State Auto Financial CORP
Form 10-K
March 08, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x **Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the fiscal year ended December 31, 2010 or

¨ **Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from to

Commission File Number 000-19289

STATE AUTO FINANCIAL CORPORATION

(Exact name of Registrant as specified in its charter)

Ohio	**31-1324304**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

518 East Broad Street, Columbus, Ohio	**43215-3976**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code:

(614) 464-5000

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

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

Common Shares, without par value

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

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 x

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 x No ¨

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

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

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

Large accelerated filer ¨	Accelerated filer x
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of June 30, 2010, the last business day of the Registrant s most recently completed second fiscal quarter, the aggregate market value (based on the closing sales price on that date) of the voting stock held by non-affiliates of the Registrant was $228,141,029.

On February 25, 2011, the Registrant had 40,151,913 Common Shares outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant s Proxy Statement relating to the annual meeting of stockholders to be held May 6, 2011 (the 2011 Proxy Statement), which will be filed within 120 days of December 31, 2010, are incorporated by reference into Part III of this Form 10-K.

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IMPORTANT INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

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

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IMPORTANT DEFINED TERMS USED IN THIS FORM 10-K

Glossary of Terms for State Auto Financial Corporation and Its Subsidiaries and Affiliates

State Auto Financial or STFC	Refers to our holding company, State Auto Financial Corporation.
We, us, our or the Company	Refers to STFC and its consolidated subsidiaries, namely State Auto Property & Casualty Insurance Company (State Auto P&C), Milbank Insurance Company (Milbank), Farmers Casualty Insurance Company (Farmers), State Auto Insurance Company of Ohio (SA Ohio), Stateco Financial Services, Inc. (Stateco), and through December 31, 2010, State Auto National Insurance Company (SA National), which was sold to a third party on December 31, 2010.
State Auto Mutual or our parent company	Refers to State Automobile Mutual Insurance Company, which owns approximately 63% of STFC s outstanding common shares.
STFC Pooled Companies	Refers to State Auto P&C, Milbank, Farmers, SA Ohio, and, from January 1, 2010 through December 31, 2010, SA National.
Mutual Pooled Companies	Refers to State Auto Mutual, and certain subsidiaries and affiliates of State Auto Mutual, namely State Auto Florida Insurance Company (SA Florida), State Auto Insurance Company of Wisconsin (SA Wisconsin), Meridian Security Insurance Company (Meridian Security), Meridian Citizens Mutual Insurance Company (Meridian Citizens Mutual), Beacon National Insurance Company (Beacon National), Patrons Mutual Insurance Company of Connecticut (Patrons Mutual), Litchfield Mutual Fire Insurance Company (Litchfield), and, as of January 1, 2011, Rockhill Insurance Company (RIC), Plaza Insurance Company (Plaza), American Compensation Insurance Company (American Compensation) and Bloomington Compensation Insurance Company (Bloomington Compensation).
Pooled Companies or our Pooled Companies	Refers to the STFC Pooled Companies and the Mutual Pooled Companies.
MIGI Insurers	Refers to Meridian Security and Meridian Citizens Mutual.
MIGI Companies	Refers to the MIGI Insurers and Meridian Insurance Group, Inc. (MIGI).
Beacon Insurance Group or Beacon Group	Refers to Beacon National and Beacon Lloyds Insurance Company (Beacon Lloyds).
Patrons Insurance Group or Patrons Group	Refers to Patrons Mutual and Litchfield.
Rockhill Insurance Group	

	Refers to Rockhill Holding Company, its insurance subsidiaries, namely RIC, Plaza, American Compensation and Bloomington Compensation, its majority-owned affiliate Risk Evaluation & Design, LLC (RED), which acts as a managing general underwriter, and its other non-insurance subsidiaries, including RTW, Inc. (RTW), a holding company that owns 100% of American Compensation and Bloomington Compensation.
Rockhill Insurers	Refers to RIC, Plaza, American Compensation and Bloomington Compensation.
State Auto Group	Refers to the Pooled Companies, Beacon Lloyds and, as of January 1, 2011, the Rockhill Insurers.

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Glossary of Selected Terms Including Insurance Terms as Used Herein

Accident year	The calendar year in which loss events occur, regardless of when the losses are actually reported, booked or paid.
Admitted insurer	An insurer licensed to transact insurance business within a state and subject to comprehensive policy rate, form and market conduct regulation by that state s insurance regulatory authority.
Book value per share	Total common stockholders equity divided by the number of common shares outstanding.
Captive insurance arrangement	A closely held insurance arrangement whose primary purpose is to provide insurance coverage to the captive s owners and/or their affiliates.
Catastrophe loss	Loss and ALAE from catastrophes, where catastrophes are defined as a severe loss caused by various natural events, including hurricanes, hailstorms, tornadoes, windstorms, earthquakes, severe winter weather and fires. Our catastrophe losses are those designated by the Insurance Services Office (ISO) Property Claim Services (PCS). PCS defines a catastrophe as an event that causes $25 million or more in industry insured property losses and affects a significant number of property and casualty policyholders and insurers.
Combined ratio	The sum of the loss and LAE ratio and the expense ratio. A combined ratio under 100% generally indicates an underwriting profit. A combined ratio over 100% generally indicates an underwriting loss.
Debt to capital ratio	The ratio of notes payable to the sum of total stockholders equity and notes payable.
Deferred acquisition costs or DAC	Expenses that vary with, and are primarily related to, the production of new and renewal insurance business, and are deferred and amortized to achieve a matching of revenues and expenses when reported in financial statements prepared in accordance with GAAP.
Direct written premiums	The amounts charged by an insurer to insureds in exchange for coverages provided in accordance with the terms of an insurance contract. The amounts exclude the impact of all reinsurance premiums, either assumed or ceded.
Duration	A measure of the sensitivity of a financial asset s price to interest rate movements.
Earned premiums or premiums earned	The portion of written premiums that applies to the expired portion of the policy term. Earned premiums are recognized as revenue under both SAP and GAAP.

Excess and surplus lines insurance	Specialized property and liability coverages written by non-admitted insurers. These coverages include exposures that do not fit within normal underwriting patterns, involve a degree of risk that is not commensurate with standard rates and/or policy forms, or are not written by admitted insurers because of general market conditions.
Expense ratio or underwriting expense ratio	For SAP, it is the ratio of (i) the sum of statutory underwriting and miscellaneous expenses incurred offset by miscellaneous income

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	(collectively, underwriting expenses) to (ii) written premiums. For GAAP, it is the ratio of acquisition and operating expenses incurred to earned premiums.
Generally accepted accounting principles or GAAP	Accounting practices used in the United States of America determined by the Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA).
Incurred but not reported reserves or IBNR	Estimated losses and LAE that have been incurred but not yet reported to the insurer. This includes amounts for unreported claims, development on known cases, and re-opened claims.
Loss adjustment expenses or LAE	The expenses of settling claims, including legal and other fees, and the portion of general expenses allocated to claim settlement. LAE is comprised of allocated loss adjustment expenses or ALAE and unallocated loss adjustment expenses or ULAE. ALAE are those costs that can be related to a specific claim, which may include attorney fees, external claims adjusters and investigation costs, among others while, ULAE are those costs incurred in settling claims, such as in-house processing costs, which cannot be associated with a specific claim.
Loss and LAE ratio or loss ratio	For both SAP and GAAP, it is the ratio of incurred losses and LAE to earned premiums.
Loss reserves	Liabilities established by insurers and reinsurers to reflect the estimated cost of claims incurred that the insurer or reinsurer will ultimately be required to pay in respect of insurance or reinsurance it has written. Reserves are established for losses and for LAE, and consist of case reserves and IBNR reserves.
Managing general underwriter or MGU	An independent insurance professional firm that acts as an intermediary between the insurer and retail agents, much like a wholesaler. MGUs frequently have binding authority to issue insurance policies on behalf of an insurer that fit into the underwriting guidelines provided by that insurer. MGUs typically are compensated by an override commission on the insurance coverages sold by their sub-agents.
National Association of Insurance Commissioners or NAIC	An organization of the insurance commissioners or directors of all 50 states, the District of Columbia and the five U.S. territories organized to promote consistency of regulatory practices and statutory accounting standards throughout the United States.
Net premiums written to surplus ratio or leverage ratio	A SAP calculation which measures statutory surplus available to absorb losses. This ratio is calculated by dividing the net statutory premiums written for a rolling twelve month period by the ending statutory surplus for the period. For example, a ratio of 1.5 means that for every dollar of surplus, the insurer wrote $1.50 in premiums.
Net written premiums	Direct written premiums plus assumed reinsurance premiums less ceded reinsurance premiums.

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Non-admitted insurer or surplus lines carrier	An insurer that is not required to be licensed in a state but is allowed to do business in that state subject to certain regulatory oversight by that state s insurance regulatory authority. Non-admitted insurers are not subject to most of the rate and form regulations imposed on admitted insurers because they write specialized property and liability coverages, also known as excess and surplus lines insurance, which allows them the flexibility to change coverages offered and rates charged without time constraints and financial costs associated with the filing process. As such, these insurers offer an opportunity for coverage for specialized exposures that otherwise might not be insurable.
Retail agent or retail agency	An independent insurance professional who represents, and acts as an intermediary for, admitted insurers, generally recommending, marketing and selling insurance products and services to insurance consumers.
Return on average equity	The percent derived by dividing net income by average total stockholders equity.
Risk-based capital or RBC	A measure adopted by the NAIC and state regulatory authorities for determining the minimum statutory capital and surplus requirements of insurers. Insurers having total adjusted capital less than that required by the RBC calculation will be subject to varying degrees of regulatory action depending on the level of capital inadequacy.
Risk retention groups	An insurance arrangement where members of a similar profession or business band together to self-insure their exposure.
Standard insurance	Insurance which is typically written by admitted insurers. Our personal and business insurance segments are comprised of standard insurance.
Statutory accounting practices or SAP	The practices and procedures prescribed or permitted by state insurance regulatory authorities in the United States for recording transactions and preparing financial statements.
Statutory surplus	Under SAP, the amount remaining after all liabilities, including loss reserves, are subtracted from all admitted assets. Admitted assets are assets of an insurer prescribed or permitted by a state to be recognized on the balance sheet prepared in accordance with SAP.
Underwriting gain or loss	Under SAP, earned premiums less loss and LAE and underwriting expenses.
Unearned premiums	The portion of written premiums that applies to the unexpired portion of the policy term. Unearned premiums are not recognized as revenues under both SAP and GAAP.
Wholesale broker	An independent insurance professional who offers specialized insurance products and serves as an intermediary between a retail agent and an insurer, while typically having no contact with the insured. A wholesale broker may represent both admitted and non-admitted insurers, and may offer both standard and excess and surplus lines

insurance.

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PART I

Item 1. Business

State Auto Financial is an Ohio domiciled property and casualty insurance holding company incorporated in 1990. We are primarily engaged in writing both personal and business lines of insurance. State Auto Financial s subsidiaries include State Auto P&C, Milbank, Farmers, and SA Ohio, each of which is a property and casualty insurance company, and Stateco, which provides investment management services to affiliated insurance companies. State Auto Financial s nonstandard automobile insurance subsidiary, SA National, was sold to Hallmark Insurance Company on December 31, 2010. In deciding to sell SA National, we considered those businesses core to our long-term strategy and concluded that the nonstandard auto market was no longer a strategic fit for us.

Our parent company is State Auto Mutual, an Ohio domiciled mutual property and casualty insurance company organized in 1921. It owns approximately 63% of State Auto Financial s outstanding common shares. State Auto Mutual s other subsidiaries and affiliates include SA Florida, SA Wisconsin, Meridian Security, Meridian Citizens Mutual, Beacon National, Patrons Mutual, Litchfield and the Rockhill Insurers, each of which is a property and casualty insurance company. In 2007, State Auto Mutual acquired the Beacon Insurance Group and affiliated with the Patrons Insurance Group. In 2009, State Auto Mutual acquired the Rockhill Insurance Group.

The operations of the State Auto Group are headquartered in Columbus, Ohio.

MANAGEMENT AGREEMENT

Through various management and cost sharing agreements, State Auto P&C provides the employees to perform all organizational, operational and management functions for the State Auto Group while State Auto Mutual provides certain operating facilities, including our corporate headquarters.

Our primary management agreement, which we refer to as the 2005 Management Agreement, has a ten year term and renews for an additional ten-year period unless terminated sooner in accordance with its terms. If the 2005 Management Agreement was terminated for any reason, we would have to relocate our facilities to continue our operations. However, we do not currently anticipate the termination of the 2005 Management Agreement. See Properties included in Item 2 of this Form 10-K.

FINANCIAL INFORMATION ABOUT SEGMENTS

During 2010, we operated our business in three reportable segments: personal insurance, business insurance (the insurance segments), and investment operations. The three segments reflected the manner in which we managed our business and reported our results internally to our principal operating decision makers. In 2010, the State Auto Group began writing new commercial specialty business through RED, which allowed us to offer insurance coverages in the program and alternative risk markets for business products such as general liability, commercial auto, workers compensation and property. In 2010, the financial results of business written through RED were included in our business insurance segment results. See detailed discussion regarding our segments at Item 7 of this Form 10-K Management s Discussion and Analysis of Financial Condition and Results of Operations Overview and Note 16 to our consolidated financial statements included in Item 8 of this Form 10-K.

With the acquisition of the Rockhill Insurance Group and the build out of RED, in 2010, management focused on assessing and positioning a realignment of our internal organization, including people, processes and compensation reward programs, to be more strategic in the personal, business and specialty insurance markets. Considering these internal changes, and with the inclusion of the Rockhill Insurers into the Pooling Arrangement

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(defined below) as of January 1, 2011, our reportable insurance segments will change from personal and business insurance to personal insurance, business insurance and specialty insurance, aligning how these insurance segments report to our principal operating decision makers.

INSURANCE OPERATIONS

The State Auto Group markets a broad line of property and casualty insurance products in all 50 states and the District of Columbia exclusively through independent insurance agencies, which include retail agents and wholesale brokers. Prior to the addition of the Rockhill Insurers to the Pooling Arrangement, we marketed our personal and business insurance segment products in 34 states and the District of Columbia through retail agents. All of the property and casualty insurance companies in the State Auto Group are admitted insurers, except for RIC, which is a non-admitted insurer.

Our Pooled Companies are rated A+ (Superior) by the A.M. Best Company.

Competition

The property and casualty insurance industry is highly competitive. We compete with numerous insurance companies, with varying size and financial resources. We compete in the personal and business insurance markets based on price; product offerings and innovation; underwriting criteria; quality of service to insureds, retail agents and wholesale brokers; relationships with our retail agents and wholesale brokers; prompt and fair claims handling and settlement; financial stability; and technology, making us a preferred business partner. In addition, because most of our retail agents and wholesale brokers represent more than one insurer, we face competition within each agency and broker.

Geographic Distribution

The following table sets forth the geographic distribution of our direct written premiums for the year ended December 31, 2010:

State	% of Total
Ohio	15.0%
Kentucky	8.9
Texas	7.4
Indiana	6.2
Tennessee	6.0
Pennsylvania	4.4
Minnesota	4.3
Maryland	4.1
Arkansas	3.8
West Virginia	3.7
Illinois	3.2
Wisconsin	3.0
North Carolina	3.0
All others [1]	27.0
Total	100.0%

[1] No other single state accounted for 3.0% or more of the total direct written premiums written in 2010.

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Pooling Arrangement

Our Pooled Companies are parties to a quota share reinsurance agreement which we refer to as the Pooling Arrangement. In general, under the Pooling Arrangement, State Auto Mutual assumes premiums, losses and expenses from each of the remaining Pooled Companies and in turn cedes to each of the Pooled Companies a specified portion of premiums, losses and expenses based on each of the Pooled Companies respective pooling percentages. State Auto Mutual then retains the balance of the pooled business. The participation percentage for the STFC Pooled Companies has remained at 80% since 2001. Prior to 2011, the Pooling Arrangement covered all property and casualty insurance written by the Pooled Companies except for business written by the Rockhill Insurers. As of January 1, 2011, we added the Rockhill Insurers to the pool with a participation percentage of 0.0%. See the detailed discussion of our Pooling Arrangement at Item 7 of this Form 10-K, Management s Discussion and Analysis of Financial Condition and Results of Operations Pooling Arrangement.

PERSONAL AND BUSINESS INSURANCE

Products offered in our personal and business insurance segments are marketed exclusively through retail agents, but the segments are managed separately from each other due to the differences in the types of customer they serve or products they provide or services they offer.

Products

Personal Insurance

In our personal insurance segment, we write standard insurance covering personal exposures to individuals. The primary coverages offered are personal auto and homeowners.

Business Insurance

In our business insurance segment, we write standard insurance covering small-to-medium sized commercial exposures. We offer a broad range of coverages which include commercial auto, commercial multi-peril, fire & allied and general liability.

Marketing

We market the products of our personal and business insurance segments through approximately 3,400 retail agencies. We view our retail agents as our primary customers, because they are in a position to recommend either our insurance products or those of a competitor to their customers. We strongly support the independent agency system and believe its maintenance is essential to our present and future success. We continually develop programs and procedures to enhance our agency relationships, including the following: regular travel by senior management and regional office staff to meet with agents, in person, in their home states; training opportunities; and incentives related to profit and growth. In addition, we share the cost of approved advertising with selected agencies.

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

We provide our retail agents with defined travel and cash incentives if they achieve certain sales and underwriting profit levels. Further, we recognize our very top agencies measured by consistent profitability, achievement of written premium thresholds and growth as Inner Circle Agencies. Inner Circle Agencies are rewarded with additional trip and financial incentives.

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

Claims

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

Claim settlement authority levels are established for each adjuster, supervisor and manager based on his or her level of expertise and experience. Our claims division is responsible for reviewing the claim, obtaining necessary documentation and establishing loss and expense reserves of certain claims. Generally, property or casualty claims estimated to reach $100,000 or above are sent to our home office to be supervised by claims division specialists. Regions with low volumes of large claims are assigned a lower dollar threshold for referring claims to the home office. In territories in which there is not sufficient volume to justify having full-time adjusters, we use independent appraisers and adjusters to evaluate and settle claims under the supervision of claims division personnel.

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

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

SPECIALTY INSURANCE

In our specialty insurance segment, we offer commercial coverages that require specialized product underwriting, claims handling or risk management services through a distribution channel of retail agents and wholesale brokers, which may include program administrators and other specialty sources. Our specialty insurance products are written through our admitted and non-admitted insurers. Our specialty insurance segment is organized into the following three units:

Our RED unit markets and underwrites small-to-medium commercial exposures, offering property and casualty programs for customers with common risk characteristics or coverage requirements. This unit may also offer alternative forms of risk protection that include various forms of self-insurance or high deductibles, some of which may utilize captive insurance arrangements or risk retention groups. Coverages offered by this unit include commercial auto, workers compensation, general liability and property. We use approved external claim services for claims notification, handling and settlement with centralized management oversight by our home office team. In 2010, the financial results of our RED unit were included for the first time in our business insurance segment and accounted for $83.2 million of net written premium. Beginning in 2011, the financial results of our RED unit will be reported in the specialty insurance segment.

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Our Rockhill unit markets and underwrites commercial exposures which have unique insurance requirements, including difficult to place classes of commercial business which may require customized rates and forms, along with customized insurance programs for specialty niche and homogenous groups of exposures. Coverages offered by this unit may include commercial auto, property, bonds (fidelity and surety) and general liability. Our Rockhill unit uses a combination of a dedicated internal claims unit and also approved external claim services for claims notification, handling and settlement with centralized management oversight by our home office team. In 2010, 2009 and 2008, our business insurance segment included $4.8 million, $3.6 million and $3.9 million, respectively, of net written premiums from bonds, which will be reported in the specialty insurance segment beginning in 2011.

Our Workers Compensation unit serves the small-to-medium account and association business. This unit has a dedicated internal claims team emphasizing managed care cost containment strategies including focusing on the injured employee s early return to work and cost-effective quality care. In 2010, 2009 and 2008, our business insurance segment included $38.9 million, $43.3 million and $47.5 million, respectively, of net written premiums from workers compensation business, which will be reported in the specialty insurance segment beginning in 2011.

REINSURANCE

Members of the State Auto Group follow the customary industry practice of reinsuring a portion of their exposures and paying to the reinsurers a portion of the premiums received. Insurance is ceded principally to reduce net liability on individual risks or for individual loss occurrences, including catastrophic losses. Although reinsurance does not legally discharge the individual members of the State Auto Group from primary liability under their policies, it does make the assuming reinsurer liable to the extent of the reinsurance ceded. See the detailed discussion of our reinsurance arrangements at Item 7 of this Form 10-K, Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Reinsurance Arrangements.

