. Claims have also emerged from parties claiming additional insured status on policies issued to other

parties, such as contractors seeking coverage from a subcontractor's policy.

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In addition to these issues, other variables also contribute to a high degree of uncertainty in establishing reserves for construction defect claims. These variables include: whether coverage exists; when losses occur; the size of each loss; expectations for future interpretive rulings concerning contract provisions; and the extent to which the assertion of these claims will expand geographically. In recent years, we have implemented various underwriting measures that we anticipate will mitigate the amount of construction defect losses experienced. These initiatives include increased care regarding additional insured endorsements and stricter underwriting guidelines on the writing of residential contractors and an increased utilization of loss control.

Asbestos and Environmental Reserves

Included in the other liability and assumed reinsurance lines of business are gross reserves for asbestos and other environmental losses and loss settlement expenses. At December 31, 2009 and 2008, we had \$3.8 million in direct and assumed asbestos and environmental loss reserves. In addition, we had ceded asbestos and environmental loss reserves of \$.5 million and \$.6 million at December 31, 2009 and 2008, respectively. The estimation of loss reserves for environmental claims and claims related to long-term exposure to asbestos and other substances is one of the most difficult aspects of establishing reserves, especially given the inherent uncertainties surrounding such claims. Although we record our best estimate of loss and loss settlement expense reserves, the ultimate amounts paid upon settlement of such claims may be more or less than the amount of the reserves, because of the significant uncertainties involved and the likelihood that these uncertainties will not be resolved for many years.

Workers Compensation Reserves

Like the other liability line of business, workers compensation losses and loss settlement expense reserves are based upon variables that create imprecision in estimating the ultimate reserve. Estimates for workers compensation are particularly sensitive to assumptions about medical cost inflation, which has been steadily increasing over the past few years. Other variables that we consider and that contribute to the uncertainty in establishing reserves for workers compensation claims include: the state legislative and regulatory environments; trends in jury awards; and mortality rates. Because of these variables, the process of reserving for the ultimate loss and loss settlement expense requires the use of informed judgment and is inherently uncertain. Consequently, actual loss and loss settlement expense reserves may deviate from our estimates. Such deviations may be significant. Our reserve for workers compensation claims at December 31, 2009, is \$131.7 million and consists of 3,416 claims, compared with \$126.6 million, consisting of 3,386 claims, at December 31, 2008. If our reserve for workers compensation loss and loss settlement expenses is overstated or understated by 10 percent, the potential impact to our Consolidated Financial Statements would be approximately \$13.2 million, before federal income taxes.

Reserve Development

In establishing reserves, management's goal is to ensure that our net reserves for losses and loss settlement expenses are adequate to cover all costs, while sustaining minimal variation from the time reserves for losses and loss settlement expenses are initially estimated until losses and loss settlement expenses are concluded. Changes in our estimates of losses and loss settlement expenses over time, also referred to as development, will occur and may be material. Favorable development is recognized and reported in the Consolidated Financial Statements when we decrease our previous estimate of ultimate losses and loss settlement expenses, which results in an increase to net income in the period recognized. Adverse development is recognized and reported in the Consolidated Financial Statements when we increase our previous estimate of ultimate losses and loss settlement expenses, which results in a decrease to net income.

In two of the past ten years, our development has resulted in deficiencies in our net reserves for prior accident years totaling \$26.2 million and \$.5 million for 2009 and 2008, respectively. In 2007, our development resulted in a redundancy of \$45.2 million. Our reserves have been negatively impacted by an increase in our prior accident year loss reserves due to adverse development from Hurricane Katrina claims and litigation totaling \$38.0 million, \$26.6 million and \$8.7 million in 2009, 2008 and 2007, respectively. Also contributing to our deficiency in 2009 and 2008 was the deterioration in our other liability lines of business which includes claims for construction defects.

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Generally, we base reserves for each claim on the estimated ultimate exposure for that claim, determined from a pessimistic point of view. We believe that in determining reserves, it is appropriate and reasonable to establish a best estimate within a range of reasonable estimates, especially when we are reserving for claims for bodily injury, disabilities and similar claims, for which settlements and verdicts can vary widely. Our reserving philosophy may result in favorable development in future years that will decrease loss and loss settlement expenses for prior year claims in the year of adjustment. While we realize that this philosophy, coupled with what we believe to be aggressive and successful claims management and loss settlement practices, has resulted in year-to-year redundancies in reserves, we believe our approach is better than experiencing year-to-year uncertainty as to the adequacy of our reserves. The factors contributing to our year-to-year redundancy include the following:

Establishing reserves that are appropriate and reasonable, but assuming a pessimistic view of potential outcomes.