See Regulation in this Item 1 for a discussion of the Terrorism Acts.

LOSS RESERVES

We maintain reserves for the eventual payment of losses and LAE for both reported claims and IBNR. Loss reserves are management s best estimate at a given point in time of what we expect to pay to settle all losses incurred as of the end of the accounting period, based on facts, circumstances and historical trends then known. During the loss settlement period, additional facts regarding individual claims may become known, and consequently it often becomes necessary to revise the estimates of liability. The results of our operations and financial condition could be impacted, perhaps significantly, in the future if the ultimate payments required to settle claims vary from the loss reserves currently recorded.

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

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The following table sets forth our one-year development information on changes in the loss reserve for the years ended December 31, 2010, 2009 and 2008:

($ millions)	Year Ended December 31		
	2010	2009	2008
Beginning of Year:			
Loss and loss expenses payable	**$ 840.2**	791.2	658.3
Less: Reinsurance recoverable on losses and loss expenses payable(1)	**20.8**	21.2	11.2
Net losses and loss expenses payable(2)	**819.4**	770.0	647.1
Impact of pooling change, January 1, 2010 and 2008	**(4.0)**		51.3
Provision for losses and loss expenses occurring:			
Current year	**954.2**	899.5	874.0
Prior years(3)	**(64.6)**	(56.2)	(27.3)
Total	**889.6**	843.3	846.7
Loss and loss expense payments for claims occurring during:			
Current year	**543.9**	524.8	518.7
Prior years	**286.9**	269.1	256.4
Total	**830.8**	793.9	775.1
End of Year:			
Net losses and loss expenses payable	**874.2**	819.4	770.0
Add: Reinsurance recoverable on losses and loss expenses payable(4)	**18.8**	20.8	21.2
Losses and loss expenses payable(5)	**$ 893.0**	840.2	791.2

(1) Includes amounts due from affiliates of $0.1 million, $0.6 million, and $1.2 million at beginning of year 2010, 2009, and 2008, respectively.
(2) Includes net amounts assumed from affiliates of $346.2 million, $343.0 million, and $257.2 million at beginning of year 2010, 2009, and 2008, respectively.
(3) This line item shows decreases in the current calendar year in the provision for losses and loss expenses attributable to claims occurring in prior years. See discussion regarding the calendar year developments at Item 7 of this Form 10-K Management s Discussion and Analysis section at Results of Operations Loss and LAE.
(4) Includes amounts due from affiliates of $0.1 million and $0.6 million at end of year 2009 and 2008, respectively.
(5) Includes net amounts assumed from affiliates of $375.8 million, $346.2 million, and $343.0 million at end of year 2010, 2009, and 2008, respectively.

The following table sets forth our development of loss reserves from 2000 through 2010. Net liability for losses and loss expenses payable sets forth the estimated liability for unpaid losses and LAE recorded at the balance sheet date, net of reinsurance recoverable, for each year shown. This liability represents the estimated amount of losses and LAE for claims incurred during the current year or incurred during prior years that are unpaid at the balance sheet date, including IBNR.

The upper section of the table shows the cumulative amounts paid with respect to the previously reported loss reserve as of the end of each succeeding year. For example, through December 31, 2010, we have paid 121.3% of the losses and LAE that had been incurred but not paid, as estimated at December 31, 2000.

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

The amounts on the cumulative redundancy (deficiency) line represent the aggregate change in the estimates over all prior years. For example, the year end 2000 loss reserve has developed $94.2 million or 39.8% deficient through December 31, 2010. This $94.2 million amount has been included in operating results over the ten years and did not have a significant effect on income in any one year.

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In evaluating the information in the table, it should be noted that each amount includes the effects of all changes in amounts for prior periods. For example, the amount of the redundancy or deficiency evaluated at December 31, 2002, on claims incurred in 2000 includes the cumulative redundancy or deficiency for years 2000, 2001 and 2002. Conditions and trends that have affected the development of the liability in the past may not necessarily occur in the future. Accordingly, it may not be appropriate to extrapolate future redundancies or deficiencies based on this table.

In 2000 and 2001, the Pooling Arrangement was amended to increase our share of premiums, losses and expenses. An amount of assets equal to the increase in net liabilities was transferred to us from our parent company in 2000 and 2001 in conjunction with each year s respective pooling change. In 2005, the MIGI Insurers were added to the pool and our share of their net liabilities and assets were transferred to us from them. In 2008, Beacon National, the Patrons Insurance Group, State Auto middle market business and voluntary assumed reinsurance from parties affiliated with State Auto Mutual were added to the pool, and accordingly net assets equal to the increase in net liabilities were transferred to us from them. In 2010, SA National and voluntary assumed reinsurance from third parties unaffiliated with the Pooled Companies that was assumed on or after January 1, 2009 by State Auto Mutual were added to the pool, and accordingly net assets equal to the increase in net liabilities were transferred to us from them. The amount of the assets transferred on the reserve liabilities assumed/ceded in 2000, 2001, 2005, 2008 and 2010 has been netted against and has reduced/increased the cumulative amounts paid for years prior to 2000, 2001, 2005, 2008 and 2010, respectively.

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($ millions)	Years Ended December 31										
	2000	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Net liability for losses and loss expenses payable	$ 236.7	$ 509.9	$ 592.1	$ 628.8	$ 655.9	$ 711.3	$ 661.0	$ 647.1	$ 770.0	$ 819.4	$ 874.2
Paid (cumulative) as of:											
One year later	5.9%	43.4%	41.2%	36.7%	31.6%	34.9%	34.9%	31.7%	34.9%	35.5%	
Two years later	52.7%	65.3%	60.8%	53.2%	48.4%	51.1%	50.5%	49.4%	53.2%		
Three years later	79.9%	78.4%	71.4%	63.3%	59.6%	60.9%	60.4%	62.6%			
Four years later	95.5%	84.4%	77.3%	70.6%	66.1%	66.0%	67.8%				
Five years later	101.6%	88.5%	82.3%	74.3%	69.2%	70.3%					
Six years later	107.0%	92.3%	85.1%	76.0%	72.3%						
Seven years later	112.2%	94.7%	86.4%	78.4%							
Eight years later	116.4%	95.9%	88.4%								
Nine years later	117.9%	97.8%									
Ten years later	121.3%										
Net liability re-estimate as of:											
One year later	125.7%	102.4%	99.7%	96.5%	93.3%	89.9%	91.7%	95.8%	92.7%	92.1%	
Two years later	129.1%	105.1%	100.6%	93.2%	87.6%	86.4%	90.5%	93.7%	89.5%		
Three years later	133.1%	106.9%	98.8%	91.0%	86.9%	85.6%	88.8%	91.9%			
Four years later	136.1%	106.2%	98.5%	90.6%	86.2%	85.3%	87.4%				
Five years later	135.6%	107.1%	98.8%	89.8%	85.5%	84.7%					
Six years later	138.2%	107.7%	98.4%	89.7%	85.2%						
Seven years later	140.1%	107.4%	98.6%	89.7%							
Eight years later	139.5%	107.6%	98.6%								
Nine years later	139.6%	107.8%									
Ten years later	139.8%										
Cumulative redundancy (deficiency)	$ (94.2)	$ (39.6)	$ 8.5	$ 64.6	$ 97.3	$ 108.6	$ 83.2	$ 52.1	$ 80.6	$ 64.6	
Cumulative redundancy (deficiency)	(39.8%)	(7.8%)	1.4%	10.3%	14.8%	15.3%	12.6%	8.1%	10.5%	7.9%	
Gross* liability end of year	$ 457.2	$ 743.7	$ 862.4	$ 934.0	$ 1,006.4	$ 1,111.1	$ 1,032.7	$ 1,029.9	$ 1,198.6	$ 1,293.2	$ 1,391.4
Reinsurance recoverable	$ 220.5	$ 233.8	$ 270.3	$ 305.2	$ 350.5	$ 399.8	$ 371.7	$ 382.8	$ 428.6	$ 473.8	$ 517.2
Net liability end of year	$ 236.7	$ 509.9	$ 592.1	$ 628.8	$ 655.9	$ 711.3	$ 661.0	$ 647.1	$ 770.0	$ 819.4	$ 874.2
Gross liability re-estimated latest	125.0%	107.7%	99.3%	92.4%	88.7%	87.7%	89.6%	93.6%	90.7%	92.4%	
Reinsurance recoverable re-estimated latest	109.1%	107.5%	101.0%	97.9%	95.4%	92.9%	93.4%	96.3%	92.7%	92.9%	
Net liability re-estimated latest	139.8%	107.8%	98.6%	89.7%	85.2%	84.7%	87.4%	91.9%	89.5%	92.1%	

* Gross liability includes: Direct and assumed losses and loss expenses payable.

As the Pooling Arrangement provides for the right of offset, we have reported losses and loss expenses payable ceded to our parent company as assets only in situations when net amounts ceded to our parent company exceed that assumed. The following table provides a reconciliation of the reinsurance recoverable to the amount reported in our consolidated financial statements at each balance sheet date:

Reinsurance recoverable	$ 220.5	$ 233.8	$ 270.3	$ 305.2	$ 350.5	$ 399.8	$ 371.7	$ 382.8	$ 428.6	$ 473.8	$ 517.2
Amount netted against assumed from State Auto Mutual	$ 212.6	$ 219.9	$ 261.5	$ 291.0	$ 324.6	$ 382.4	$ 358.2	$ 371.6	$ 407.4	$ 453.0	$ 498.4
Net reinsurance recoverable	$ 7.9	$ 13.9	$ 8.8	$ 14.2	$ 25.9	$ 17.4	$ 13.5	$ 11.2	$ 21.2	$ 20.8	$ 18.8

INVESTMENT OPERATIONS

Our investment portfolio is managed to provide growth of statutory surplus to facilitate increased premium writings over the long-term while maintaining the ability to fund current insurance operations. The primary objectives are to generate income, preserve capital and maintain liquidity. Our investment portfolio is managed

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separately from that of our parent company and its subsidiaries, and investment results are not shared by our Pooled Companies through the Pooling Arrangement. Stateco performs investment management services for us and our parent company and its subsidiaries, although investment policies implemented by Stateco continue to be set for each company through the Investment Committee of its respective Board of Directors.

For additional discussion regarding our investments, including the market risks related to our investment portfolio, see Item 7 of this Form 10-K, Management s Discussion and Analysis of Financial Condition and Results of Operations Investment Operations Segment.

REGULATION

Most states, including all the domiciliary states of the State Auto Group, have enacted legislation that regulates insurance holding company systems. Each insurance company in our holding company system is required to register with the insurance supervisory agency of its state of domicile and furnish information concerning the operations of companies within our holding company system that may materially affect the operations, management or financial condition of the insurers within the system. Pursuant to these laws, the respective insurance departments may examine any members of the State Auto Group, at any time, require disclosure of material transactions involving insurer members of our holding company system, and require prior notice and an opportunity to disapprove of certain extraordinary transactions, including, but not limited to, extraordinary dividends to stockholders. Pursuant to these laws, all transactions within our holding company system affecting any insurance subsidiary within the State Auto Group must be fair and equitable. In addition, approval of the applicable state insurance commissioner is required prior to the consummation of transactions affecting the control of an insurer. The insurance laws of all the domiciliary states of the State Auto Group provide that no person may acquire direct or indirect control of a domestic insurer without obtaining the prior written approval of the state insurance commissioner for such acquisition.

In addition to being regulated by the insurance department of its state of domicile, each of our insurance companies is subject to supervision and regulation in the states in which we transact business. Such supervision and regulation relate to numerous aspects of an insurance company s business operations and financial condition. The primary purpose of such supervision and regulation is to ensure financial stability of insurance companies for the protection of policyholders. The laws of the various states establish insurance departments with broad regulatory powers relative to granting and revoking licenses to transact business, regulating trade practices, licensing agents, approving policy forms, setting reserve requirements, determining the form and content of required statutory financial statements, prescribing the types and amount of investments permitted and requiring minimum levels of statutory capital and surplus. Although premium rate regulation varies among states and lines of insurance, such regulations generally require approval of the regulatory authority prior to any changes in rates. In addition, all of the states in which the State Auto Group transacts business have enacted laws which restrict these companies underwriting discretion. Examples of these laws include restrictions on policy terminations, restrictions on agency terminations and laws requiring companies to accept any applicant for automobile insurance. These laws may adversely affect the ability of the insurers in the State Auto Group to earn a profit on their underwriting operations.

We are required to file detailed annual reports with the supervisory agencies in each of the states in which we do business, and our business and accounts are subject to examination by such agencies at any time.

There can be no assurance that such regulatory requirements will not become more stringent in the future and have an adverse effect on the operations of the State Auto Group.

Dividends. Our insurance subsidiaries generally are restricted by the insurance laws of our respective states of domicile as to the amount of dividends we may pay without the prior approval of our respective state regulatory authorities. Generally, the maximum dividend that may be paid by an insurance subsidiary during any year without prior regulatory approval is limited to the greater of a stated percentage of that subsidiary s statutory

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surplus as of a certain date, or adjusted net income of the subsidiary for the preceding year. Under current law, $78.3 million is available in 2011 for payment as a dividend from our insurance subsidiaries to STFC without prior approval from our respective domiciliary state insurance departments. STFC received dividends of $56.4 million, $11.5 million, and $39.0 million in 2010, 2009, and 2008, respectively, from its insurance subsidiaries.

Rates and Related Regulation. Except as discussed below, we are not aware of the adoption of any adverse legislation or regulation in any state in which we conducted business during 2010 which would materially impact our business.

Many of the states in which we operate have passed or are considering legislation restricting or banning the use of credit scoring in the rating and risk selection process. The Fair and Accurate Credit Transactions Act, passed by the United States Congress in 2003, directed the Federal Trade Commission (FTC) to consult with the Office of Fair Housing and Equal Opportunity on, among other things, how the use of credit information may affect the availability and affordability of property/casualty insurance, and whether the use of certain factors by credit scoring systems could have a disparate impact on minorities. In July of 2007, the FTC released a report on credit scoring and its impact on automobile insurance. The FTC concluded that credit-based scoring is an effective predictor of risk with respect to the issuance of automobile insurance policies to consumers, but has little effect as an indicator of racial or ethnic status of consumers. Despite the FTC s conclusions, some consumer groups and certain regulatory and legislative entities continue to resist the use of credit scoring in the rating and risk selection process. In 2008, the FTC asked nine of the nation s largest homeowners insurance companies to provide information that the FTC says will allow it to determine how consumer credit data is used by the companies in underwriting and rate setting in this line of business. The FTC continues to analyze the responses received from the nine insurance companies and expects to issue its report to Congress in late 2011 or 2012, though no specific release date has been published. Upon release, the results of the study could affect the future use of credit scoring. Banning or restricting this practice or data mining would limit our ability, and the ability of other carriers, to take advantage of the predictive value of this information.

In an attempt to make capital and surplus requirements more accurately reflect the underwriting risk of different lines of insurance, as well as investment risks that attend insurers operations, the NAIC annually tests insurers risk-based capital requirements. As of December 31, 2010, each of the Pooled Companies had adequate levels of capital as defined by the NAIC with its respective risk-based capital requirements.

The property and casualty insurance industry is also affected by court decisions. In general, premium rates are actuarially determined to enable an insurance company to generate an underwriting profit. These rates contemplate a certain level of risk. The courts may modify, in a number of ways, the level of risk which insurers had expected to assume, including eliminating exclusions, expanding the terms of the contract, multiplying limits of coverage, creating rights for policyholders not intended to be included in the contract and interpreting applicable statutes expansively to create obligations on insurers not originally considered when the statute was passed. Courts have also undone legal reforms passed by legislatures, which reforms were intended to reduce a litigant s rights of action or amounts recoverable and so reduce the costs borne by the insurance mechanism. These court decisions can adversely affect an insurer s profitability. They also create pressure on rates charged for coverages adversely affected, and this can cause a legislative response resulting in rate suppression that can unfavorably impact an insurer.

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 terrorist attacks within the United States. Under the Terrorism Acts, commercial property and casualty insurers must offer their commercial policyholders coverage against certified acts of terrorism, but the policyholders may choose to reject this coverage. If the policyholder rejects coverage for certified acts of terrorism, we will cover only such acts of terrorism that are not certified acts under the Terrorism Acts and continue to apply policy exclusions that may limit any coverage from loss due to nuclear, biological or chemical agents. By enacting the Terrorism Risk Insurance Program Reauthorization Act

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of 2007, Congress made modest changes to the previous Terrorism Acts for example, deleting the distinction between certified and non-certified (essentially foreign and domestic) acts of terrorism. Lines of business covered, as well as other important features (such as loss triggers, company deductibles and industry retentions) were not changed. Our current property reinsurance treaties exclude certified acts of terrorism.

The Federal Insurance Office was established in 2010 by the enactment of the Dodd-Frank Act. The Federal Insurance Office will be a separate office within the United States Department of Treasury. While lacking regulatory authority, the primary objectives of the Federal Insurance Office will be to monitor, collect data and report on the insurance industry. It is not known how this federal office will coordinate and interact with the NAIC and state insurance regulators.

EMPLOYEES

As of February 25, 2011, we had 2,483 employees. Our employees are not covered by any collective bargaining agreement. We consider the relationship with our employees to be good.

AVAILABLE INFORMATION

Our website address is www.StateAuto.com. Through this website (found by clicking the Investors link, then the All SEC Filings link), we make available, free of charge, our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, proxy and information statements and all amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the Exchange Act), as soon as reasonably practicable after we electronically file such material with the Securities and Exchange Commission (the SEC). Also available on our website is information pertaining to our corporate governance, including the charters of each of our standing committees of our Board of Directors, our corporate governance guidelines, our employees code of business conduct and our directors ethical principles.

Any of the materials we file with the SEC may also be read and copied at the SEC s Public Reference Room at 100 F Street, NE, Washington, DC 20549. Information on the operation of the SEC s Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains a website that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at www.sec.gov.

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Executive Officers of the Registrant

Name of Executive Officer and Position(s) with Company	Age[1]	Principal Occupation(s) During the Past Five Years	An Executive Officer of the Company Since[2]
Robert P. Restrepo, Jr., Chairman, President and Chief Executive Officer	60	Chairman of the Board and Chief Executive Officer of STFC and State Auto Mutual, 2/06 to present; President of STFC and State Auto Mutual, 3/06 to present; Senior Vice President, Insurance Operations, of Main Street America Group, a property and casualty insurance company, 4/05 2/06; President and Chief Executive Officer for two property and casualty insurance subsidiaries of Allmerica Financial Corporation (now known as Hanover Insurance Group), 1998 2003.	2006
Steven E. English, Vice President and Chief Financial Officer	50	Vice President of STFC and State Auto Mutual, 05/06 to present; Chief Financial Officer of STFC and State Auto Mutual, 12/06 to present; Assistant Vice President of State Auto Mutual, 06/01 to 05/06.	2006
Joel E. Brown, Vice President	53	Vice President, Standard Lines, of STFC and State Auto Mutual, 01/11 to present; Vice President, Personal Lines, and Regional Vice President of STFC and State Auto Mutual, 01/01 to 01/11.	2011
Jessica E. Buss, Chief Operating Officer of Specialty Insurance	39	Chief Operating Officer, Specialty Insurance, of STFC and State Auto Mutual, 01/11 to present; Chief Operating Officer of Rockhill Insurance Company, 11/08 to 01/11; Chief Financial Officer of Rockhill Insurance Company, 11/05 to 11/08.	2011
James E. Duemey, Vice President and Investment Officer	64	Vice President and Investment Officer of STFC and State Auto Mutual, 5/91 to present.	1991
Clyde H. Fitch, Jr., Senior Vice President and Chief Sales Officer	60	Senior Vice President and Chief Sales Officer of STFC and State Auto Mutual, 11/07 to present; Senior Vice President of Travelers Companies, Inc. for more than five years prior to 11/07.	2007
Cynthia A. Powell, Vice President and Treasurer	50	Treasurer of STFC and State Auto Mutual, 06/06 to present; Vice President of State Auto Mutual, 3/00 to present; Vice President of STFC, 5/00 to present.	2000
Lorraine M. Siegworth, Vice President	43	Vice President of STFC and State Auto Mutual, 11/06 to present; Vice President of Nationwide Insurance or its affiliates, 09/00 to 03/06, most recently serving as Vice President of Corporate HR of Nationwide Insurance.	2006
James A. Yano, Vice President, Secretary and General Counsel	59	Vice President, Secretary and General Counsel of STFC and State Auto Mutual, 4/07 to present; Senior Vice President, Secretary and General Counsel of Abercrombie & Fitch Co. 5/05 to 3/07; Partner, law firm of Vorys, Sater, Seymour and Pease LLP for more than five years prior thereto.	2007

(1) Age as of March 8, 2011.