Using claims negotiation to control the size of settlements.

Assuming that we have liability for all claims, even though the issue of liability may, in some cases, be resolved in our favor.

Promoting claims management services to encourage return-to-work programs, case management by nurses for serious injuries and management of medical provider services and billings.

Using programs and services to help prevent fraud and to assist in favorably resolving cases.

Based upon our comparison of carried reserves to actual claims experience over the last several years, we believe that using company historical premium and claims data to establish reserves for losses and loss settlement expenses results in adequate and reasonable reserves. Based upon this comparison, we believe that our total recorded loss reserves at December 31, 2009, are unlikely to vary by more than 10 percent of the recorded amounts, either positively or negatively. Historically, our reserves have had an average variance of less than 10 percent of recorded amounts, with our reserves booked as of December 31, 2008, generating a deficiency of 4.9 percent in 2009. Our reserves booked as of December 31, 2007, generated a reserve deficiency of 0.1 percent in 2008. These deficiencies are discussed in detail in the under the heading Reserve Development in the Property and Casualty Insurance Segment of the Results of Operations section in this item.

The following table details the pre-tax impact on our property and casualty insurance segment's financial results and financial condition of reasonably likely changes in our reserve development. Our lines of business that have historically been most susceptible to significant volatility in reserve development have been shown separately and utilize hypothetical levels of volatility of five percent and ten percent. Our other, less volatile, lines have been aggregated and utilize hypothetical levels of volatility of three percent and five percent.

(In Thousands)

Hypothetical Reserve Development Volatility Levels	-10%	-5%	+5%	+10%
Impact on loss and loss settlement expenses:				
Other liability	\$ (25,385)	\$ (12,693)	\$ 12,693	\$ 25,385
Workers' compensation	(13,166)	(6,583)	6,583	13,166
Automobile	(10,214)	(5,107)	5,107	10,214
Hypothetical Reserve Development Volatility Levels	-5%	-3%	+3%	+5%
Impact on loss and loss settlement expenses:				
All other lines	\$ (5,919)	\$ (3,552)	\$ 3,552	\$ 5,919

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Independent Actuary

We engage an independent actuarial firm to render opinions as to the reasonableness of the statutory reserves we establish. There was no material differences between our statutory reserves and those established under GAAP. During 2009 and 2008, we engaged the services of Regnier Consulting Group, Inc. as our independent actuarial firm for the property and casualty insurance segment. We anticipate that this engagement will continue in 2010.

It is management's policy to utilize staff adjusters to develop our estimate of case-basis loss reserves. IBNR and loss settlement expense reserves are established through various formulae that utilize pertinent, recent company historical data. The calculations are supplemented with knowledge of current trends and events that could result in adjustments to the level of IBNR and loss settlement expense reserves. In addition, management consults with Regnier Consulting Group, Inc. throughout the year as deemed necessary. Management annually compares our estimate of total reserves to point estimates prepared by Regnier Consulting Group, Inc. by line of business to ensure that our estimates are within the actuary's acceptable range. Regnier Consulting Group, Inc. performs an extensive review of loss and loss settlement expense reserves at each year end using generally accepted actuarial guidelines to ensure that the recorded reserves appear reasonable. If the carried reserves were deemed unreasonable, we would adjust reserves. In 2009 and 2008, after considering the actuary's range of reasonable point estimates, management believed that carried reserves were reasonable and therefore did not adjust the recorded amount.

Regnier Consulting Group, Inc. uses four projection methods in their actuarial analysis of our loss reserves and uses the paid-to-paid projection method in their analysis of our loss settlement expense reserves. Based on the results of the projection methods, the actuaries select an actuarial central estimate of the reserves. They then compare their estimate to our carried reserves to evaluate the reasonableness of the carried reserves. The four methods utilized by Regnier Consulting Group, Inc. are: paid loss development; reported loss development; expected loss emergence based on paid losses; and expected loss emergence based on reported losses.