(2) Each of the foregoing officers has been designated by our Board of Directors as an executive officer for purposes of Section 16 of the Exchange Act.

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Item 1A. Risk Factors

Statements contained in this Form 10-K may be forward-looking within the meaning of the Section 21E of the Exchange Act. Such forward-looking statements are subject to certain risks and uncertainties that could cause our operating results to differ materially from those projected. The following factors, among others, in some cases have affected, and in the future could affect, our actual financial performance.

RESERVES

If our estimated liability for losses and loss expenses is incorrect, our loss reserves may be inadequate to cover our ultimate liability for losses and loss expenses and may have to be increased.

We establish loss reserves based on actuarial estimates of the amount to be paid in the future to settle all claims incurred as of the end of the accounting period. We maintain loss reserves to cover our estimated ultimate unpaid liability for losses and loss expenses with respect to reported and unreported claims incurred as of the end of each accounting period. Loss reserves do not represent an exact calculation of liability, but instead represent estimates, generally using actuarial projection techniques at a given accounting date. Our loss reserve estimates are expectations of what the ultimate settlement and administration of claims will cost based on our assessment of facts and circumstances then known, historical settlement patterns, estimates of trends in claims severity and frequency, legal theories of liability and other factors. Variables in the loss reserve estimation process can be affected by both internal and external events, such as changes in claims handling procedures, trends in loss costs, economic inflation, legal developments and legislative changes. Many of these items are not directly quantifiable, particularly on a prospective basis. Additionally, there may be a significant reporting lag between the occurrence of an insured event and the time a claim is actually reported to the insurer. We refine loss reserve estimates in a regular ongoing process as historical loss experience develops and additional claims are reported and settled. We record adjustments to loss reserves in the results of operations for the periods in which the estimates are changed. In establishing loss reserves, we take into account estimated recoveries for reinsurance, salvage and subrogation.

Because estimating loss reserves is an inherently uncertain process, currently established loss reserves may not be adequate. If we conclude the estimates are incorrect and our loss reserves are inadequate, we are obligated to increase them. An increase in loss reserves results in an increase in losses, reducing our net income for the period in which the deficiency is identified. Accordingly, an increase in loss reserves could have a material adverse effect on our results of operations, liquidity and financial condition.

CATASTROPHE LOSSES AND GEOGRAPHIC CONCENTRATIONS

The occurrence of catastrophic events could cause volatility in our results of operations and could materially reduce our level of profitability.

Our insurance operations expose us to claims arising out of catastrophic events. We have experienced, and will in the future experience, catastrophe losses that may cause substantial volatility in our financial results for any fiscal quarter or year and could materially reduce our level of profitability or harm our financial condition, which in turn could adversely affect our ability to write new business. Catastrophes can be caused by various natural events, including hurricanes, hailstorms, tornadoes, windstorms, earthquakes, severe winter weather and fires, none of which are within our control. Catastrophe losses can vary widely and could significantly impact our results. The frequency and severity of catastrophes are inherently unpredictable. Additionally, catastrophe losses incurred by residual markets or pooling mechanisms (such as wind pools) in certain states could trigger assessments to the Company. Such assessments could be material and may not be recoupable, depending on the applicable state mechanism.

The magnitude of loss from a catastrophe is a function of the severity of the event and the total amount of insured exposure in the affected area. Accordingly, we can sustain significant losses from less severe catastrophes, such as localized windstorms, when they affect areas where our insured exposure is concentrated. Although catastrophes can cause losses in a variety of our property and casualty lines, most of our catastrophe claims in the past have related to homeowners, allied lines and commercial multi-peril coverages. The geographic distribution of our business subjects us to catastrophe exposure from severe thunderstorms, tornadoes and hail, primarily in the Midwest and Texas, as well as earthquakes and hurricanes affecting the United States. In the last three years, the largest catastrophe or series of catastrophes affecting STFC s results of operations in any one year were as follows: 2010 with losses from a series of spring storms including wind and hail in northern Ohio and a rash of flood related claims in Nashville, Tennessee, both which affected our auto physical damage results in both personal and business insurance auto lines resulting in approximately $22.2 million in pre-tax losses; 2009 with losses from two winter storms in the South and Midwest resulting in approximately $41.1 million in pre-tax losses; and 2008 with losses from Hurricane Ike as it travelled through the Midwest resulting in approximately $44.1 million in pre-tax losses.

We believe that increases in the value and geographic concentration of insured properties and the effects of inflation could increase the severity of claims from catastrophic events in the future. In addition, states have from time to time passed legislation that limits the ability of insurers to manage catastrophe risk, such as legislation prohibiting insurers from withdrawing from catastrophe-prone areas. Although we attempt to reduce the impact of catastrophes on our business by controlling concentrations of exposures in catastrophe prone areas and through the purchase of reinsurance covering various categories of catastrophes, reinsurance may prove inadequate if a major catastrophic loss exceeds the reinsurance limit, or an insurance subsidiary incurs a number of smaller catastrophes that, individually, fall below the reinsurance retention level.

Along with others in the industry, we utilize catastrophe models developed by third party vendors to help assess and manage our exposure to catastrophe losses. Such models assume various conditions and probability scenarios and use historical information about catastrophic events, along with detailed information about our business. There are limitations to the usefulness of such models and they do not necessarily accurately predict future losses. Climate change, to the extent it affects changes in weather patterns, could impact the frequency or severity of weather events. Our ongoing catastrophe management efforts could negatively impact growth to the extent constraints on property exposures are deemed necessary in certain territories.

UNDERWRITING AND PRICING

Our financial results depend primarily on our ability to underwrite risks effectively and to charge adequate rates to policyholders.

Our financial condition, cash flows and results of operations depend on our ability to underwrite and set rates adequately for a full spectrum of risks, across a number of lines of insurance. Rate adequacy is necessary to generate sufficient premium to pay losses, loss adjustment expenses and underwriting expenses and to earn a profit.

Our ability to underwrite and set rates effectively is subject to a number of risks and uncertainties, including, without limitation:

- the availability of sufficient, reliable data;
- our ability to conduct a complete and accurate analysis of available data;
- our ability to timely recognize changes in trends and to project both the severity and frequency of losses with reasonable accuracy;
- uncertainties which are generally inherent in estimates and assumptions;
- our ability to project changes in certain operating expense levels with reasonable certainty;

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- the development, selection and application of appropriate rating formulae or other pricing methodologies;
- our use of modeling tools to assist with correctly and consistently achieving the intended results in underwriting and pricing;
- our ability to establish and consistently follow appropriate underwriting guidelines;
- our ability to innovate with new pricing strategies, and the success of those innovations on implementation;
- our ability to secure regulatory approval of premium rates on an adequate and timely basis;
- our ability to predict policyholder retention accurately;
- unanticipated court decisions, legislation or regulatory action;
- unanticipated changes or execution problems in our claim settlement practices;
- changing driving patterns for auto exposures; changing weather patterns (including those which may be related to climate change) for property exposures;
- changes in the medical sector of the economy;
- unanticipated changes in auto repair costs, auto parts prices and used car prices;
- impact of inflation and other factors on cost of construction materials, labor and other expenditures;
- our ability to monitor and manage property concentration in catastrophe prone areas, such as hurricane, earthquake and wind/hail regions; and
- the general state of the economy in the states in which we operate.

Such risks may result in our rates being based on inadequate or inaccurate data or inappropriate assumptions or methodologies, and may cause our estimates of future changes in the frequency or severity of claims to be incorrect. As a result, we could under price risks, which would negatively affect our margins, or we could overprice risks, which could reduce our premium reserves and competitiveness. In either event, our operating results, financial condition and cash flows could be materially adversely affected.

TECHNOLOGY AND TELECOMMUNICATION SYSTEMS

Our business success and profitability depend, in part, on effective information technology and telecommunication systems. If we are unable to keep pace with the rapidly developing technological advancements in the insurance industry, our ability to compete effectively could be impaired.

We depend in large part on our technology and telecommunication systems for conducting business and processing claims. Our business success is dependent on maintaining the effectiveness of existing technology and telecommunication systems and on their continued development and enhancement to support our business processes and strategic initiatives in a cost effective manner. We recently began the development of a new claims system. This effort will involve a significant commitment of resources over the next 24 months. The new system is expected to add functionality, increase our claims efficiency and result in indemnity savings. In spite of our best planning and efforts, it is possible that the system may not be developed within the planned time frame or budget and/or that the expected benefits may not be realized upon implementation.

An ongoing challenge during system development and enhancement is the effective and efficient utilization of current technology in face of a constantly changing technological landscape. There can be no assurance that the development of current technology for future use will not result in our being competitively disadvantaged, especially with those carriers that have greater resources. If we are unable to keep pace with the advancements being made in technology, our ability to compete with other insurance companies who have advanced technological capabilities will be negatively affected. Further, if we are unable to effectively execute and update or replace our key legacy technology and telecommunication systems as they become obsolete or as emerging technology renders them competitively inefficient, our competitive position and/or cost structure could be adversely affected.

BUSINESS CONTINUITY

Our business depends on the uninterrupted operation of our facilities, systems and business functions, including our information technology, telecommunications and other business systems. Our business continuity and disaster recovery plans may not sufficiently address all contingencies.

Our business is highly dependent upon our ability to execute, in an efficient and uninterrupted fashion, necessary business functions, such as Internet support and 24-hour claims contact centers, processing new and renewal business, receiving and processing payment receipts and processing and paying claims. A shut-down of or inability to access one or more of our facilities, a power outage, a pandemic, or a failure of one or more of our information technology, telecommunications or other systems could significantly impair our ability to perform such functions on a timely basis. In addition, because our information technology and telecommunications systems interface with and depend on third party systems, we could experience service denials if demand for such service exceeds capacity, or if our system or a third party system fails or experiences an interruption. If sustained or repeated, such a business interruption, systems failure or service denial could result in a deterioration of our ability to write and process new and renewal business, provide customer service, receive premium payments, pay claims in a timely manner or perform other necessary corporate functions. This could result in a materially adverse effect on our business results and liquidity.

A security breach of our computer systems could also interrupt or damage our operations or harm our reputation. In addition, we could be subject to liability if confidential customer information is misappropriated from our computer systems. Despite the implementation of security measures, including hiring an independent firm to perform intrusion vulnerability testing of our computer infrastructure, these systems may be vulnerable to physical break-ins, computer viruses, programming errors, attacks by third parties or similar disruptive problems. Any well-publicized compromise of security could deter people from entering into transactions that involve transmitting confidential information to our systems, which could have a material adverse effect on our business and reputation.

We have established a business continuity plan in an effort to ensure the continuation of core business operations in the event that normal business operations could not be performed due to a catastrophic event. While we continue to test and assess our business continuity plan to ensure it meets the needs of our core business operations and addresses multiple business interruption events, there is no assurance that core business operations could be performed upon the occurrence of such an event, which may result in a material adverse effect on our financial position and results of operations.

REALIZATION OF DEFERRED INCOME TAX ASSETS

If some or all of our deferred tax assets will not be realized, we will be required to establish a valuation allowance against the deferred income tax asset, which could have a material adverse effect on our results of operations and financial condition.

Deferred tax assets and liabilities represent the tax effect of the differences between the financial statement carrying value of existing assets and liabilities and their respective tax bases. At December 31, 2010, we have net deferred federal income tax assets of $86.3 million, consisting of deferred tax assets of $177.2 million and deferred tax liabilities of $90.9 million. Deferred tax assets are reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. At December 31, 2010, we held no valuation allowance on our net deferred tax assets.

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The determination of the valuation allowance for deferred tax assets requires us to make certain judgments and assumptions. In evaluating the ability to recover deferred tax assets, we consider all available evidence in determining the realizability of the net deferred tax assets including loss carryback potential, past operating results, existence of cumulative losses in the most recent years, projected performance of the business, future taxable income, including the ability to generate capital gains, and prudent and feasible tax planning strategies. In the event we determine that we most likely would not be able to realize all or part of our deferred tax assets in the future, we would be required to establish a valuation allowance with a charge to earnings and/or other comprehensive income in the period such determination is made. Our judgment and assumptions are subject to change given the inherent uncertainty in predicting future performance or realizing tax planning strategies, which is impacted by such things as severity and frequency of catastrophe losses, current premium rate environment, investment market conditions, and planned loss and expense control initiatives that might not be realized.

REINSURANCE

Reinsurance may not be available, collectible or adequate to protect us against losses, or may cause us to constrain the amount of business we underwrite in certain lines of business and locations.

We use reinsurance to help manage our exposure to insurance risks and to manage our capital. The availability and cost of reinsurance are subject to prevailing market conditions, which can affect our business volume and profitability. Although the reinsurer is liable to us to the extent of the ceded reinsurance, we remain liable as the direct insurer on all risks reinsured. Ceded reinsurance arrangements do not eliminate our obligation to pay claims. As a result, we are subject to counterparty risk with respect to our ability to recover amounts due from reinsurers. Reinsurance may not be adequate to protect us against losses and may not be available to us in the future at commercially reasonable rates. In addition, the magnitude of losses in the reinsurance industry resulting from catastrophes may adversely affect the financial strength of certain reinsurers, which may result in our inability to collect or recover reinsurance. Reinsurers also may reserve their right to dispute coverage with respect to specific claims. With respect to catastrophic or other loss, if we experience difficulty collecting from reinsurers or obtaining additional reinsurance in the future, we will bear a greater portion of the total financial responsibility for such loss, which could materially reduce our profitability or harm our financial condition.

CYCLICAL NATURE OF THE INDUSTRY

The property and casualty insurance industry is highly cyclical, which may cause fluctuations in our operating results.

The property and casualty insurance industry, particularly business insurance, has been historically characterized by periods of intense price competition due to excess underwriting capacity, as well as periods of shortages of underwriting capacity that result in higher prices and more restrictive contract and/or coverage terms. The periods of intense price competition may adversely affect our operating results, and the overall cyclicality of the industry may cause fluctuations in our operating results. While we may adjust prices during periods of intense competition, it remains our strategy to allow for acceptable profit levels and to decline coverage in situations where pricing or risk would not result in acceptable returns. Accordingly, our commercial and specialty lines of business tend to contract during periods of severe competition and price declines and expand when market pricing allows an acceptable return. This can cause volatility in our premium revenues. Our specialty insurance units, RED and Rockhill, market and underwrite commercial exposures through wholesale brokers, program administrators and other specialty sources. The nature of such distribution channels reacting to price competition may result in the movement of business and volatility of premium revenues.

The personal lines businesses are characterized by an auto underwriting cycle of loss cost trends. Driving patterns, inflation in the cost of auto repairs and medical care and increasing litigation of liability claims are some of the more important factors that affect loss cost trends. Inflation in the cost of building materials and

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labor costs and demand caused by weather-related catastrophic events affect personal lines homeowners loss cost trends. Our Company and other personal lines insurers may be unable to increase premiums at the same pace as coverage costs increase. Accordingly, profit margins generally decline in periods of increasing loss costs.

ECONOMIC CONDITIONS

The current and future difficult economic conditions can adversely affect our business, results of operations and financial condition.

Current economic conditions and economic declines in future reporting periods could adversely impact our business and results of operations. While the volatility of the economic climate makes it difficult for us to predict the complete impact of economic conditions on our business and results of operations, our business may be impacted in a variety of ways.

The economy has caused a number of consumers and businesses to decrease their spending, which may impact the demand for our insurance products. For example, declining automotive sales and weaknesses in the housing market generally impact the purchase of our personal auto and homeowners insurance products by consumers and business insurance products by businesses involved in these industries. As unemployment rates rise, there may be a tendency for the number of workers compensation claims to increase, as laid-off and unemployed workers may seek workers compensation benefits to replace their lost health care benefits. Similarly, uninsured and underinsured motorist claims may rise. Vacated homes and business properties pose increased insurance industry risk.

Volatility and weakness in the financial and capital markets may negatively impact the value of our investment portfolio.

We may be adversely affected by business difficulties, bankruptcies and impairments of other parties with whom we do business, such as independent agents, key vendors and suppliers, reinsurers or banks, which increases our credit risk and other counterparty risks. Bankruptcies among our current business insurance customers can negatively affect our retention. Reductions in new business start-ups may negatively affect the number of future potential business insurance customers.

In addition, departments of insurance, taxing authorities and other state and local agencies may seek to impose or increase taxes, assessments and other revenue-generating fees in response to funding reductions caused by economic downturns. These actions may increase the cost of doing business in these states. Economic strains on states and municipalities could result in downgrades or defaults of certain municipal obligations.

In response to economic conditions, the United States federal government and other governmental and regulatory bodies have taken action and may take additional actions to address such conditions. There can be no assurance as to what impact such actions or future actions will have on the financial markets, economic conditions or our Company.

In addition, government spending and monetary policies or other factors may cause the rate of inflation to increase in the future. Inflation can have a significant negative impact on property and casualty insurers because premium rates are established before the amount of losses and loss expenses are known. When establishing rates, we attempt to anticipate increases from inflation subject to the limitations of modeling economic variables. Premium rates may prove to be inadequate due to low trend assumptions arising from the use of historical data. Even when general inflation is relatively modest, price inflation on the goods and services purchased by insurance companies in settling claims can steadily increase. Reserves may develop adversely and become inadequate. Retentions and deductibles may be exhausted more quickly. Interest rate increases in an inflationary environment could cause the values of our fixed income investments to decline.

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Adverse capital and credit market conditions may negatively affect our ability to meet unexpected liquidity needs or to obtain credit on acceptable terms.

The capital and credit markets have been experiencing significant volatility and disruption. In some cases, the markets have negatively affected the availability of liquidity and credit capacity. In the event that we need access to additional capital to pay our operating expenses, make payments on our indebtedness, pay for capital expenditures or fund acquisitions, our ability to obtain such capital may be constrained and the cost of any such capital may be significant. Our ability to obtain additional financing will depend on numerous factors, such as market conditions, the general availability of credit, the overall availability of credit to our industry, our credit ratings and credit capacity, as well as lenders perception of our long- or short-term financial prospects. Our access to funds may also be constrained if regulatory authorities or rating agencies take negative actions. If certain factors were to occur, our internal sources of liquidity may prove to be insufficient and we may not be able to successfully obtain additional financing on satisfactory terms.

DIVIDENDS

We may not be able to receive sufficient dividends from our insurance subsidiaries, and although we have a history of paying cash dividends to our shareholders, there can be no assurance that we will continue to pay cash dividends in the future.

We have a history of consistently paying cash dividends to our shareholders. However, the future payment of cash dividends will depend upon a variety of factors, such as our results of operations, financial condition and cash requirements, as well as the ability of our insurance subsidiaries to make distributions to STFC. State insurance laws restrict the payment of dividends by insurance companies to their shareholders. In addition, competitive pressures generally require insurance companies to maintain insurance financial strength ratings. Such restrictions and other requirements and factors may affect the ability of our insurance subsidiaries to make dividend payments to STFC. Limits on the ability of our insurance subsidiaries to pay dividends could adversely affect our liquidity, including our ability to pay cash dividends to shareholders.

DISTRIBUTION SYSTEM

Our retail agents, who are part of the independent agency distribution channel, are our sole distribution channel for our personal and business insurance segments. Our exclusive use of this distribution channel may constrain our ability to grow at a comparable pace to our competitors that utilize multiple distribution channels. In addition, consumers may prefer to purchase insurance products through alternative channels, such as through the internet, rather than through agents.

We market our insurance products in our personal and business insurance segments exclusively through independent, non-exclusive insurance agents and brokers, whereas some of our competitors sell their insurance products through direct marketing techniques, the internet or captive insurance agents who sell products exclusively for one insurance company. Throughout its history, the State Auto Group has supported the independent agency system as our distribution channel. However, we recognize that although the number of distribution locations has expanded, the number of independent agencies in the industry has dramatically shrunk over the past decade due to agency purchases, consolidations, bankruptcies and agent retirements. We also recognize that it will be progressively more difficult to expand the number of independent agencies representing us. If we are unsuccessful in maintaining and increasing the number of agencies in our independent agency distribution system, our sales and results of operations could be adversely affected.

The retail agents that market and sell our products also sell products of our competitors. These agents may recommend our competitors products over our products or may stop selling our products altogether. Our strategy of not pursuing market share at prices that are not expected to produce an underwriting profit can have the effect of making top line growth more difficult. When price competition is intense, this effect is exaggerated by the fact our independent agent distribution force has products to sell from other carriers that may be more willing to lower prices to grow top line sales. Consequently, we must remain focused on attracting and retaining productive agents to market and sell our products. We compete for productive agents primarily on the basis of our financial position, support services, ease of doing business, compensation and product features. Although we make efforts to ensure we have strong relationships with our retail agents and to persuade them to promote and sell our products, we may not be successful in executing these efforts. If we are unsuccessful in attracting and retaining these agents, our sales and results of operations could be adversely affected.

In addition, consumers are increasingly using the internet and other alternative channels to purchase insurance products. While our website provides a significant amount of information about our insurance products, consumers cannot purchase insurance through our website. Instead, consumers must contact one of our independent agents in order to purchase any of our insurance products or make changes to their existing policies. This primary distribution system may place us at a disadvantage with consumers who prefer to purchase insurance products online or through other alternative distribution channels.

REGULATION

Our business is heavily regulated, and changes in regulation may reduce our profitability and limit our growth.

We are subject to extensive regulation in the states in which we conduct business. This regulation is generally designed to protect the interests of policyholders, as opposed to stockholders and other investors, and relates to authorization for lines of business, capital and surplus requirements, investment limitations, underwriting limitations, transactions with affiliates, dividend limitations (see Regulation-Dividends in Item 1), changes in control, premium rates and a variety of other financial and non-financial components of an insurance company s business. The NAIC and state insurance regulators are constantly reexamining existing laws and regulations, generally focusing on modifications to holding company regulations, interpretations of existing laws and the development of new laws.

From time to time, some states in which we conduct business have considered or enacted laws that may alter or increase state authority to regulate insurance companies and insurance holding companies. In other situations, states in which we conduct business have considered or enacted laws that impact the competitive environment and marketplace for property and casualty insurance.

Nearly all states require licensed insurers to participate in guaranty funds through assessments covering a portion of insurance claims against impaired or insolvent insurers. An increase in the magnitude of impaired companies could result in an increase in our share of such assessments. Residual market or pooling arrangements exist in many states to provide certain types of insurance coverage to those that are otherwise unable to find private insurers willing to insure them. Licensed insurers voluntarily writing such coverage are required to participate in these residual markets or pooling mechanisms. Such participation exposes the Company to possible assessments, some of which could be material to our results of operations. The potential availability of recoupments or premium rate increases, if applicable, may not offset such assessments in the financial statements nor do so in the same fiscal periods.

Many of the states in which we operate have passed or are considering legislation restricting or banning the use of credit scoring in rating and/or risk selection in personal lines of business. Similarly, several states are considering restricting insurers rights to use loss history information maintained in various databases by insurance support organizations. These tools help us price our products more fairly and enhance our ability to compete for business that we believe will be profitable. Such regulations would limit our ability, as well as the ability of all other insurance carriers operating in any affected jurisdiction, to take advantage of these tools.

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Currently the federal government does not directly regulate the insurance business. However, in recent years the state insurance regulatory framework has come under increased federal scrutiny. Congress and some federal agencies from time to time investigate the current condition of insurance regulation in the United States to determine whether to impose federal regulation or to allow an optional federal charter, similar to banks. In addition, changes in federal legislation and administrative policies in several areas, including changes in the Gramm-Leach-Bliley Act, financial services regulation and federal taxation, or repeal of McCarran-Ferguson Act (which largely exempts the insurance industry from the federal antitrust laws), could significantly impact the insurance industry and us.

The Federal Insurance Office was established in 2010 by the enactment of the Dodd-Frank Act. The Federal Insurance Office will be a separate office within the United States Department of Treasury. While lacking regulatory authority, the primary objectives of the Federal Insurance Office will be to monitor, collect data and report on the insurance industry. It is not known how this federal office will coordinate and interact with the NAIC and state insurance regulators.

We cannot predict with certainty the effect any enacted, proposed or future state or federal legislation or NAIC initiatives may have on the conduct of our business. Furthermore, there can be no assurance that the regulatory requirements applicable to our business will not become more stringent in the future or result in materially higher costs than current requirements. For example, concerns over climate change may prompt federal, state or local laws intended to protect the environment. Changes in the regulation of our business may reduce our profitability, limit our growth or otherwise adversely affect our operations.

We could be adversely affected if our controls designed to assure compliance with guidelines, policies, and legal and regulatory standards are ineffective. Our business is dependent on our ability to regularly engage in a large number of insurance underwriting, claim processing, personnel and human resources, and investment activities, many of which are complex. These activities often are subject to internal guidelines and policies, as well as legal and regulatory requirements. No matter how well designed and executed, control systems provide only reasonable assurance that the system objectives will be met. If our controls are not effective, it could lead to financial loss, unexpected risk exposures or damage to our reputation.

Tax legislation initiatives or challenges to our tax positions could adversely affect our results of operations and financial condition.

We are subject to the tax laws and regulations of the United States federal, state and local governments. From time to time, various legislative initiatives may be proposed that could adversely affect our tax positions. There can be no assurance that our effective tax rate or tax payments will not be adversely affected by these initiatives. In addition, United States federal, state and local tax laws and regulations are extremely complex and subject to varying interpretations. There can be no assurance that our tax positions will not be challenged by relevant tax authorities or that we would be successful in any such challenge.

CLAIM AND COVERAGE DEVELOPMENTS

Developing claim and coverage issues in our industry are uncertain and may adversely affect our insurance operations.

As industry practices and legislative, judicial and regulatory conditions change, unexpected and unintended issues related to claims and coverage may develop. These issues could have an adverse effect on our business by either extending coverage beyond our underwriting intent or by increasing the frequency or severity of claims. The premiums we charge for our insurance products are based upon certain risk expectations. When legislative, judicial or regulatory authorities expand the burden of risk beyond our expectations, the premiums we previously charged or collected may no longer be sufficient to cover the risk, and we do not have the ability to retroactively modify premium amounts. Furthermore, our reserve estimates do not take into consideration a major retroactive expansion of coverage through legislative or regulatory actions or judicial interpretations.

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In particular, court decisions have had, and are expected to continue to have, significant impact on the property and casualty insurance industry. Court decisions may increase the level of risk which insurers are expected to assume in a number of ways, such as by eliminating exclusions, increasing limits of coverage, creating rights in claimants not intended by the insurer and interpreting applicable statutes expansively to create obligations on insurers not originally considered when the statute was passed. In some cases, court decisions have been applied retroactively. Court decisions have also negated legal reforms passed by state legislatures.

There is also a growing trend of plaintiffs targeting property and casualty insurers, including us, in purported class action litigation relating to claim-handling and other practices, particularly with respect to the handling of personal lines auto and homeowners claims.

There are concerns that the focus on climate change and global warming could effect court decisions or result in litigation, including potential matters arising from federal, state or local laws intended to protect the environment.

Many of these issues are beyond our control. The effects of these and other unforeseen claims and coverage issues are extremely hard to predict and could materially harm our business and results of operations.

LITIGATION

We may suffer losses from litigation, which could materially and adversely affect our operating results or cash flows and financial condition.

As is typical in our industry, we face risks associated with litigation of various types, including disputes relating to insurance claims under our policies, as well as other general commercial and corporate litigation. Litigation is subject to inherent uncertainties and in the event of an unfavorable outcome in one or more litigation matters, the ultimate liability may be in excess of amounts currently reserved and may be material to our operating results or cash flows for a particular quarter or annual period and to our financial condition.

TERRORISM

Terrorist attacks, and the threat of terrorist attacks, and ensuing events could have an adverse effect on us.

Terrorism, both within the United States and abroad, and military and other actions and heightened security measures in response to these types of threats, may cause loss of life, property damage, reduced economic activity, and additional disruptions to commerce. Actual terrorist attacks could cause losses from insurance claims related to the property and casualty insurance operations of the State Auto Group, as well as a decrease in our stockholders equity, net income and/or revenue. The Terrorism Acts require the federal government and the insurance industry to share in insured losses up to $100 billion per year resulting from certain terrorist attacks within the United States. Under the Terrorism Acts, we must offer our commercial policyholders coverage against certified acts of terrorism. In December 2007, the United States Congress extended the Terrorism Acts through December 31, 2014, and made some modest changes to the Terrorism Acts. See Regulation in this Item 1 for a discussion of the Terrorism Acts.

In addition, some of the assets in our investment portfolio may be adversely affected by declines in the equity markets and economic activity caused by the continued threat of terrorism, ongoing military and other actions and heightened security measures. We cannot predict at this time whether and the extent to which industry sectors in which we maintain investments may suffer losses as a result of potentially decreased commercial and economic activity, or how any such decrease might impact the ability of companies within the affected industry sectors to pay interest or principal on their securities, or how the value of any underlying collateral might be affected.

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INVESTMENTS

The performance of our investment portfolios is subject to investment risks.

Like other property and casualty insurance companies, we depend on income from our investment portfolio for a portion of our revenues and earnings and are therefore subject to market risk, credit risk and the risk that we will incur losses due to adverse changes in equity, interest, commodity or foreign currency exchange rates and prices. Our primary market risk exposures are to changes in interest rates and equity prices. Future increases in interest rates could cause the values of our fixed income portfolios to decline, with the magnitude of the decline depending on the duration of our portfolio. Individual securities in our fixed income portfolio are subject to credit risk and default. Downgrades in the credit ratings of fixed maturities can have a significant negative effect on the market valuation of such securities. For example, budget strains on certain states and local governments could negatively affect the credit quality and ratings of their issued securities.

If the fixed income or equity portfolios, or both, were to be impaired by market, sector or issuer-specific conditions to a substantial degree, our liquidity, financial position and financial results could be materially adversely affected. Under these circumstances, our income from these investments could be materially reduced, and declines in the value of certain securities could further reduce our reported earnings and capital levels. A decrease in value of our investment portfolio could also put our insurance subsidiaries at risk of failing to satisfy regulatory minimum capital requirements. If we were not at that time able to supplement our subsidiaries capital from STFC or by issuing debt or equity securities on acceptable terms, our business could be materially adversely affected. Also, a decline in market rates of fixed income securities or a decline in the fair value of equity securities could cause the investments in our pension plans to decrease, resulting in additional expense and increasing required contributions to the pension plan.

In addition, our investments are subject to risks inherent in the nation s and world s capital markets. The functioning of those markets, the values of the investments held by us and our ability to liquidate investments on favorable terms or short notice may be adversely affected if those markets are disrupted or otherwise affected by local, national or international events, such as power outages, system failures, wars or terrorist attacks or by recessions or depressions, a significant change in inflation expectations, a significant devaluation of governmental or private sector credit, currencies or financial markets and other factors or events.

Changes in tax laws impacting marginal tax rates and/or the preferred tax treatment of municipal obligations under current law, could adversely affect the market value of municipal obligations. Since a majority of our investment portfolio is invested in tax-exempt municipal obligations, any such changes in tax law could adversely affect the value of the investment portfolio. Additionally, any such changes in tax law could reduce the difference between tax-exempt interest rates and taxable rates.

EMPLOYEES

Our ability to attract, develop and retain talented employees, managers and executives, and to maintain appropriate staffing levels, is critical to our success.

Our success depends on our ability to attract, train, develop and retain talented, diverse employees, including executives and other key managers in a specialized industry. Our loss of certain key officers and employees or the failure to attract and develop talented new executives and managers could have a materially adverse effect on our business. Talent management is a key consideration in our specialty insurance segment, which requires specialized product underwriting, claims handling and risk management services and involves distribution through channels other than our retail agents.

In addition, we must forecast the changing business environments (for multiple business units and in many geographic markets) with reasonable accuracy and adjust hiring programs and/or employment levels accordingly.

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Our failure to recognize the need for such adjustments, or the failure or inability to react appropriately on a timely basis, could lead either to over-staffing (which would adversely affect our cost structure) or under-staffing (impairing our ability to execute and effectively service our ongoing and new business) in one or more business units or locations. In either event, our financial results could be materially adversely affected.

ACQUISITIONS

Acquisitions subject us to a number of financial and operational risks.

Since going public in 1991, we and State Auto Mutual have acquired or affiliated with other insurance companies, most recently the 2009 acquisition of the Rockhill Insurance Group by State Auto Mutual. It is anticipated that we and State Auto Mutual will continue to pursue acquisitions or affiliations of other insurance companies in the future.

Insurance company acquisitions and affiliations involving State Auto Mutual generally do not have a material financial impact on State Auto Financial unless and until the target insurers are added to our Pooling Arrangement, such as the addition of the Rockhill Insurance Group as of January 1, 2011.

Acquisitions and affiliations involve numerous risks and uncertainties, such as:

- obtaining necessary regulatory approvals may prove to be more difficult than anticipated;
- integrating the business may prove to be more costly than anticipated;
- integrating the business without material disruption to existing operations may prove to be more difficult than anticipated;
- anticipated cost savings may not be fully realized (or not realized within the anticipated time frame);
- loss results of the acquired or affiliated company or business may be worse than expected;
- losses may develop differently than what we expected them to; and
- retaining key employees of the acquired company or business may prove to be more difficult than anticipated.

In addition, other companies in the insurance industry have similar acquisition and affiliation strategies. Competition for target companies or businesses may intensify or we may not be able to complete such acquisitions or affiliations on terms and conditions acceptable to us. There is no assurance that any businesses acquired in the future will be successfully integrated. Ineffective integration may adversely affect our results and our ability to compete. Also, the acquired business may not perform as projected and anticipated cost savings and other synergies may not be realized.

FINANCIAL STRENGTH RATINGS

A downgrade in our financial strength ratings may negatively affect our business.

Insurance companies are subject to financial strength ratings produced by external rating agencies. Higher ratings generally indicate financial stability and a strong ability to pay claims. Ratings are assigned by rating agencies to insurers based upon factors that they believe are relevant to policyholders and creditors. Ratings are important to maintaining public confidence in our Company and in our ability to market our products. A downgrade in our financial strength ratings could, among other things, negatively affect our ability to sell certain insurance products, our relationships with agents and our ability to compete. In May 2010, Standard & Poor s lowered our financial strength rating from A to A- with stable outlook primarily because of our recent operating and financial results in comparison to our historical results, among other factors.

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Although other agencies cover the property and casualty industry, we believe our ability to write business is most influenced by our rating from A.M. Best. According to A.M. Best, its ratings are designed to assess an insurer s financial strength and ability to meet ongoing obligations to policyholders. Our Pooled Companies currently have a rating from A.M. Best Company of A+ (Superior) (the second highest of A.M. Best s 15 ratings) with negative outlook. We may not be able to maintain our current A.M. Best or Standard & Poor s ratings, or our current ratings from other rating agencies.

CONTROL BY OUR PARENT COMPANY

Our parent company owns a significant interest in us and may exercise its control in a manner detrimental to your interests.

As of December 31, 2010, our parent company owned approximately 63% of the voting power of our Company. Therefore, State Auto Mutual has the power to direct our affairs and is able to determine the outcome of substantially all matters required to be submitted to stockholders for approval, including the election of all our directors. State Auto Mutual could exercise its control over us in a manner detrimental to the interests of other STFC stockholders.

COMPETITION

Our industry is highly competitive, which could adversely affect our sales and profitability.

The property and casualty insurance business is highly competitive, and we compete with a large number of other insurers. Many of our competitors have well-established national reputations, and substantially greater financial, technical and operating resources and market share than we. We may not be able to effectively compete, which could adversely affect our sales or profitability. We believe that competition in our lines of business is based primarily on price, service, commission structure, product features, financial strength ratings, producer relationships, reputation and name or brand recognition. Our competitors sell through various distribution channels, including independent agents, captive agents and directly to the consumer. We compete not only for personal and business insurance customers, but also for independent agents and brokers to market and sell our products. Our specialty insurance segment faces competitors attempting to sell their products through the distribution system of wholesale brokers, program administrators and other specialty sources. Some of our competitors offer a broader array of products, have more competitive pricing or have higher claims paying ability ratings. In addition, other financial institutions are now able to offer services similar to our own as a result of the Gramm-Leach-Bliley Act.

The increased transparency that arises from information available from the use of tools such as comparative rater software, could work to our disadvantage. We may have difficulty differentiating our products or becoming among the lowest cost providers. Expense efficiencies are important to maintaining and increasing our growth and profitability. If we are unable to efficiently execute and realize future expense efficiencies, it could affect our ability to establish competitive pricing and could have a negative effect on new business growth and retention of existing policyholders.

VOLATILITY OF OUR COMMON STOCK

The price of our common stock could be volatile.

The trading price of our common stock may fluctuate substantially due to a variety of factors, some of which may not be related to our operating performance and are beyond our control. Such factors include, but are not limited to, the following: volatility and variations in our actual or anticipated operating results or changes in the expectations of financial market analysts; investor perceptions of our Company and/or the property and casualty industry; market conditions in the insurance industry and any significant volatility in the market; and major catastrophic events.

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Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We share our operating facilities with State Auto Mutual pursuant to the terms of the 2005 Management Agreement. Our corporate headquarters are located in Columbus, Ohio, in buildings owned by State Auto Mutual that contain approximately 280,000 square feet of office space. Our Company and State Auto Mutual also own and lease other office facilities in numerous locations throughout the State Auto Group s geographical areas of operation.

Item 3. Legal Proceedings

We are involved in a number of lawsuits, and may become involved in other potential litigation, arising in the ordinary course of our business. Generally, our involvement in a lawsuit involves defending third-party claims brought against our insureds in our role as liability insurer or against us as a principal of surety bonds, as well as defending policy coverage claims brought against us. We consider all lawsuits relating to such insurance claims in establishing our loss and loss adjustment expense reserves.

The following describes the significant pending legal proceedings, other than ordinary routine litigation incidental to our business, to which State Auto Financial or any of its subsidiaries is a party or to which any of our property is subject:

In December 2010, a putative class action lawsuit (Kelly vs. State Automobile Mutual Insurance Company, et al.) was filed against State Auto Financial, State Auto P&C and State Auto Mutual in state court in Ohio. In this lawsuit, plaintiffs allege that the State Auto Group has engaged, and continues to engage, in deceptive practices by failing to disclose to plaintiffs the availability, through one or more related companies, of insurance policies providing for identical coverage and service as those policies purchased by plaintiffs but at a lower premium amount. Plaintiffs are seeking class certification and compensatory and punitive damages to be determined by the court and restitution and/or disgorgement of profits derived from plaintiffs and the alleged class. We filed a motion to dismiss on March 1, 2011, and it remains pending. We believe our practices with respect to pricing, quoting and selling our insurance policies are in compliance with all applicable laws, deny any and all liability to plaintiffs or the alleged class, and intend to vigorously defend this lawsuit.

We accrue for a litigation-related liability, other than insurance claims, when it is probable that such a liability has been incurred and the amount of the loss can be reasonably estimated. Based on currently available information known to us, we believe that our reserves for these litigation-related liabilities are reasonable and that the ultimate outcomes of any pending matters are not likely to have a material adverse effect on our consolidated financial position or results of operations. However, regarding the putative class action litigation described above, it is not currently possible to predict the legal outcome of this litigation or its impact on the future development of claims and litigation relating to similar claims. Any such development will be affected by future court decisions and interpretations. Because of these uncertainties, additional liabilities may arise in amounts in excess of our currently held reserves. In addition, our estimate of ultimate claims and claim adjustment expenses may change. These additional liabilities or increases in estimates, or a range of either, cannot now be reasonably estimated and could result in income statement charges that could be material to our results of operations in future periods.

Additionally, our insurance subsidiaries may be impacted by adverse regulatory actions and adverse court decisions where insurance coverages are expanded beyond the scope originally contemplated in our insurance policies. We believe that the effects, if any, of such regulatory actions and published court decisions are not likely to have a material adverse effect on our financial position or results from operations.

Item 4. Reserved

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PART II

Item 5. Market for the Registrant s Common Equity, Related Shareholder Matters, and Issuer Purchases of Equity Securities

Market Information; Holders of Record

Our common shares are traded on the NASDAQ Global Select Market under the symbol STFC. As of February 25, 2011, there were 1,348 stockholders of record of our common shares.

Market Price Ranges and Dividends Declared on Common Shares

Initial Public Offering June 28, 1991 $2.25[1] The following table sets forth information with respect to the high and low sale prices of our common shares for each quarterly period for the past two years as reported by NASDAQ, along with the amount of cash dividends declared by us with respect to our common shares for each quarterly period for the past two years:

2010	**High**	**Low**	**Dividend**
First Quarter	**$ 19.06**	**$ 15.11**	**$ 0.15**
Second Quarter	**20.38**	**15.42**	**0.15**
Third Quarter	**16.30**	**13.40**	**0.15**
Fourth Quarter	**17.89**	**15.06**	**0.15**

2009	High	Low	Dividend
First Quarter	$ 30.25	$ 14.29	$ 0.15
Second Quarter	18.64	14.75	0.15
Third Quarter	18.56	15.62	0.15
Fourth Quarter	18.92	15.54	0.15

(1) Adjusted for stock splits.