Based on the results of the projection methods, a reasonable range of net reserves from \$500.9 million to \$615.1 million has been calculated. Our net reserves for losses and loss settlement expenses as of December 31, 2009 were \$572.3 million.

We do not view the result of a single projection method as superior over the results of a combination of projection methods. That is, our actuary has not selected one method to determine the reserves. The results of Regnier Consulting Group, Inc.'s use of various methods, in conjunction with their actuarial judgment, leads to the actuarially-determined estimate of the reserves. The impact of reasonably likely changes in the reserving variables is implicitly considered in Regnier Consulting Group, Inc.'s use of several reserving methods.

Future Policy Benefits and Losses, Claims and Loss Settlement Expenses Life Insurance Segment

We establish reserves for amounts that are payable under traditional insurance policies, including traditional life insurance, disability income, and income annuities. Reserves are calculated as the present value of future benefits expected to be paid, reduced by the present value of future expected premiums. Our estimates use methods and underlying assumptions that are in accordance with GAAP and applicable actuarial standards. The key assumptions that we utilize in establishing reserves are mortality, morbidity, policy lapse, renewal, retirement, investment returns, inflation, and expenses. Future investment return assumptions are determined based upon prevailing investment yields as well as estimated reinvestment yields. Mortality, morbidity and policy lapse assumptions are based on our experience. Expense assumptions include the estimated effects of inflation and expenses to be incurred beyond the premium-paying period. These assumptions are established at the time the policy is issued, are consistent with assumptions for determining DAC amortization for these contracts, and are generally not changed during the policy coverage period. However, if actual experience emerges in a manner that is significantly adverse relative to the original assumptions, adjustments to reserves (or DAC) may be required resulting in a charge to earnings which could have a material adverse effect on our operating results and financial condition.

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We periodically review the adequacy of these reserves and recoverability of DAC for these contracts on an aggregate basis using actual experience. In the event that actual experience is significantly adverse compared to the original assumptions, any remaining unamortized DAC balance must be expensed to the extent not recoverable and the establishment of a premium deficiency reserve may be required. The effects of changes in reserve estimates are reported in the results of operations in the period in which the changes are determined. We have not made any changes in methods or assumptions for estimated reserves in the past three years. We anticipate that mortality, investment and reinvestment yields, and policy terminations are the factors that would be most likely to require adjustment to these reserves or related DAC. Assumptions are established when the policy is issued. If actual experience is less favorable than assumptions, we may need to increase our reserves, resulting in a charge to policyholder benefits and claims. Liabilities for future policy benefits for disability claims are estimated using the present value of benefits method and experience assumptions as to claim terminations, expenses and interest. Other policyholder reserves include claims that have been reported but not settled and claims incurred but not reported on life and disability income insurance. We use our own historical experience and other assumptions such as any known or anticipated developments or trends to establish reserves for these unsettled or unreported claims. The effects of changes in our estimated reserves are included in the results of operations in the period in which the changes occur. Our reserves for universal life and deferred annuity contracts are based upon the policyholders' current account value. Acquisition expenses are amortized in relation to expected gross profits forecast based upon current best estimates of anticipated premium income, investment earnings, benefits and expenses. Annually, we review our estimates of reserves and deferred policy acquisition cost assets and compare them with actual experience. Differences between actual experience and the assumptions that we used in the pricing of policies, guarantees and riders and in the establishment of the related reserves result in variances in profit and could result in changes in net income. The effects of the changes in such estimated reserves are included in the results of operations in the period in which the changes occur.

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The following table reflects the estimated pre-tax impact to DAC, net of unearned revenue liabilities to our universal life and fixed annuity products that could occur in a twelve-month period on account of an unlocking adjustment due to reasonably likely changes in significant assumptions. Changes in assumptions of the same magnitude in the opposite direction would have an impact of a similar magnitude but opposite direction of the examples provided.