On March 4, 2011, the Board of Directors of State Auto Financial declared a cash dividend of $0.15 per share. The dividend is payable on March 31, 2011, to shareholders of record on March 14, 2011. Additionally, see Item 7 of this Form 10-K, Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Regulatory Considerations, for additional information regarding regulatory restrictions on the payment of dividends to State Auto Financial by its insurance subsidiaries.

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Performance Graph

The line graph below compares the total return on $100 invested on December 31, 2005, in STFC s shares, the CRSP Total Return Index for the NASDAQ Stock Market (NASDAQ Index), and the CRSP Total Return Index for NASDAQ insurance stocks (NASDAQ Ins. Index), with dividends reinvested.

	12/31/2005	12/31/2006	12/31/2007	12/31/2008	12/31/2009	**12/31/2010**
STFC	100.000	96.160	74.311	86.630	55.227	**53.940**
NASDAQ Index	100.000	110.335	122.063	73.483	106.814	**126.202**
NASDAQ Ins. Index	100.000	113.726	114.725	103.742	107.207	**126.646**

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Item 6. Selected Consolidated Financial Data

(dollars and shares in millions, except per share data)	Year ended December 31:				
	2010*	2009	2008*	2007	2006
Statement of Income Data					
GAAP Basis:					
Earned premiums	**$ 1,257.2**	1,176.5	1,126.0	1,011.6	1,023.8
Net investment income	**$ 80.8**	82.1	87.4	84.7	83.1
Total revenues	**$ 1,355.1**	1,256.9	1,181.9	1,113.4	1,117.4
Net income (loss)	**$ 24.5**	10.2	(31.1)	119.1	120.4
Earned premium growth	**6.9%**	4.5	11.3	(1.2)	(2.5)
Return on average invested assets[(1)]	**3.6%**	3.9	4.1	4.3	4.4
Balance Sheet Data					
GAAP Basis:					
Total investments	**$ 2,307.1**	2,179.1	1,941.3	2,021.2	1,937.9
Total assets	**$ 2,722.0**	2,564.5	2,443.6	2,337.9	2,255.1
Total notes payable	**$ 116.8**	117.2	117.6	118.0	118.4
Total stockholders equity	**$ 851.8**	849.4	761.0	935.5	834.2
Common shares outstanding	**40.1**	39.8	39.5	40.5	41.0
Return on average equity	**2.9%**	1.3	(3.7)	13.5	15.1
Debt to capital ratio	**12.1%**	12.1	13.4	11.2	12.4
Per Common Share Data					
GAAP Basis:					
Basic EPS	**$ 0.61**	0.26	(0.78)	2.90	2.95
Diluted EPS	**$ 0.62**	0.25	(0.78)	2.86	2.90
Cash dividends per share	**$ 0.60**	0.60	0.60	0.50	0.38
Book value per share	**$ 21.23**	21.33	19.23	23.10	20.32
Common Share Price:					
High	**$ 20.38**	30.25	37.08	35.22	39.94
Low	**$ 13.40**	14.29	17.38	23.99	28.40
Close at December 31	**$ 17.42**	18.50	30.06	26.30	34.68
Close price to basic EPS	**28.56**	71.15	(38.54)	9.07	11.76
Close price to book value per share	**0.82**	0.87	1.56	1.14	1.71
GAAP Ratios:					
Loss and LAE ratio	**70.8%**	71.7	75.2	58.4	57.4
Expense ratio	**33.8%**	34.1	34.6	34.4	34.0
Combined ratio	**104.6%**	105.8	109.8	92.8	91.4
Statutory Ratios:					
Loss and LAE ratio	**70.3%**	71.3	74.8	57.9	56.8
Expense ratio	**32.9%**	33.5	33.1	33.2	32.9
Combined ratio	**103.2%**	104.8	107.9	91.1	89.7
Net premiums written to surplus	**1.7**	1.5	1.6	1.1	1.2

(1) Invested assets include investments and cash equivalents.

* Reflects changes in Pooling Arrangement, effective January 1, 2010 and 2008.

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

Capitalized terms used in this Item 7 and not otherwise defined have the meanings ascribed to such terms under the caption Important Defined Terms Used in this Form 10-K which immediately precedes Part I of this Form 10-K. This discussion should be read in conjunction with the consolidated financial statements and notes thereto included in Item 8 of this Form 10-K and the narrative description of our business contained in Item 1 of this Form 10-K.

OVERVIEW

State Auto Financial is a property and casualty insurance holding company. Our insurance subsidiaries are part of the State Auto Group and Pooling Arrangement described below. The State Auto Group markets a broad line of property and casualty insurance products in all 50 states and the District of Columbia exclusively through independent insurance agencies, which include retail agents and wholesale brokers. Our Pooled Companies are rated A+ (Superior) by the A.M. Best Company.

State Auto Financial s principal subsidiaries are State Auto P&C, Milbank, Farmers and SA Ohio, each of which is a property and casualty insurance company, and Stateco, which provides investment management services to affiliated insurance companies.

Prior to January 1, 2011, we operated our business in three reportable segments: personal insurance, business insurance (collectively the insurance segments or our insurance segments) and investment operations. The three segments reflected the manner in which we managed our business and reported our results internally to our principal operating decision makers. The personal insurance segment provides primarily personal auto and homeowners to the personal insurance market. The business insurance segment provides primarily commercial auto, commercial multi-peril, fire & allied lines, other & product liability and workers compensation insurance to small-to-medium sized businesses within the commercial insurance market. The investment operations segment, managed by Stateco, provides investment services for our invested assets. In 2010, the State Auto Group began writing new commercial specialty business through RED, which allowed us to offer insurance coverages in the program and alternative risk markets for business products such as general liability, commercial auto, workers compensation and property. In 2010, the financial results of business written through RED were included in our business insurance segment results.

With the acquisition of the Rockhill Insurance Group and the build out of RED, in 2010, management focused on assessing and positioning a realignment of our internal organization, including people, processes and compensation reward programs, to be more strategic in the personal, business and specialty insurance markets. Considering these internal changes, and with the inclusion of the Rockhill Insurers into the Pooling Arrangement as of January 1, 2011, our reportable insurance segments will change from personal and business insurance to personal insurance, business insurance and specialty insurance, aligning how these insurance segments report to our principal operating decision makers.

We evaluate the performance of our insurance segments using industry financial measurements determined based on SAP, and certain measures determined under GAAP. We evaluate our investment operations segment based on investment returns of assets managed. Financial information about our segments for 2010 is set forth in this Item 7 and in Note 16 to our consolidated financial statements included in Item 8 of this Form 10-K.

EXECUTIVE SUMMARY

In order to improve our operating and financial results, we focus on four performance drivers rational growth, underwriting profit, risk management, and capital management.

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Rational Growth

Our growth in 2008 and 2009 outperformed the industry, which generally contracted, and based on preliminary data now available to us, we believe our premium growth again outperformed the industry in 2010. We consider rational growth to be premium growth that matches or exceeds the premium growth rates of designated peer property and casualty insurance companies, as well as the property and casualty insurance industry as a whole, while still considering underwriting profit, risk management, and capital management.

There are primarily two ways we grow our business. The first way is referred to as organic growth. This means we either sell more policies or increase the price of our product. Ideally, we will accomplish both simultaneously. Organic growth is challenging, especially in a stagnant economy and well-capitalized industry. If the price of our product is too high, customers may go elsewhere, and so the desired premium increases could be offset by a reduction in policy count. If the price is too low, we could increase our policy count at the risk of surrendering profit.

We also seek growth in ways other than price. When we are faced with untenably low prices from our competition, our goal is to remain an attractive market to our insureds, retail agents and wholesale brokers by stressing the strengths we bring to the marketplace, such as our product offerings and innovation; underwriting criteria; quality of service to insureds, retail agents and wholesale brokers; relationships with our retail agents and wholesale brokers; prompt and fair claims handling and settlement; financial stability; and technology, making us a preferred business partner.

Organic growth in our business insurance segment, other than our RED book of business, has been more difficult for us to achieve than growth in our personal insurance segment. The primary reasons are the continued impact of the economy on premium bases and our commitment to underwriting. The business lines segment has been extremely competitive. Generally, business lines premiums and coverages are higher per policy than personal lines. Until the market accepts adequately priced product, we will be challenged to grow our standard business insurance book. However, we are seeking to balance our traditional underwriting discipline with new products and pricing tools that support the production of profitable new business. Our industry is characterized by its cyclical nature. During the current phase in the cycle, we are willing to sacrifice premium growth in our business lines in favor of achieving underwriting profitability.

While organic growth in the standard business insurance market has been difficult, we are competing effectively in the personal lines market. Our retail agents are finding attractive sales opportunities for auto and homeowners business. In addition, because we are heavily cross-sold in personal lines and continue to experience strong retention, we are well positioned to benefit from this trend.

Alternatively, we can grow by acquiring other companies and their distribution points, entering new states, offering new products, appointing new agents or offering our products through alternative distribution channels. This can be generally labeled as growth through merger and acquisition. Since STFC went public in 1991, the State Auto Group has successfully acquired six insurance groups comprising more than a dozen companies. Acquisition, as opposed to organic growth, has several advantages. It can be a practical, efficient way to leverage the acquired company s existing channel relationships when introducing our products and services into a new state or new markets, rather than appointing one agent at a time, which can be expensive and difficult. Often acquisitions bring with it needed talent and competencies to the larger State Auto Group. An acquisition though, is also a major investment of capital. Immediate consequences of a poor acquisition choice can include overstaffing, incompatible automation systems and an ineffective distribution force.

We believe it is important to have processes and talent in place to grow both organically and through mergers and acquisitions. In 2009, our parent, State Auto Mutual, took a major growth step by acquiring the Rockhill Insurance Group, a specialty property and casualty insurance group, serving both the standard and excess and surplus lines insurance markets, whose product lines include commercial auto, property, bonds (surety and fidelity) and general liability. RED acts as a managing general underwriter for a variety of property and casualty coverages in the program and alternative risk markets. The insurers owned by RTW provide

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workers compensation coverage. While our top line growth in business insurance benefited from RED in 2010, we will see additional benefit from the other specialty businesses of Rockhill and RTW, when the financial results of these units are incorporated into our pooled results beginning January 1, 2011. We believe the growth and profit potential are excellent and provide diversification to our current product lines.

Underwriting Profit

We have long been known as an insurance company that produces an underwriting profit. Our combined ratio, however, has exceeded 100% for the last three years. It is critical to us that we return homeowners to underwriting profitability. Homeowners insurance is our second largest product concentration, after standard auto. A multi-year effort to implement solutions has produced an aggressive insurance to value program that audits policy coverage against the actual value of the property. We have also implemented separate, mandatory wind and hail deductibles for properties in select states and by-peril rating for homeowners in key states. By-peril rating calculates a separate premium for each peril and allows us to price more effectively for weather differences, which is the leading cause of homeowners losses. Our claim handling has become more specialized, with the addition of dedicated large and small property claim handlers and the formation of a catastrophe claim team, lessening our dependency on independent adjusters. We are also continuing our efforts to diversify geographically, with particular emphasis on those areas less prone to catastrophic property losses. Underwriting results in homeowners have improved in 2010.

Pricing the property and casualty insurance product has become a sophisticated science, and to that end we have made significant investment in our actuarial and financial teams, adding depth and talent to these important functions. We are dedicated to cost-based pricing, with each line of business priced to generate a profit. We implement periodic rate changes throughout our states.

Underwriting profitably requires more than sensible pricing, coverage enhancements and discerning risk evaluation. By reducing the per policy costs of operating our business, we increase the profit margin. In early 2009, we began a restructuring of our field and claims operations. We are seeing productivity and expense ratio improvements. The restructuring meant a reduction in both the personal and commercial lines staffs and an increase in our information technology and claims personnel. While difficult for us, these reductions were necessary, and we believe we handled the reductions with sensitivity, including providing severance packages and retirement incentives to those associates affected.

Changes currently underway in our claim organization are expected to positively impact indemnity payout, improve service and reduce costs. We have already reduced salvage yard vendor fees through negotiation with vendors. A new auto physical damage unit has significantly reduced independent adjuster expenses and improved indemnity benefits on auto physical damage claims. The expansion of our house counsel operation not only contributes to a lower loss ratio, but also improves service.

Risk Management

The objective of our enterprise risk management program is to help identify, understand, communicate and assure satisfactory mitigation or exploitation of risks associated with our business. Numerous risks are addressed, including a variety of underwriting, operational, market, credit and strategic risks. All of our business units play important roles in risk identification and in developing and executing risk mitigation strategies.

An internal, multi-disciplined team was formed in 2010 to address our geographic spread of risk and catastrophe loss exposure. Weather related catastrophes, including localized wind and hail storms, have been an onerous variable in our profitability formula in recent years, contributing to volatility in our financial results. We remain committed to taking steps to more effectively manage our catastrophe exposures and improve our geographic diversification. The combination of walking away from business in high risk or highly concentrated areas, while growing more aggressively in areas with lower property exposures or in less catastrophe-prone areas,

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or in areas where the catastrophe risk is uncorrelated to our existing footprints, are effective approaches to spread risk. Our merger and acquisition strategy also contributes to spread of risk. For example, the RED, Rockhill and RTW operations provide an additional measure of product and geographical diversification.

Catastrophe exposure management focuses on the perils of hurricane, earthquake, severe thunderstorms, tornadoes and hail. Computer modeling is used to project estimates of potential losses from these events. Such modeling is an important element of designing our property reinsurance programs. The results of hurricane modeling affect our risk appetites across six relevant geographic zones: Texas, the Gulf States, Florida, the Southeast, the Mid-Atlantic, and the Northeast. Modeling for severe thunderstorms, tornadoes and hail has helped us identify areas of Midwest property concentrations for reduction or constraint, as well as areas with lower and/or uncorrelated exposure to target for growth.

Risk management is also relevant to our business operations. In 2010, State Auto Mutual completed the construction of a new data center located more than 20 miles from our corporate headquarters, and we are in the process of migrating many of our IT functions to it. Its state-of-the-art design allows it to function securely under work load and environmental pressures. The commitment to make our data centers and processing systems secure and dependable is ongoing and, given the critical nature of information technology, will continue to remain a risk management priority.

Capital Management

In capital management, our number one goal remains preserving capital and enhancing liquidity in order to maintain a financial strength rating from A.M. Best that will enable us to maintain our preferred partnership status with our insureds, retail agents and wholesale brokers. STFC has paid a dividend every quarter since its inception in 1991, and has never lowered that dividend. We have maintained a debt to capital ratio that reinforces our strong capital structure.

Members of the State Auto Group pay a portion of the premiums received to reinsurers in exchange for reinsuring a portion of their exposures. This is done primarily to reduce net liability on individual risks or for individual loss occurrences, including catastrophic losses. We maintain reserves for the eventual payment of losses and loss expenses for both reported claims and IBNR, based on management s best estimate at a given point in time. Although management uses many resources to calculate reserves, there is no precise method for determining the ultimate liability. Our objective is to set reserves that reasonably approximate the ultimate liability for insured losses and loss expenses. We regularly review and adjust loss reserves as appropriate.

Our disciplined investment strategy emphasizes the quality of our investment grade fixed maturity portfolio and an internally managed, diversified equity portfolio. We have diversified our equity portfolio, utilizing outside managers to invest in U.S. small-cap equities and international equity funds. This was designed to achieve greater total return over time with reduced volatility. We suffered investment losses in the broad-based and dramatic market decline in 2008, but we have since more than recovered those losses in the healthier markets of 2009 and 2010. In our opinion, a diversified portfolio heavily weighted in investment grade bonds, coupled with a diversified equity portfolio, is the right strategy for most market cycles.

CRITICAL ACCOUNTING POLICIES

Our significant accounting policies are more fully described in Note 1 of the notes to our consolidated financial statements included in Item 8 of this Form 10-K. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet, revenues and expenses for the period then ended and the financial entries in the accompanying notes to the financial statements. Such estimates and assumptions could change in the future, as more information becomes known which could impact the amounts reported and disclosed in this Item 7. We have identified the policies and estimates described below as critical to our business operations and the understanding of the results of our operations.

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Investments

Our fixed maturity, equity security and certain other invested asset investments are classified as available-for-sale and carried at fair value. The unrealized holding gains or losses, net of applicable deferred taxes, are shown as a separate component of stockholders equity in accumulated other comprehensive income (loss), and as such are not included in the determination of net income. Investment income is recognized when earned, and capital gains and losses are recognized when investments are sold.

We regularly monitor our investment portfolio for declines in value that are other-than-temporarily impaired (OTTI), an assessment that requires significant management judgment regarding the evidence known. Such judgments could change in the future as more information becomes known which could negatively impact the amounts reported herein. We consider the following factors when assessing our equity securities and other invested assets for OTTI: (1) the length of time and/or the significance of decline below cost; (2) our ability and intent to hold these securities through their recovery periods; (3) the current financial condition of the issuer and its future business prospects; and (4) the ability of the market value to recover to cost in the near term. We recognize OTTI charges on our externally managed small-cap equity portfolio and a segment of our large-cap portfolio, as we are unable to make the assertion regarding our intent to hold these securities that are currently valued below cost until recovery in the near term. When an equity security or other invested asset has been determined to have a decline in fair value that is other-than-temporary, we adjust the cost basis of the security to fair value. This results in a charge to earnings as a realized loss, which is not reversed for subsequent recoveries in fair value. Future increases or decreases in fair value, if not other-than-temporary, are included in accumulated other comprehensive income (loss).

We also consider the following factors when assessing our fixed maturity investments for OTTI: (1) the financial condition of the issuer including receipt of scheduled principal and interest cash flows; (2) our intent to sell; and (3) if it is more likely than not that we will be required to sell the investments before recovery. When a fixed maturity has been determined to have an other-than-temporary impairment, the impairment charge is separated into an amount representing the credit loss, which is recognized in earnings as a realized loss, and the amount related to non-credit factors, which is recognized in accumulated other comprehensive income (loss). Future increases or decreases in fair value, if not other-than-temporary, are included in accumulated other comprehensive income (loss).

Deferred Acquisition Costs

Acquisition costs, consisting of commissions, premium taxes and certain underwriting expenses relating to the production of property and casualty business, are deferred and amortized over the same period in which the related premiums are earned. The method followed for computing the acquisition costs limits the amount of such deferred costs to their estimated realizable value. In determining estimated realizable value, the computation gives effect to the premiums to be earned, losses and loss expenses expected to be incurred, and certain other costs expected to be incurred as premium is earned. Future changes in estimates, the most significant of which is expected losses and loss adjustment expenses, that indicate a reduction in expected future profitability may result in unrecoverable deferred acquisition costs. We have not recorded any significant changes in estimates for the years ended December 31, 2010, 2009 and 2008, respectively.

Losses and Loss Expenses Payable

Our loss reserves reflect all unpaid amounts for claims that have been reported, as well as for IBNR claims. Our loss reserves are not discounted to present value.

Loss reserves are management s best estimates (MBE) at a given point in time of what we expect to pay to settle all claims incurred as of that date based on known facts, circumstances and historical trends. Loss reserves at the individual claim level are established on either a case reserve basis or formula reserve basis

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depending on the type and circumstances of the loss. The case reserve amounts are determined by claims adjusters based on our reserving practices, which take into account the type of risk, the circumstances surrounding each claim and applicable policy provisions. The formula reserves are based on historical data for similar claims with provision for changes caused by inflation. Case reserves and formula reserves are reviewed on a regular basis, and as new data becomes available, estimates are updated resulting in adjustments to loss reserves. Generally, reported losses initially reserved on a formula basis and not settled after six months are case reserved at that time. The process for calculating the IBNR component of the loss reserve is to develop an estimate of the ultimate losses and allocated loss expenses incurred, and subtract all amounts already paid or held as case or formula reserves.

The determination of ultimate losses integrates information and analysis provided by several disciplines within our Company, including claims, actuarial and accounting. This assessment requires considerable judgment in understanding how claims mature, which lines of business are the most volatile, and how trends change over time. Loss reserves represent an estimate at a given point in time based on many variables including historical and statistical information, inflation, legal developments, storm loss estimates and economic conditions. Although we consider many different sources of information, as well as a number of actuarial methodologies to estimate our loss reserves, there is no single method for determining the exact ultimate liability.

Our internal actuarial staff conducts quarterly reviews of projected loss development information to assist management in making estimates of ultimate losses and loss expenses. Several factors are considered in estimating ultimate liabilities including consistency in relative case reserve adequacy, consistency in claims settlement practices, recent legal developments, historical data, actuarial projections, accounting projections, exposure growth, current business conditions, catastrophe developments and late reported claims. In addition, reasonableness tests are performed on many of the assumptions underlying each reserving methodology, such as claim frequency, claim severity and loss ratios. Nonetheless, changes which are not contemplated do occur over time, and those changes are incorporated in subsequent valuations of our loss reserves.

We use a number of different methodologies to estimate the IBNR component of our loss reserves. Our loss reserves include amounts related to short tail and long tail lines of business. Tail refers to the time period between the occurrence of a loss and the settlement of the claim. In general, 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. The reserving methods and strengths and weaknesses of each are described below.

Short-Tail Business: For short-tail business, claims are typically settled within five years, and the most common actuarial estimates are based on techniques using link ratio projections of incurred losses, paid losses, claim counts and claim severities. Each of these methods is described below in detail. Separate projections are made for catastrophes that are in the very early stages of development based on specific information known through the reporting date.

Incurred Loss Development Method: The Incurred Loss Development Method is probably the most common actuarial method used in projecting indicated IBNR reserves. This method uses paid loss experience as well as the outstanding estimates (formula and case reserves) for claims that have been reported and are still open. The underlying assumption of the Incurred Loss Development Method is that case reserve adequacy remains consistent over time. This method s advantage is its responsiveness to changes in reported losses, which is particularly valuable in the less mature accident years. The disadvantage of the Incurred Loss Development Method is that case reserve adequacy changes will distort the IBNR projections.

Paid Loss Development Method: The Paid Loss Development Method uses calculations that are very similar to the Incurred Loss Development Method. The key difference is that the data used in the paid method exclude case reserve estimates, so only paid losses are utilized. With this method, a payment pattern is estimated to project ultimate settlement values for each accident year, with the underlying assumption that claims are settled at a consistent rate over time. Neither case reserves nor the rate at which claims are reported (except to the extent that the reporting pattern influences the payment pattern) is relevant to the results of this method. This method s advantage is the estimates of ultimate loss are independent of case reserve adequacy and are unaffected by company changes in case reserving philosophy. The disadvantages are that the paid method does not use all of the available information, and in some cases the liability payment patterns require the application of very large development factors to relatively small payments in less mature accident years.

Claim Counts and Severities Method: The Counts and Severities Method calculations are very similar to the other methods. The incurred claim counts reported to date are projected to an ultimate number. Similarly, the incurred loss severities are projected to an ultimate value. The ultimate incurred count is multiplied by the ultimate incurred severity, for each accident year, to arrive at the ultimate incurred loss. Finally, as with the other loss development methods, an estimate of the IBNR reserve is calculated by subtracting the reported losses from the estimated ultimate losses.

Long-Tail Business: Reserve estimates for long-tail business use the same methods listed above along with several other methods as determined by the actuary. For example, premium-based methods may be used in developing ultimate loss estimates, including the Expected Loss Ratio, Bornhuetter-Ferguson, and Least-Squares techniques as described below. We may also use statistical models when the historical patterns can be reasonably approximated.

Expected Loss Ratio Method: The Expected Loss Ratio Method generates indicated IBNR by multiplying an expected loss ratio by earned premiums, then subtracting incurred-to-date losses. For slower reporting lines of business, new products, or data that is very immature, the actual claim data is often too limited or too volatile for other projection methods. With this method the premiums are used as a measure of loss exposure, and the loss ratios can be derived from pricing expectations.

Bornhuetter-Ferguson Method: The Bornhuetter-Ferguson Method is a weighted average of the Expected Loss Ratio Method and the Incurred Loss Development Method, using the percentage of losses reported as the weight. This method is particularly useful where there is a low volume of data in the current accident period, or where the experience is volatile. In general, this method produces estimates that are similar to the Incurred Loss Development Method.

Least Square Loss Development Method: In the Least Squares Loss Development Method the statistical technique of least squares regression is applied to a triangle of reported loss ratios to project the ultimate loss ratio in each accident year. Using historical loss ratios puts the data for each time period on a more consistent exposure basis, because premium levels are generally correlated with insured exposures. A by-product of the regression function is an estimate of credibility for each stage of development. In cases where the regression parameters fall outside of a reasonable range, the projection defaults to the incurred loss method.

Selection Process: In determining which reserving method to use for a particular line of business or accident year, diagnostic tests of loss ratios and severity trends are considered, as well as the historic case reserve adequacy and claim settlement rate. In general, the Incurred Loss Development Method is used if the projections are stable, the data is credible, historic case reserve adequacy is consistent, and the loss ratios and loss severities are reasonable. Other reserving methods are considered as well for particular lines of business or accident years, along with supplemental information such as open claim counts and prior period development. For example, if more than one method provides a reasonable projection, the actuary may select an average of those methods. There is considerable judgment applied in the analysis of the historical patterns and in applying business knowledge of our underwriting and claims functions.

Reserve ranges provide a quantification of the variability in the loss reserve projections. The primary determinant in estimating the loss reserve range boundaries are the variances measured within the historical reserving data for the various lines of business. MBE of loss reserves considers the expected variation to establish an appropriate position within a range. MBE loss and ALAE reserves for the STFC Pooled Companies

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share of the Pooled Companies reserves at December 31, 2010, was $884.1 million, within an estimated range of $811.4 million to $904.7 million. (These values presented are on a direct basis, gross of salvage and subrogation recoverable, and before reinsurance, except for the STFC Pooled Companies participation in the inter-company Pooling Arrangement. Therefore, these values cannot be compared to other loss and loss expenses payable tables included elsewhere within this Form 10-K.)

The potential impact of the loss reserve variability on net income can be illustrated using the range end points and carried reserve amounts listed above. For example, if ultimate losses reach a level corresponding to the high point of the range, $904.7 million, the reserve increase of $20.6 million corresponds to an after-tax decrease of $13.4 million in net income, assuming a tax rate of 35%. Likewise, should ultimate losses decline to a level corresponding to the low point of the range, $811.4 million, the $72.7 million reserve decrease would add $47.3 million of after-tax net income. The loss reserve range noted above represents a range of reasonably likely reserves, not a range of all possible reserves. Therefore, the ultimate losses could reach levels corresponding to reserve amounts outside the range provided.

An important assumption underlying the loss reserve estimation methods for the major casualty lines is that the loss cost trends implicitly built into the loss and ALAE patterns will continue into the future. To estimate the sensitivity of reserves to an unexpected change in inflation, projected calendar year payment patterns were applied to the December 31, 2010, other & product liability loss and ALAE reserve to generate estimated annual incremental loss and ALAE payments for each subsequent calendar year. Then, for purposes of sensitivity testing, an additional annual loss cost trend of 10% was added to the trend implicitly embedded in the estimated payment pattern, and revised incremental loss and ALAE payments were calculated. This type of inflationary increase could arise from a variety of sources including tort law changes, development of new medical procedures, social inflation, and other inflationary changes in costs beyond assumed levels.

The estimated cumulative impact that this additional, unexpected 10% increase in the loss cost trend would have on our results of operations over the lifetime of the underlying claims in other & product liability is an increase of $76.3 million on reserves, or a $49.6 million reduction to net income, assuming a tax rate of 35%. Inflation changes have much more impact on the longer tail commercial lines like other & product liability and workers compensation, and much less impact on the shorter tail personal lines reserves.

In addition to establishing loss reserves, as described above, we establish reserves for ULAE. Historical patterns of paid ULAE relative to paid loss are analyzed along with historical claim counts including claims opened, claims closed, and claims remaining open. The product of this analysis is an estimate of the relationship, or ratio, between ULAE and loss underlying the current loss reserves. This ratio is applied to the current outstanding loss reserves to estimate the required ULAE reserve. Consequently, this component of the loss expense reserve has a proportional relationship to the overall claim inventory and held loss reserves. The method assumes that the underlying claims process and mix of business do not change materially over time.

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The following table sets forth a reconciliation of MBE of our direct loss and ALAE reserve to our net loss and loss expenses payable at December 31, 2010 and 2009. The STFC Pooled Companies net additional share of transactions assumed from State Auto Mutual through the Pooling Arrangement for the years ended December 31, 2010 and 2009, respectively, has been reflected in the table below as assumed by STFC Pooled Companies.

($ millions)	**2010**	2009
Direct loss and ALAE reserve:		
STFC Pooled Companies	**$ 487.7**	488.0
Assumed by STFC Pooled Companies	**396.4**	394.5
Total direct loss and ALAE reserve	**884.1**	882.5
Direct ULAE reserve:		
STFC Pooled Companies	**27.2**	26.6
Assumed by STFC Pooled Companies	**24.9**	24.5
Total direct ULAE reserve	**52.1**	51.1
Direct salvage and subrogation recoverable:		
STFC Pooled Companies	**(18.9)**	(25.0)
Assumed by STFC Pooled Companies	**(9.4)**	(8.3)
Total direct salvage and subrogation recoverable	**(28.3)**	(33.3)
Reinsurance recoverable	**(18.8)**	(20.8)
Assumed reinsurance	**21.2**	4.4
Reinsurance assumed by STFC Pooled Companies	**(36.1)**	(64.5)
Total losses and loss expenses payable, net of reinsurance recoverable on losses and loss expenses payable of $18.8 and $20.8 in 2010 and 2009, respectively	**$ 874.2**	819.4

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The following tables set forth the loss and loss expenses payable by major line of business at December 31, 2010 and 2009:

($ millions)	Ending Loss & ALAE Case & Formula	Ending Loss & ALAE IBNR	Ending ULAE Bulk	Total Reserves
December 31, 2010				
Personal insurance segment:				
Standard auto	**$ 159.6**	**61.6**	**12.8**	**234.0**
Nonstandard auto	**11.6**	**2.1**		**13.7**
Homeowners	**51.5**	**26.7**	**2.5**	**80.7**
Other personal	**8.9**	**3.6**	**0.3**	**12.8**
Total personal	**231.6**	**94.0**	**15.6**	**341.2**
Business insurance segment:				
Commercial auto	**55.1**	**47.3**	**4.9**	**107.3**
Commercial multi-peril	**40.9**	**54.3**	**5.2**	**100.4**
Fire & allied lines	**25.3**	**5.1**	**1.0**	**31.4**
Other & product liability	**66.4**	**100.2**	**16.8**	**183.4**
Workers compensation	**43.3**	**52.6**	**8.3**	**104.2**
Other commercial	**3.9**	**2.1**	**0.3**	**6.3**
Total business	**234.9**	**261.6**	**36.5**	**533.0**
Total losses and loss expenses payable net of reinsurance recoverable on losses and loss expenses payable	**$ 466.5**	**355.6**	**52.1**	**874.2**

($ millions)	Ending Loss & ALAE Case & Formula	Ending Loss & ALAE IBNR	Ending ULAE Bulk	Total Reserves
December 31, 2009				
Personal insurance segment:				
Standard auto	$ 149.8	54.3	12.2	216.3
Nonstandard auto	15.5	3.2	1.5	20.2
Homeowners	45.3	27.9	2.5	75.7
Other personal	9.8	3.3	0.3	13.4
Total personal	220.4	88.7	16.5	325.6
Business insurance segment:				
Commercial auto	45.4	43.5	4.8	93.7

Commercial multi-peril	35.1	49.1	5.1	89.3
Fire & allied lines	28.1	4.7	1.0	33.8
Other & product liability	57.6	94.1	15.4	167.1
Workers compensation	48.5	47.4	7.9	103.8
Other commercial	3.5	2.2	0.4	6.1
Total business	218.2	241.0	34.6	493.8
Total losses and loss expenses payable net of reinsurance recoverable on losses and loss expenses payable	$ 438.6	329.7	51.1	819.4

See discussion in Results of Operations Loss and LAE section included in this Item 7.

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The property and casualty industry has experienced significant loss from claims related to asbestos, environmental remediation, product liability, mold and other mass torts. Asbestos reserves are $1.5 million, and environmental reserves are $8.8 million, for a total of $10.3 million, or 1.2% of net losses and loss expenses payable. Asbestos reserves decreased $0.5 million and environmental reserves increased $0.2 million from 2009. Because we have insured primarily product retailers and distributors, we do not expect to incur the same level of liability, particularly related to asbestos, as companies that have insured manufacturing risks.

Pension and Postretirement Benefit Obligations

Pension and postretirement benefit obligations are long-term in nature and require management s judgment in estimating the factors used to determine these amounts. We review these factors annually, including the discount rate and expected long-term rate of return on plan assets. Because these obligations are based on estimates which could change, the ultimate benefit obligation could be different from the amount estimated.

The State Auto Group has a defined benefit pension plan and a postretirement health care plan covering substantially all employees hired prior to January 1, 2010 (collectively the benefit plans). Several factors, which attempt to anticipate future events, are used in calculating the expense and liability related to the benefit plans. Key factors include assumptions about the expected rates of return on plan assets, discount rates, and health care cost trend rates. We consider market conditions, including changes in investment returns and interest rates, in making these assumptions. The actuarial assumptions used by us in determining benefit obligations may differ materially from actual results due to changing market and economic conditions, higher or lower turnover and retirement rates, or longer or shorter life spans of participants. While we believe that the assumptions used are appropriate, differences in actual experience or changes in assumptions may materially affect our financial position or results of operations.

To calculate the State Auto Group s December 31, 2010 benefit obligation for each of the benefit plans, we used a discount rate of 5.50% based on an evaluation of the expected future benefit cash flows of our benefit plans used in conjunction with the Citigroup Pension Discount Curve at the measurement date. A lower discount rate results in, all else being equal, a higher present value of the benefit obligation. To calculate our benefit obligation at December 31, 2010 and net periodic benefit cost for the year ended December 31, 2011, a discount rate of 5.50% and an expected long-term rate of return on plan assets of 8.00% were used. We selected an expected long-term rate of return on our plan assets by considering the mix of investments and stability of investment portfolio along with actual investment experience during the lifetime of the plans. Our assumptions regarding the discount rate and expected return on plan assets could have an effect on the amounts related to our benefit obligations and net periodic benefit cost depending on the degree of change between reporting periods.

The following table sets forth an illustration of variability with respect to the discount rate on our December 31, 2010 benefit obligation and expected net periodic benefit cost for the year ending December 31, 2011, along with the variability of the expected return on plan assets to our expected net periodic benefit cost for the year ending December 31, 2011. Holding all other assumptions constant, sensitivity to changes in any one of our key assumptions are as follows:

($ millions)	Pension Discount rate			Postretirement Discount rate		
	-0.25%	5.50%	+0.25%	-0.25%	5.50%	+0.25%
Benefit obligation	$ 293.0	282.8	273.2	$ 124.3	119.4	114.8
Net periodic benefit cost	15.5	14.5	13.5	11.5	10.9	10.6
	Expected return on plan assets			Expected return on plan assets		
	-0.25%	8.00%	+0.25%	-0.25%	8.00%	+0.25%
Net periodic benefit cost	$ 15.1	14.5	13.9	$ 10.9	10.9	10.9

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The accumulated benefit obligation (ABO) of a defined benefit pension plan represents the actuarial present value of benefits attributed by the pension benefit formula to employee service rendered prior to the measurement date and based on current and past compensation levels, while the projected benefit obligation (PBO) is the ABO plus a factor for future compensation levels. The ABO, which considers current compensations level only, provides information about the obligation an employer would have if the plan were discontinued at the measurement date. At December 31, 2010, the ABO and PBO were $258.3 million and $282.8 million, respectively. At December 31, 2010, the fair value of the assets of our defined benefit pension plan was $219.6 million, which resulted in an underfunded status within our balance sheet of $63.2 million. On a cash flow basis, we target an annual contribution level that meets at least the targeted normal cost of the plan, as defined by ERISA. Currently, we expect to make a cash contribution to the pension plan up to $15.0 million in 2011.

Our unfunded status on our pension plan increased from $52.1 million at December 31, 2009, to $63.2 million at December 31, 2010. Primarily influencing this increase are unrecognized gains and losses arising from factors including a decrease in the discount rate and expected to actual demographic changes, such as retirement age, mortality, turnover, and rate of compensation increases. The cumulative unrecognized actuarial loss is systematically recognized as an increase in net periodic cost over the average future service period of active participants. Additional factors influencing this increase are as follows: (1) actual return on our plan assets was a gain of $24.0 million compared to an expected return of $17.3 million for a net decrease to our obligation and unrecognized actuarial loss of approximately $6.7 million; and (2) a $2.4 million curtailment gain which reduced our obligation and unrecognized actuarial loss.

In November 2009, we announced to our employees a one-time election to select between two retirement benefit options: to either continue participation in the existing defined benefit pension plan with no changes; or to choose a new defined contribution plan in which we automatically contribute a percentage of the employee s annual income resulting in a freeze to the employee s existing accrued defined pension benefit. On May 31, 2010, employees elections were finalized which resulted in a $2.4 million curtailment gain on this date.

Our unfunded status on our postretirement medical plan (retiree med plan) increased from $92.8 million at December 31, 2009 to $116.7 million at December 31, 2010. Influencing this increase are unrecognized net actuarial gain and loss adjustments arising from a decrease in the discount rate, as well as demographic changes and expected to actual claims experience, which at December 31, 2010 had the effect of increasing our obligation and unrecognized actuarial loss.

See Note 10, Pension and Postretirement Benefit Plans to our consolidated financial statements included in Item 8 of this Form 10-K for further disclosures regarding our pension and postretirement benefit plans.

Deferred Income Taxes

Deferred income tax assets and liabilities represent the tax effect of the differences between the financial statement carrying value of existing assets and liabilities and their respective tax basis. Deferred tax assets are evaluated periodically by management to determine if they are realizable, requiring us to make certain judgments and assumptions. In evaluating the ability to recover deferred tax assets, we consider all available evidence, including loss carryback potential, past operating results, existence of cumulative losses in the most recent years, projected performance of the business, future taxable income, including the ability to generate capital gains, and prudent and feasible tax planning strategies. If, based on available information, it is more likely than not that the deferred income tax asset will not be realized, then a valuation allowance must be established with a corresponding charge to net income and/or accumulated comprehensive income (loss). No valuation allowance was held by us at December 31, 2010.

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Other

Other items that could have a significant impact on the financial statements include the risks and uncertainties listed in Item 1A of this Form 10-K under Risk Factors. Actual results could differ materially using different estimates and assumptions, or if conditions are significantly different in the future.

POOLING ARRANGEMENT

The STFC Pooled Companies and the Mutual Pooled Companies participate in a quota share reinsurance pooling arrangement referred to as the Pooling Arrangement. Under the Pooling Arrangement, State Auto Mutual assumes premiums, losses and expenses from each of the remaining Pooled Companies and in turn cedes to each of the Pooled Companies a specified portion of premiums, losses and expenses based on each of the Pooled Companies respective pooling percentages. State Auto Mutual then retains the balance of the pooled business. The participation percentage for the STFC Pooled Companies has remained at 80% since 2001.

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

- Added Beacon National to the pool with a participation percentage of 0.0%;
- Added Patrons Mutual and Litchfield to the pool with participation percentages of 0.4% and 0.1%, respectively;
- Reduced State Auto Mutual s participation percentage from 19.5% to 19.0% to accommodate the participation percentages allocated to Patrons Mutual and Litchfield;
- Included State Auto middle market business insurance written by State Auto Mutual and Meridian Security; and
- Included voluntary assumed reinsurance from parties affiliated with State Auto Mutual.

In 2010, we made the following changes to the Pooling Arrangement (the 2010 pooling changes):

- Added SA National to the pool with a participation percentage of 0.0%; and
- Included voluntary assumed reinsurance from third parties unaffiliated with the Pooled Companies that was assumed on or after January 1, 2009 by State Auto Mutual.