Critical Accounting Estimate	Determination Methodology	Potential One-Time Effect on DAC Asset, Net of Unearned Revenue Liabilities
Mortality Experience	Based on our mortality experience and consideration is given to industry experience and trends	A 10.0% increase in expected mortality experience for all future years would result in a reduction in DAC, net of unearned revenue liabilities and an increase in current period amortization expense of \$2.7 million.
Surrender Rates	Based on our surrender experience and consideration is given to industry experience and trends	A 10% increase in expected surrender rates for all future years would result in a reduction in DAC, net of unearned revenue liabilities and an increase in current period amortization expense of \$2.2 million.
Interest Spreads	Based on our expected future investment returns and expected future crediting rates applied to policy holder account balances; future crediting rates include constraints imposed by policy guarantees	A 10 basis point reduction in future interest rate spreads would result in a reduction in DAC, net of unearned revenue liabilities and an increase in current period amortization expense of \$1.7 million.
Maintenance Expenses	Based on our experience using an internal expense allocation methodology	A 10% increase in future maintenance expenses would result in a reduction in DAC, net of unearned revenue liabilities and an increase in current period amortization expense of \$5 million.

Independent Actuary

We engage an independent actuarial firm to render opinions as to the reasonableness of the statutory reserves we establish. Statutory reserves are established using considerably more conservative assumptions regarding future investment earnings and contractual benefit payments, than are used for GAAP reserves. During 2009 and 2008, we engaged the services of Griffith, Ballard and Company as our independent actuarial firm for the life insurance segment. We anticipate that this engagement will continue in 2010.

PENDING ACCOUNTING STANDARDS

Incorporated by reference from Note 1 Significant Accounting Policies under the heading Pending Accounting Standards, contained in Part II, Item 8 Financial Statements and Supplementary Data.

STATUTORY FINANCIAL MEASURES

United Fire and its subsidiaries are required to file financial statements based on statutory accounting principles in each of the states where our insurance companies are domiciled and licensed to conduct business.

The following definitions of key statutory measures are provided for our readers convenience. United Fire is not required to reconcile data prepared under statutory accounting principles to those prepared under U.S. GAAP because Regulation G excludes data prepared under a system of regulation of a government or governmental authority or self-regulatory organization that is applicable to the registrant.

Management analyzes financial data and statements that are required to be reconciled to data prepared in accordance with statutory accounting principles, and those reconciliations are presented as required.

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Premiums written is a measure of our overall business volume. Net premiums written comprise direct and assumed premiums written, less ceded premiums written. Direct premiums written is the amount of premiums charged for policies issued during the period. Assumed premiums written is consideration or payment we receive in exchange for insurance we provide to other insurance companies. We report these premiums as revenue as they are earned over the underlying policy period. Ceded premiums written is the portion of direct premiums written that we cede to our reinsurers under our reinsurance contracts. Premiums written is an important measure of business production for the period under review.

(In Thousands)	Years Ended December 31,		
	2009	2008	2007
Net premiums written	\$ 467,427	\$ 496,897	\$ 501,849
Net change in unearned premium	10,956	7,564	6,847
Net change in prepaid reinsurance premium	115	(1,086)	(2,933)
Net premiums earned	\$ 478,498	\$ 503,375	\$ 505,763

Combined ratio is a commonly used financial measure of underwriting performance. A combined ratio below 100 percent generally indicates a profitable book of business. The combined ratio is the sum of two separately calculated ratios, the loss and loss settlement expense ratio (referred to as the net loss ratio) and the underwriting expense ratio (the expense ratio).

When prepared in accordance with U.S. GAAP, the net loss ratio is calculated by dividing the sum of losses and loss settlement expenses by net premiums earned. The expense ratio is calculated by dividing nondeferred underwriting expenses and amortization of DAC by net premiums earned.

When prepared in accordance with statutory accounting principles, the net loss ratio is calculated by dividing the sum of losses and loss settlement expenses by net premium earned and the expense ratio is calculated by dividing underwriting expenses by net premiums written.

NON-GAAP FINANCIAL MEASURES

We believe that disclosure of certain Non-GAAP financial measures enhances investor understanding of our financial performance. The following Non-GAAP financial measure is utilized in this filing:

Catastrophe losses utilize the designations of the Insurance Services Office (ISO) and are reported with loss and loss settlement expense amounts net of reinsurance recoverables, unless specified otherwise. According to the ISO, a catastrophe loss is a single unpredictable incident or series of closely related incidents causing severe insured losses that cause \$25.0 million or more in industry-wide direct insured losses to property and that affect a significant number of insureds and insurers (ISO catastrophes). We also include as catastrophes those events we believe are, or will be, material to our operations, either in amount or in number of claims made. Management at times may determine for comparison purposes that it is more meaningful to exclude unusual catastrophe losses or litigation resulting from a catastrophe. The frequency and severity of catastrophic losses we experience in any year affect our results of operations and financial position. In analyzing the underwriting performance of our property and casualty insurance segment, we evaluate performance both including and excluding catastrophe losses. Portions of our catastrophe losses may be recoverable under our catastrophe reinsurance agreements. We include a discussion of the impact of catastrophes because we believe it is meaningful for investors to understand the variability in periodic earnings.