In conjunction with the 2010 pooling changes, the STFC Pooled Companies received $3.7 million in cash from the Mutual Pooled Companies, for net insurance assets transferred on January 1, 2010. The following table sets forth the impact on our balance sheet at January 1, 2010, relating to the 2010 pooling changes:

($ millions)	
Losses and loss expenses payable	$ (4.0)
Unearned premiums	(1.4)
Other liabilities	(0.6)
Less:	
Deferred acquisition costs	(0.2)

Other assets	(9.5)
Net cash received	$ 3.7

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In 2011, we changed the Pooling Arrangement to add the Rockhill Insurers to the pool each with a participation percentage of 0.0% (the 2011 pooling change). In conjunction with the 2011 pooling change, the STFC Pooled Companies will receive approximately $150.9 million in cash and/or investment securities from the Rockhill Insurers, for net insurance liabilities transferred on January 1, 2011. The following table sets forth an estimate of the impact on our balance sheet at January 1, 2011, relating to the 2011 pooling change:

($ millions)	
Losses and loss expenses payable	$ 123.7
Unearned premiums	34.3
Other liabilities	(0.1)
Less:	
Deferred acquisition costs	7.0
Net cash and/or investment securities to be received	$ 150.9

The following table sets forth the participants and their participation percentages in the Pooling Arrangement:

	2008 2009	2010	2011
STFC Pooled Companies:			
State Auto P&C	59.0%	59.0%	59.0%
Milbank	17.0	17.0	17.0
Farmers	3.0	3.0	3.0
SA Ohio	1.0	1.0	1.0
SA National	N/A	0.0	N/A
Total STFC Pooled Companies	80.0	80.0	80.0
State Auto Mutual Pooled Companies:			
State Auto Mutual	19.0	19.0	19.0
SA Wisconsin	0.0	0.0	0.0
SA Florida	0.0	0.0	0.0
Meridian Security	0.0	0.0	0.0
Meridian Citizens Mutual	0.5	0.5	0.5
Beacon National	0.0	0.0	0.0
Patrons Mutual	0.4	0.4	0.4
Litchfield	0.1	0.1	0.1
RIC	N/A	N/A	0.0
Plaza	N/A	N/A	0.0
American Compensation	N/A	N/A	0.0
Bloomington Compensation	N/A	N/A	0.0
Total State Auto Mutual Pooled Companies	20.0	20.0	20.0

It is not management s intention to recommend an adjustment to the STFC Pooled Companies 80% participation level in the foreseeable future. Under applicable governance procedures, if the Pooling Arrangement were to be amended, management would make recommendations to the Independent Committees of the Board of Directors of both State Auto Mutual and STFC. The Independent Committees review and evaluate such factors as they deem relevant and recommend any appropriate pooling change to the Board of Directors of both State Auto Mutual and STFC. The Pooling Arrangement is terminable by any of our Pooled Companies at any time by any party by giving twelve months notice to the other parties and their respective

domiciliary insurance departments. None of our Pooled Companies currently intends to terminate the Pooling Arrangement.

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

RESULTS OF OPERATIONS

Summary

The following table sets forth certain key performance indicators we use to monitor our operations for the years ended December 31, 2010, 2009 and 2008:

($ millions, except per share data)	**2010**	2009	2008
GAAP Basis:			
Total revenues	**$ 1,355.1**	1,256.9	1,181.9
Net income (loss)	**$ 24.5**	10.2	(31.1)
Stockholders equity	**$ 851.8**	849.4	761.0
Book value per share	**$ 21.23**	21.33	19.23
Return on average equity	**2.9**	1.3	(3.7)
Debt to capital ratio	**12.1**	12.1	13.4
Loss and LAE ratio	**70.8**	71.7	75.2
Expense ratio	**33.8**	34.1	34.6
Combined ratio	**104.6**	105.8	109.8
Catastrophe Loss and LAE points	**7.9%**	7.7	13.9
Premiums written growth[1]	**9.3%**	5.1	18.2
Premiums earned growth	**6.9%**	4.5	11.3
Investment yield	**3.6%**	3.9	4.1
SAP Basis:			
Loss and LAE ratio	**70.3**	71.3	74.8
Expense ratio	**32.9**	33.5	33.1
Combined ratio	**103.2**	104.8	107.9
Net premiums written to surplus	**1.7**	1.5	1.6

(1) Includes a decrease of 0.2 points for 2010, related to the one-time $1.4 million transfer of unearned premiums to the Mutual Pooled Companies on January 1, 2010, in conjunction with the 2010 pooling changes, and an increase of 5.3 points for 2008, related to the one-time $53.6 million transfer of unearned premiums to us on January 1, 2008, in conjunction with the 2008 pooling changes.

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2010 Highlights

Our 2010 pre-tax income was $24.5 million compared to pre-tax losses of $12.8 million and $75.1 million in 2009 and 2008, respectively. Revenues increased to $1,355.1 million in 2010 from $1,256.9 million and $1,181.9 million in 2009 and 2008, respectively, while expenses increased to $1,330.6 million in 2010 from $1,269.7 million and $1,257.0 million in 2009 and 2008, respectively. The following highlights significant factors that impacted 2010 results as compared to 2009 and 2008:

- Earned premiums in 2010 were $1,257.2 million compared to $1,176.5 million and $1,126.0 million in 2009 and 2008, respectively. This growth was primarily driven by a combination of an increase in the level of exposures written and the result of rate increases in our personal lines.

- We recognized $3.6 million of OTTI on our investment portfolio during 2010 compared to $9.0 million and $39.3 million in 2009 and 2008, respectively.

- Net realized gains on investments, excluding OTTI, were $18.5 million in 2010, compared to $3.8 million and $2.9 million in 2009 and 2008, respectively. Included in the 2010 net realized gains on investments was $3.9 million related to the sale of our nonstandard automobile subsidiary, SA National.

- On December 31, 2010, we sold SA National to a third party for $14.0 million plus a contingent earn-out. In deciding to sell SA National, we considered those businesses core to our long-term strategy and concluded that the nonstandard auto market was no longer a strategic fit for us. In 2010, SA National wrote approximately $37.0 million in direct written premiums through our independent agents in 21 states, with 80% (or approximately $30.0 million) retained by us under our Pooling Arrangement. We will continue to write SA National renewal business until such business is transitioned from our system to the buyer s system, which should occur during the second quarter of 2011. See Reinsurance Arrangements section included in this Item 7.

- Catastrophe losses for 2010 were $99.0 million (7.9 loss ratio points) compared to $90.3 million (7.7 loss ratio points) and $156.1 million (13.9 loss ratio points) for the same 2009 and 2008 periods, respectively. The 2008 catastrophe losses included catastrophe losses related to Hurricane Ike, which delivered tropical storm force winds to Texas and three of our largest states, Ohio, Kentucky and Indiana, accounting for $44.1 million of losses or 3.9 loss ratio points.

- Our non-catastrophe losses for 2010 were $790.6 million (62.9 loss ratio points) compared to $753.0 million (64.0 loss ratio points) and $690.6 million (61.3 loss ratio points) for the same 2009 and 2008 periods, respectively.

Insurance Segments

Insurance industry regulators require our insurance subsidiaries to report their financial condition and results of operations using SAP. We use SAP financial results, along with industry standard financial measures determined on a SAP basis and certain measures determined on a GAAP basis, to internally monitor the performance of our insurance segments and reward our employees.

One of the more significant differences between GAAP and SAP is that SAP requires all underwriting expenses to be expensed immediately and not deferred over the same period that the premium is earned. In converting SAP underwriting results to GAAP underwriting results, acquisition costs are deferred and amortized over the periods the related written premiums are earned. For a discussion of deferred acquisition costs, see Critical Accounting Policies Deferred Acquisition Costs section included in this Item 7.

Charges related to the restructuring of our field and claims operations, as well as those recorded due to the North Carolina Beach Plan write-off in 2009, contributed to the difference between our GAAP expense ratio and our SAP expense ratio. The restructuring differences relate mainly to the timing of the recognition of employee

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termination benefits. SAP requires us to estimate and immediately recognize the entire estimated costs related to severance, while GAAP requires similar estimated costs to be recognized ratably over the remaining service period of the employees impacted. The write-off in 2009 related to the North Carolina Beach Plan was included in the other expenses line item in the accompanying consolidated statements of income, and was therefore not included in the computation of the GAAP expense ratio.

All references to financial measures or components thereof in this discussion are calculated on a GAAP basis, unless otherwise noted.

The following tables set forth a summary of our insurance segments SAP underwriting loss and SAP combined ratio for the years ended December 31, 2010, 2009 and 2008:

($ millions)			2010			
	Personal	% Ratio	Business	% Ratio	Total	% Ratio
Written premiums[1]	**$ 819.9**		**$ 503.6**		**$ 1,323.5**	
Earned premiums	**798.5**		**458.7**		**1,257.2**	
Losses and loss expenses	**569.4**	**71.3**	**313.8**	**68.4**	**883.2**	**70.3**
Underwriting expenses	**238.4**	**29.1**	**197.4**	**39.2**	**435.8**	**32.9**
SAP underwriting loss and SAP combined ratio	**$ (9.3)**	**100.4**	**$ (52.5)**	**107.6**	**$ (61.8)**	**103.2**

($ millions)			2009			
	Personal	% Ratio	Business	% Ratio	Total	% Ratio
Written premiums	$ 775.1		$ 435.3		$ 1,210.4	
Earned premiums	732.8		443.7		1,176.5	
Losses and loss expenses	554.8	75.7	283.7	64.0	838.5	71.3
Underwriting expenses	237.5	30.6	168.4	38.7	405.9	33.5
SAP underwriting loss and SAP combined ratio	$ (59.5)	106.3	$ (8.4)	102.7	$ (67.9)	104.8

($ millions)			2008			
	Personal	% Ratio	Business	% Ratio	Total	% Ratio
Written premiums[2]	$ 715.6		$ 489.3		$ 1,204.9	
Earned premiums	670.9		455.1		1,126.0	
Losses and loss expenses	520.3	77.6	322.1	70.8	842.4	74.8
Underwriting expenses	206.8	28.9	191.5	39.1	398.3	33.1
SAP underwriting loss and SAP combined ratio	$ (56.2)	106.5	$ (58.5)	109.9	$ (114.7)	107.9

(1) Includes the one-time transfer of $1.4 million of unearned premiums to the Mutual Pooled Companies on January 1, 2010, in conjunction with the 2010 pooling changes (transfer of $2.1 million of our personal insurance segment and receipt of $0.7 million for the Mutual Pooled Companies business insurance segment).

(2)

Includes the one-time transfer of $53.6 million of unearned premiums to us on January 1, 2008, in conjunction with the 2008 pooling changes (receipt of $24.8 million for our personal insurance segment and $28.8 million for our business insurance segment).

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Revenue

We measure our top-line growth for our insurance segments based on net written premiums, which provide us with an indication of how well we are doing in terms of revenue growth before it is actually earned. Our policies provide a fixed amount of coverage for a stated period of time, often referred to as the policy term. As such, our written premiums are recognized as earned ratably over the policy term. Unearned premiums are reflected on our balance sheet as a liability and represent our obligation to provide coverage for the unexpired term of the policy.

The following table sets forth the reconciliation of the one-time impact on net written premiums for the year ended December 31, 2010, of the unearned premiums transferred to the Mutual Pooled Companies on January 1, 2010, in conjunction with the 2010 pooling changes:

($ millions)	Net Written Premiums Reconciliation Table		
	Including Pooling Change	Pooling Change Impact	Excluding Pooling Change
Personal insurance segment:			
Standard auto	$ 491.5		491.5
Nonstandard auto	25.6	(2.1)	27.7
Homeowners	268.8		268.8
Other personal	34.0		34.0
Total personal	819.9	(2.1)	822.0
Business insurance segment:			
Commercial auto	147.8		147.8
Commercial multi-peril	127.5	0.7	126.8
Fire & allied lines	95.6		95.6
Other & product liability	68.7		68.7
Workers compensation	38.9		38.9
Other business	25.1		25.1
Total business	503.6	0.7	502.9
Total net written premiums	$ 1,323.5	(1.4)	1,324.9

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The following table sets forth the reconciliation of the one-time impact on net written premiums for the year ended December 31, 2008, of the unearned premiums transferred to us on January 1, 2008, in conjunction with the 2008 pooling changes:

($ millions)	Net Written Premiums Reconciliation Table		
	Including Pooling Change	Pooling Change Impact	Excluding Pooling Change
Personal insurance segment:			
Standard auto	$ 406.7	7.9	398.8
Nonstandard auto	42.2		42.2
Homeowners	234.2	14.4	219.8
Other personal	32.5	2.5	30.0
Total personal	715.6	24.8	690.8
Business insurance segment:			
Commercial auto	120.0	10.0	110.0
Commercial multi-peril	105.1	6.1	99.0
Fire & allied lines	102.5	5.7	96.8
Other & product liability	84.4	3.9	80.5
Workers compensation	47.5	2.0	45.5
Other commercial	29.8	1.1	28.7
Total business	489.3	28.8	460.5
Total net written premiums	$ 1,204.9	53.6	1,151.3

Personal Insurance Segment Revenue

Our personal insurance segment consists primarily of auto and homeowners products, with personal auto representing 39%, 41% and 38% of our total consolidated net written premiums in 2010, 2009 and 2008, respectively. We believe introducing new products, leveraging predictive modeling capabilities and making it easier for our agents and policyholders to do business with us through enhanced systems and easier to use technologies will enable us to strategically grow our personal lines business in desired geographic locations.

CustomFit SM, our standard auto product, provides additional quoting opportunities by allowing our agents to tailor policies to fit the insured s needs. Further expanding our product portfolio, in the fourth quarter of 2009 we introduced our new homeowners CustomFit product which employs predictive modeling and by-peril rating, allowing us to target business with expected long-term profit potential. Compared to the traditional method of using fire as the main basis for rating, by-peril rating uses multiple perils (such as wind, hail and water) in the rating process designed to provide a more accurate and adequate rate. Our CustomFit homeowners product has now been deployed in eight states and future deployment is planned for our remaining states.

Our emphasis in personal insurance continues to be homeowners profitability. In addition to rate increases and the introduction of our CustomFit homeowners product, we are aggressively evaluating and monitoring unprofitable agencies, which may include the review of an agency s existing policies, implementation of tighter new business and renewal guidelines for that agency, and the application of other loss mitigation tools for use by that agency, all with the purpose of improving operating results at the agency level. We are continuing with a proactive insurance to value program, which is designed to have our insureds maintain an amount of coverage sufficient to replace their home and contents in the case of a total loss consistent with our loss settlement practices. In addition, we have implemented wind and hail deductibles in 15 states and are deploying strategies to provide greater spread of risk for our homeowners line.

Over the years, we have focused on improved technology interfaces with our agents and policyholders. This has included enhancing our personal lines sale portal netXpress SM for our agents, including increasing the number of integration points to our rating engine thus eliminating duplicate entry for agents. These actions have resulted in increased levels of quote activity by our agents. For our policyholders, we have increased the number of electronic bill pay options, including 24 x 7 online capability, along with introduction of claim reporting technology.

The following table sets forth a summary of written and earned premium, net of reinsurance, by major product line of business for our personal insurance segment for the years ended December 31, 2010, 2009 and 2008. The one-time impacts of the 2010 and 2008 pooling changes have been excluded from 2010 and 2008 to present net written premiums on a comparative basis (see Net Written Premiums Reconciliation Tables above).

($ millions)	**2010**	2009	2008
Personal Insurance Segment:			
Net Written Premiums			
Standard auto	**$ 491.5**	460.4	398.8
Nonstandard auto	**27.7**	37.7	42.2
Homeowners	**268.8**	245.2	219.8
Other personal	**34.0**	31.8	30.0
Total personal	**$ 822.0**	775.1	690.8
Net Earned Premiums			
Standard auto	**$ 479.7**	433.2	384.3
Nonstandard auto	**28.4**	38.7	42.6
Homeowners	**257.3**	230.0	215.4
Other personal	**33.1**	30.9	28.6
Total personal	**$ 798.5**	732.8	670.9

Standard personal auto net written premiums for the year ended December 31, 2010 increased 6.8% compared to the same 2009 period. Rate increases contributed to approximately half of this premium growth, while the State Auto Group s expansion of its operations within four of our newer states, Texas, Colorado, Arizona and Connecticut, contributed to the balance. Net written premiums for the year ended December 31, 2009 increased 15.4% compared to the same 2008 period. The expansion into Texas, Colorado, Arizona and Connecticut contributed to approximately 5 points of this growth in 2009, and rate increases also contributed to this growth. While growth continues to be strong, we are experiencing a slowdown in new business and a lower issue-to-quote ratio which we attribute to the impact of our rate increases.

Nonstandard auto net written premiums for the year ended December 31, 2010 decreased 26.5% compared to the same 2009 period. Approximately two-thirds of this decline was due to the inclusion of the nonstandard auto business in the Pooling Arrangement effective January 1, 2010 (20% of this business is ceded to the Mutual Pooled Companies). In August 2010, we announced that STFC had entered into an agreement to sell our nonstandard automobile insurance subsidiary, SA National, which resulted in a slowdown of new business submitted by our agents. The decline in net written premiums was also due to certain underwriting actions taken in 2009 and 2010 that included increasing rates and terminating certain agencies that had failed to consistently perform to our expectations. These actions, coupled with the impact of general economic conditions, continued to result in a reduction of nonstandard auto business. The actions taken in 2009 also contributed to the decline in net written premiums for the year ended December 31, 2009 of 10.7% compared to the same 2008 period.

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Homeowners net written premiums for the year ended December 31, 2010 increased 9.6% compared to the same 2009 period. Approximately two-thirds of the growth was attributable to rate increases, while expansion of our business in Texas, Colorado, Arizona and Connecticut contributed to the balance. Net written premiums for the year ended December 31, 2009 increased 11.6% compared to the same 2008 period, with one-third of this premium growth from rate increases, one-third from our expansion into Texas, Colorado, Arizona and Connecticut, and the remaining one-third from expansion in our other states. We continue to aggressively address our rate needs in this line of business, seeking higher rates in 2011. In addition, we intend to continue a state-by-state deployment of our CustomFit homeowners product throughout 2011.

Business Insurance Segment Revenue

Our business insurance accounts are primarily small-to-medium sized exposures where we offer a broad range of both property and liability coverages. New to us in 2010 are property and casualty coverages written through RED, which acts as a managing general underwriter for a variety of property and casualty coverages in the program and alternative risk markets, such as commercial auto, workers compensation, general liability and property. The underwriting management agreement with RED went into effect during the fourth quarter 2009. The insurance coverages written by our Pooled Companies through RED are subject to the Pooling Arrangement.

The following table sets forth a summary of written and earned premiums, net of reinsurance, by major product line of business for our business insurance segment for the years ended December 31, 2010, 2009 and 2008. The one-time impacts of the 2010 and 2008 pooling changes have been excluded from 2010 and 2008 to present net written premiums on a comparative basis (see Net Written Premiums Reconciliation Tables above).

($ millions)	**2010**	2009	2008
Business Insurance Segment:			
Net Written Premiums			
Commercial auto	**$ 147.8**	100.3	110.0
Commercial multi-peril	**126.8**	94.5	99.0
Fire & allied lines	**95.6**	99.3	96.8
Other & product liability	**68.7**	72.4	80.5
Workers compensation	**38.9**	43.3	45.5
Other commercial	**25.1**	25.5	28.7
Total business	**$ 502.9**	435.3	460.5
Net Earned Premiums			
Commercial auto	**$ 115.4**	106.2	110.5
Commercial multi-peril	**110.1**	95.2	97.9
Fire & allied lines	**97.7**	97.6	94.7
Other & product liability	**69.6**	74.8	79.9
Workers compensation	**40.5**	43.2	43.4
Other commercial	**25.4**	26.7	28.7
Total business	**$ 458.7**	443.7	455.1

Net written premiums for the business insurance segment for the year ended December 31, 2010 increased 15.5% compared to the same 2009 period, with business written through RED accounting for 19.1 points of this premium growth or $83.2 million of new business written premium opportunities ($52.0 million of commercial auto, $28.4 million of commercial multi-peril, $0.3 million of fire & allied lines and $2.5 million of other & product liability), with our historic mainline business declining 3.6%. Net written premiums for the year ended December 31, 2009 decreased 5.5% compared to the same 2008 period. Business insurance continues to be

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impacted by rate competition, general economic conditions, and depressed premium bases, such as payrolls, sales and number of vehicles, as well as ease of doing business issues. After strengthening our premium per exposure on our renewal policies in the second half of 2009, our premium per exposure on policies other than policies issued through RED decreased slightly in 2010. New business other than RED declined in 2010. We believe it will be difficult to generate measurable premium growth in our current book of business, other than our RED book of business, given the continued impact of the economy on premium bases. However, we are seeking to balance our traditional underwriting discipline with new products and pricing tools that support the production of profitable new business.

We continue to invest in products, processes and systems that we believe will increase our business insurance writings. We have implemented a pricing process that we believe will help us price property, liability, auto and workers compensation risks at appropriate levels. In addition, we have broadened our property, liability, auto and workers compensation pricing ranges to improve our ability to recognize the spectrum of risks within our markets.