(In Thousands)	Years Ended December 31,		
	2009	2008	2007
ISO catastrophes	\$ 58,757	\$ 84,102	\$ 13,639
Less Hurricane Katrina loss development ⁽¹⁾	(37,976)	(10,790)	
ISO catastrophes without Hurricane Katrina	\$ 20,781	\$ 73,312	\$ 13,639

Non-ISO catastrophes	1,616	2,754	433
Total catastrophes	\$ 22,397	\$ 76,066	\$ 14,072

(1) This number reflects the reserves established for Hurricane Katrina litigation and does not include other Hurricane Katrina loss development.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our consolidated balance sheet includes financial instruments whose fair values are subject to market risk. Market risk is the potential for loss due to a decrease in the value of securities resulting from uncontrollable fluctuations such as: interest rate risk, equity price risk, foreign exchange risk, credit risk, inflation, or world political conditions. Our primary market risk exposure is to changes in interest rates. Interest rate risk is the price sensitivity of a fixed maturity security or portfolio to changes in interest rates. We also have limited exposure to equity price risk and foreign exchange risk.

Interest Rate Risk

We invest in interest rate sensitive securities, primarily fixed maturity securities. While it is generally our intent to hold our fixed maturity securities to maturity, we have classified a majority of our fixed maturity portfolio as available-for-sale. Our available-for-sale fixed maturity securities are carried at fair value on the balance sheet with unrealized gains or losses reported net of tax in accumulated other comprehensive income.

Increases and decreases in prevailing interest rates generally translate into decreases and increases in the fair value of our fixed maturity securities. Additionally, fair values of interest rate sensitive instruments may be affected by the creditworthiness of the issuer, prepayment options, relative values of alternative investments, the liquidity of the instrument and other general market conditions.

Market Risk and Duration

The active management of market risk is integral to our operations. We analyze potential changes in the value of our investment portfolio due to the market risk factors noted above within the overall context of asset and liability management. A technique we use in the management of our investment and reserve portfolio is the calculation of duration. Our actuaries estimate the payout pattern of our reserve liabilities to determine their duration, which is the present value of the weighted average payments expressed in years. We then establish a target duration for our investment portfolio so that at any given time the estimated cash generated by the investment portfolio will match the estimated cash flowing out of the reserve portfolio. We structure the investment portfolio to meet the target duration to achieve the required cash flow, based on liquidity and market risk factors.

Duration relates primarily to our life insurance segment because the long-term nature of these reserve liabilities increases the importance of projecting estimated cash flows over an extended time frame. At December 31, 2009, our life insurance segment had \$914.0 million in deferred annuity liabilities that were specifically allocated to fixed maturities. We manage the life insurance segment investments by focusing on matching the duration of the investments to that of the deferred annuity obligations. The duration for the investment portfolio must take into consideration interest rate risk. This is accomplished through the use of sensitivity analysis, which measures the price sensitivity of the fixed maturities to changes in interest rates. The alternative valuations of the investment portfolio, given the various hypothetical interest rate changes utilized by the sensitivity analysis, allow management to revalue the potential cash flow from the investment portfolio under varying market interest rate scenarios. Duration can then be recalculated at the differing levels of projected cash flows.

Impact of Interest Rate Changes

The amounts set forth in the following tables detail the material impact of hypothetical interest rate changes on the fair value of certain core fixed maturity investments held at December 31, 2009 and 2008. The sensitivity analysis measures the change in fair values arising from immediate changes in selected interest rate scenarios. We employed hypothetical parallel shifts in the yield curve of plus or minus 100 and 200 basis points in the simulations. Additionally, based upon the yield curve shifts, we employ estimates of prepayment speeds for mortgage-related products and the likelihood of call or put options being exercised within the simulations. According to this analysis, at current levels of interest rates, the duration of the investments supporting the deferred annuity liabilities i