We continue to enhance our insurance policy administration system to attempt to make it easier for our agents to quote and submit business insurance policies to us. Our system now allows transactions to be processed throughout the day using real-time and straight-through processing rather than in large batch cycles at night. We have leveraged this functionality with bizXpress^{SM}, our web-based quote system, to give agents the ability to quote businessowners, commercial auto and workers compensation risks online. We believe this technology investment should better position us for revenue growth opportunities in the future and start to drive efficiencies into our business model much like we have seen in personal insurance. The majority of all transactions in business insurance utilize the straight-through processing technology. The use of this technology has resulted in faster delivery of policies to our agents and their insureds for new business and endorsements. In the third quarter 2010, we expanded our electronic funds transfer billing capability, making it available to business insurance policyholders.

We have also expanded the eligibility of our businessowners product to facilitate businesses with greater liability exposures, such as artisan contractors, auto service garages, manufacturers and restaurants. While we regularly insure these types of businesses through other insurance products, offering them in our businessowners program leverages our bizXpress technology, simplifies agents rating and submission processes, and offers broader base coverages for these types of risks. In 2010, we completed the implementation of our enhanced businessowners product, which has been introduced into 28 states.

Loss and LAE

Losses and loss expenses for a calendar year represent the combined estimated ultimate liability for claims occurring in the current calendar year along with any change in estimated ultimate liability for claims occurring in prior years. The following table sets forth the provision for losses and loss expenses for those claims occurring in the current and prior years, along with the GAAP loss and LAE ratio for the years ended December 31, 2010, 2009 and 2008:

($ millions)	**2010**	**% GAAP Loss and LAE**	2009	% GAAP Loss and LAE	2008	% GAAP Loss and LAE
Provision for losses and loss expenses occurring:						
Current year	**$ 954.2**	**75.9**	$ 899.5	76.5	$ 874.0	77.6
Prior years	**(64.6)**	**(5.1)**	(56.2)	(4.8)	(27.3)	(2.4)
Total losses and loss expenses	**$ 889.6**	**70.8**	$ 843.3	71.7	$ 846.7	75.2

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As shown above, the 2010 loss and loss expenses attributable to prior years totaled a decrease of $64.6 million, or favorable development, in the estimated ultimate liability for prior years claims. The following table sets forth a tabular presentation of the favorable development by accident year for the year ended December 31, 2010:

($ millions) Accident Year	Current Year Development of Ultimate Liability *Redundancy / (Deficiency)*
2000 and prior	**$ (0.5)**
2001	**(0.2)**
2002	**0.7**
2003	**0.1**
2004	**2.2**
2005	**1.4**
2006	**5.7**
2007	**2.0**
2008	**13.0**
2009	**40.2**
Total	**$ 64.6**

While emergence by accident year includes normal fluctuations due to the uncertainty associated with loss reserve development and claim settlement, the favorable development in 2010 came primarily from accident year 2009. The more notable items contributing to the 2010 favorable development were:

- ULAE was $12.7 million lower than anticipated in the reserves at December 31, 2009, with approximately 78% being attributable to the 2009 accident year.

- Favorable catastrophe loss development of $3.3 million was primarily associated with the 2009 accident year. This development occurred primarily within our homeowners and commercial multi-peril lines of business.

- Favorable development in the auto liability, homeowners and fire & allied lines accounts for the majority of the development in the non-catastrophe reserves, with the balance spread across multiple lines of business. Standard, nonstandard and commercial auto liability reserves developed favorably by $10.7 million. Homeowners and fire & allied reserves developed lower than anticipated by $10.4 million and $9.0 million, respectively. The favorable development in these lines of business was driven by emergence of lower than anticipated claim severity, as well as lower than anticipated claim frequency for fire & allied lines. The favorable development was primarily associated with the 2009 and, to a lesser extent, 2008 accident years.

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In 2009, loss and loss expenses attributable to prior years totaled a decrease of $56.2 million, or favorable development, in the estimated ultimate liability for prior years claims. The following table sets forth a tabular presentation of the favorable development by accident year for the year ended December 31, 2009:

($ millions) Accident Year	Current Year Development of Ultimate Liability *Redundancy / (Deficiency)*
1999 and prior	$ 0.8
2000	(1.0)
2001	(1.1)
2002	0.6
2003	1.4
2004	3.6
2005	(1.6)
2006	8.0
2007	3.1
2008	42.4
Total	$ 56.2

The favorable development in 2009 came primarily from accident year 2008. The more notable items contributing to the 2009 favorable development were:

ULAE was $10.9 million lower than anticipated in the reserves at December 31, 2008, with approximately 75% being attributable to the 2008 accident year.

Favorable catastrophe loss development of $10.9 million was primarily associated with the 2008 accident year. This development occurred primarily within our homeowners, fire & allied and commercial multi-peril lines of business.

Non-catastrophe reserves for the auto liability lines and other & product liability developed lower than anticipated. Standard, nonstandard and commercial auto liability reserves developed $9.5 million lower and other & product liability developed $8.3 million lower than anticipated. This favorable development, which was primarily associated with the 2008 accident year, was driven by lower than anticipated tabular loss severity, as well as lower than anticipated loss frequency for other & product liability.

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In 2008, loss and loss expenses attributable to prior years totaled a decrease of $27.3 million, or favorable development, in the estimated ultimate liability for prior years claims. The following table sets forth a tabular presentation of the favorable development by accident year for the year ended December 31, 2008:

($ millions) Accident Year	Current Year Development of Ultimate Liability *Redundancy / (Deficiency)*
1998 and prior	$ 0.7
1999	0.3
2000	0.5
2001	(0.1)
2002	0.7
2003	2.6
2004	(0.2)
2005	0.8
2006	3.1
2007	18.9
Total	$ 27.3

The favorable development in 2008 came primarily from accident year 2007. The more notable items contributing to the 2008 favorable development were:

ULAE was $13.7 million lower than anticipated in the reserves at December 31, 2007.

Favorable catastrophe loss development of $6.4 million was primarily associated with the 2007 accident year. This development occurred primarily within our homeowners, fire & allied and commercial multi-peril lines of business.

Non-catastrophe homeowners reserves developed $4.9 million lower than anticipated. Current loss projections using more mature claim data resulted in lower expected average claim severity than prior projections, primarily from losses occurring in 2007.

See additional discussion regarding loss and loss expense reserves at the Critical Accounting Policies Losses and Loss Expenses Payable section included in this Item 7.

Catastrophe losses for 2010 totaled $99.0 million (7.9 loss ratio points) compared to $90.3 million (7.7 loss ratio points) for 2009 and $156.1 million (13.9 loss ratio points) for 2008. During 2010, we were impacted by losses from thirty of the thirty-three storms that were classified as numbered catastrophes by PCS as compared to twenty-seven of the twenty-eight PCS classified storms in 2009. In 2008, we were impacted by losses from thirty-five of the thirty-seven PCS classified storms, one of which was Hurricane Ike. The losses from these catastrophes have had a significant impact on both our personal and business insurance property lines.

During 2010 and 2009, members of the State Auto Group maintained a property catastrophe net aggregate excess of loss reinsurance agreement (the CAT Aggregate Agreement). See Reinsurance Arrangements section included in this Item 7 for a further discussion of the CAT Aggregate Agreement. Of the thirty catastrophes from which we experienced losses during 2010, nine met the minimum $5.0 million requirement; however, in aggregate the total State Auto Group losses of $81.9 million related to the nine qualifying catastrophes did not exceed the State Auto Group s $90 million retention level. Six of the twenty-seven catastrophes experienced during 2009 met the minimum $5.0 million requirement and in aggregate exceeded the State Auto Group s $80 million retention level. Our share of recoveries under the CAT Aggregate Agreement for the year ended December 31, 2009 was $8.2 million, benefitting our loss ratio by 0.7 points.

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The following tables set forth our insurance segments SAP loss and LAE ratios by major lines of business with the catastrophe and non-catastrophe impact shown separately for the years ended December 31, 2010, 2009 and 2008:

($ millions)

2010 Statutory Loss and LAE Ratios	Earned Premiums	Cat Loss & LAE	Non-Cat Loss & LAE	Statutory Loss & LAE	Cat Ratio	Non-Cat Ratio	Total Loss and LAE Ratio
Personal insurance segment:							
Standard auto	**$ 479.7**	**$ 6.5**	**$ 317.4**	**$ 323.9**	**1.3**	**66.2**	**67.5**
Nonstandard auto	**28.4**	**0.1**	**18.6**	**18.7**	**0.5**	**65.8**	**66.3**
Homeowners	**257.3**	**62.6**	**145.4**	**208.0**	**24.3**	**56.5**	**80.8**
Other personal	**33.1**	**4.8**	**14.0**	**18.8**	**15.0**	**41.6**	**56.6**
Total personal	**798.5**	**74.0**	**495.4**	**569.4**	**9.3**	**62.0**	**71.3**
Business insurance segment:							
Commercial auto	**115.4**	**1.5**	**71.3**	**72.8**	**1.2**	**62.0**	**63.2**
Commercial multi-peril	**110.1**	**7.4**	**60.7**	**68.1**	**6.7**	**55.1**	**61.8**
Fire & allied lines	**97.7**	**15.6**	**54.4**	**70.0**	**16.0**	**55.6**	**71.6**
Other & product liability	**69.6**		**61.4**	**61.4**		**88.2**	**88.2**
Workers compensation	**40.5**		**32.0**	**32.0**		**78.9**	**78.9**
Other commercial	**25.4**	**0.5**	**9.0**	**9.5**	**2.1**	**34.9**	**37.0**
Total business	**458.7**	**25.0**	**288.8**	**313.8**	**5.4**	**63.0**	**68.4**
Total SAP personal and business	**$ 1,257.2**	**$ 99.0**	**$ 784.2**	**$ 883.2**	**7.9**	**62.4**	**70.3**

($ millions)

2009 Statutory Loss and LAE Ratios	Earned Premiums	Cat Loss & LAE	Non-Cat Loss & LAE	Statutory Loss & LAE	Cat Ratio	Non-Cat Ratio	Total Loss and LAE Ratio
Personal insurance segment:							
Standard auto	$ 433.2	$ 4.5	$ 297.8	$ 302.3	1.0	68.8	69.8
Nonstandard auto	38.7	0.3	29.1	29.4	0.5	75.3	75.8
Homeowners	230.0	64.9	144.9	209.8	28.3	62.9	91.2
Other personal	30.9	2.6	10.7	13.3	8.1	34.8	42.9
Total personal	732.8	72.3	482.5	554.8	9.9	65.8	75.7
Business insurance segment:							
Commercial auto	106.2	0.5	59.2	59.7	0.5	55.6	56.1
Commercial multi-peril	95.2	5.1	51.3	56.4	5.4	53.9	59.3
Fire & allied lines	97.6	12.2	58.3	70.5	12.5	59.7	72.2
Other & product liability	74.8		52.4	52.4		70.1	70.1
Workers compensation	43.2		34.6	34.6		80.1	80.1
Other commercial	26.7	0.2	9.9	10.1	0.5	37.9	38.4
Total business	443.7	18.0	265.7	283.7	4.1	59.9	64.0

Total SAP personal and business	$ 1,176.5	$ 90.3	$ 748.2	$ 838.5	7.7	63.6	71.3

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($ millions)

2008 Statutory Loss and LAE Ratios	Earned Premiums	Cat Loss & LAE	Non-Cat Loss & LAE	Statutory Loss & LAE	Cat Ratio	Non-Cat Ratio	Total Loss and LAE Ratio
Personal insurance segment:							
Standard auto	$ 384.3	$ 8.2	$ 254.4	$ 262.6	2.1	66.2	68.3
Nonstandard auto	42.6	0.3	31.5	31.8	0.7	74.0	74.7
Homeowners	215.4	91.5	113.0	204.5	42.5	52.5	95.0
Other personal	28.6	5.8	15.6	21.4	20.6	54.1	74.7
Total personal	670.9	105.8	414.5	520.3	15.8	61.7	77.5
Business insurance segment:							
Commercial auto	110.5	0.8	67.6	68.4	0.7	61.2	61.9
Commercial multi-peril	97.9	16.5	56.5	73.0	16.8	57.8	74.6
Fire & allied lines	94.7	32.0	52.7	84.7	33.8	55.7	89.5
Other & product liability	79.9		51.6	51.6		64.6	64.6
Workers compensation	43.4		35.0	35.0		80.7	80.7
Other commercial	28.7	1.0	8.4	9.4	3.4	29.3	32.7
Total business	455.1	50.3	271.8	322.1	11.0	59.8	70.8
Total SAP personal and business	$ 1,126.0	$ 156.1	$ 686.3	$ 842.4	13.9	60.9	74.8

In the personal insurance segment, the overall non-cat loss ratio for the year ended December 31, 2010 improved 3.8 points compared to the same 2009 period. The non-cat loss ratios for standard auto improved 2.6 points, and for homeowners improved 6.4 points, compared to the same 2009 period. The impact of rate increases contributed significantly to the improvement in standard auto. Homeowners also improved relative to 2009, benefitting from rate actions and implementation of mandatory wind and hail deductibles in many of our operating states prone to non-cat weather related losses. In homeowners we continue to file rate increases in the high single digit to low double digit range.

The personal insurance segment overall non-cat loss ratio was 4.1 points higher in 2009 than in 2008. Standard auto s non-cat loss ratio increase was driven by an increase in frequency of physical damage, comprehensive and collision coverage claims, while the nonstandard auto increase was caused by a rise in the overall severity of claims. Previously, the intense price competition in the personal lines market had impeded our ability to take appropriate rate increases. Price competition in the personal lines market became less intense, which allowed us to implement rate increases, contributing some to our 2009 growth. The increase in the non-cat homeowners loss ratio was due primarily to experiencing more large fire losses and settling one threatened class action claim. Settlement of the one class action claim increased the 2009 non-cat homeowners loss ratio by 3.2 points.

In the business insurance segment, the overall non-cat loss ratio for the year ended December 31, 2010 increased 3.1 points compared to the same 2009 period. The commercial auto non-cat loss ratio increased 6.4 points, principally driven by an increase in the number of large losses which impacted both the current and prior accident years. The other & product liability non-cat loss ratio increased by 18.1 points principally driven by an increase in large losses from prior accident years. Intense competition in the business insurance segment continues to impact our ability to implement price increases where needed.

The business insurance segment overall non-cat loss ratio for 2009 was comparable to 2008. However, commercial auto and commercial multi-peril loss ratios decreased primarily due to a reduction in the number and size of large losses when compared to 2008. The increase in the fire & allied lines loss ratio was the result of more large fires in 2009. The increase in other & product liability was due primarily to an increase in the estimate of internal claim handling expenses.

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Initiatives implemented within our claims operations during 2009 and 2010 are contributing to the overall decline in our loss ratio, particularly in the property lines of homeowners, fire and commercial multi-peril. Our dependence on outside appraisers has declined by deploying over 70 in-house property adjusters working from their homes. In addition, virtually all large property claims and a significant percentage of catastrophe claims are now being handled in-house by State Auto adjusters. These changes improve service, reduce expenses, and allow us to better manage indemnity payout all of which improves loss ratio results.

The following table sets forth loss and loss expenses payable by major line of business at December 31, 2010, 2009 and 2008:

($ millions)	**December 31, 2010**	January 1, 2010[1]	December 31, 2009	December 31, 2008
Personal insurance segment:				
Standard auto	**$ 234.0**	216.3	216.3	188.5
Nonstandard auto	**13.7**	16.2	20.2	19.6
Homeowners	**80.7**	75.7	75.7	68.6
Other personal	**12.8**	13.4	13.4	14.6
Total personal	**341.2**	321.6	325.6	291.3
Business insurance segment:				
Commercial auto	**107.3**	93.7	93.7	93.5
Commercial multi-peril	**100.4**	89.3	89.3	91.5
Fire & allied lines	**31.4**	33.8	33.8	38.6
Other & product liability	**183.4**	167.1	167.1	152.3
Workers compensation	**104.2**	103.8	103.8	97.1
Other commercial	**6.3**	6.1	6.1	5.7
Total business	**533.0**	493.8	493.8	478.7
Total losses and loss expenses payable, net of reinsurance recoverable on losses and loss expenses payable	**$ 874.2**	815.4	819.4	770.0

(1) The December 31, 2009 loss and loss expenses payable balance has been adjusted for comparative purposes to reflect the loss and loss expenses payable ceded to the Mutual Pooled Companies on January 1, 2010 due to the 2010 pooling changes.

Loss and loss expenses payable increased $58.8 million since January 1, 2010, primarily due to an increase in large losses for commercial auto and other & product liability, as well as growth. Loss and loss expenses payable as of December 31, 2009 increased $49.4 million from December 31, 2008. The increase, driven by the personal insurance segment, was primarily due to growth in exposures in our standard auto and homeowners business. We conduct quarterly reviews of loss development reports and make judgments in determining the reserves for ultimate losses and loss expenses payable. Several factors are considered by us when estimating ultimate liabilities including consistency in relative case reserve adequacy, consistency in claims settlement practices, recent legal developments, historical data, actuarial projections, accounting projections, exposure changes, anticipated inflation, current business conditions, catastrophe developments, late reported claims, and other reasonableness tests.

The risks and uncertainties inherent in our estimates include, but are not limited to, actual settlement experience different from historical data, trends, changes in business and economic conditions, court decisions creating unanticipated liabilities, ongoing interpretation of policy provisions by the courts, inconsistent decisions in lawsuits regarding coverage and additional information discovered before settlement of claims. Our results of operations and financial condition could be impacted, perhaps significantly, in the future if the ultimate payments required to settle claims vary from the liability currently recorded.

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Acquisition and Operating Expenses

Our GAAP expense ratio was 33.8% in 2010 compared to 34.1% and 34.6% in 2009 and 2008, respectively.

In the second quarter of 2009, we initiated a plan to reorganize our field and claims operations. We recognized restructuring costs totaling $2.3 million during the year ended December 31, 2010, which increased our GAAP loss and LAE and expense ratios by 0.1 points each. We recognized restructuring costs totaling $4.8 million during the year ended December 31, 2009, which increased our GAAP loss and LAE and expense ratios by 0.2 points each. See Note 9, Restructuring Costs to our consolidated financial statements included in Item 8 of this Form 10-K.

Investment Operations Segment

Our investment portfolio and the investment portfolios of other members of the State Auto Group are managed by our subsidiary, Stateco. Stateco utilizes its own personnel to invest in fixed maturities and large-cap equities and outside investment managers to invest in small-cap equities and international funds. The Investment Committee (the Committee) of the Board of Directors establishes the investment policies to be followed by Stateco. Our primary investment objectives are to generate income, preserve capital and maintain adequate liquidity for the payment of claims and expenses. Our current investment strategy does not rely on the use of derivative financial instruments.

Our decision to make a specific investment is influenced primarily by the following factors: (a) investment risks; (b) general market conditions; (c) relative valuations of investment vehicles; (d) general market interest rates; (e) our liquidity requirements at any given time; and (f) our current federal income tax position and relative spread between after tax yields on tax exempt and taxable fixed maturity investments.

We have investment policy guidelines with respect to purchasing fixed maturity investments for our insurance subsidiaries which preclude investments in bonds that are rated below investment grade by a recognized rating service. For the insurance subsidiaries, the maximum investment in any single note or bond is limited to 5.0% or less of statutory assets, other than obligations of the U.S. government or government agencies, for which there is no limit. Our fixed maturity portfolio is composed of high quality, investment grade issues, comprised almost entirely of debt issues rated AAA or AA. At December 31, 2010, there were no fixed maturity investments rated below investment grade in our available-for-sale investment portfolio. At December 31, 2010 and 2009, our only investments in mortgage backed securities were in federal agency pools (Fannie Mae and Freddie Mac) and government guaranteed pools (Ginnie Mae).

Our internally managed equity portfolio invests in U.S. large-cap, dividend-paying companies across many different industries selected based upon their potential for appreciation as well as ability to continue paying dividends. This diversification across companies and industries reduces volatility in the value of the large-cap equity portfolio. In addition, our investment policy guidelines limit the purchase of a specific stock to no more than 2% of the market value of the stock at the time of purchase, and no single equity holding should exceed 5% of the total equity portfolio.

Our externally managed equity portfolios invest in U.S. small-cap equities and international funds. These managers are permitted to manage the portfolios according to their own respective portfolio objectives. In selecting our outside investment managers we confirm that their portfolio objectives, including risk tolerance, are acceptable to us. However, there may be slight differences in their objectives with respect to dividend payments and other constraints that we apply to our large-cap equity holdings.

Diversifying our portfolio into small-cap equities and international equity funds was designed to achieve a greater total return with reduced volatility. We believe that in most market cycles, diversification of the portfolio will be beneficial to us, and we plan to continue to maintain a diversified portfolio.

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At December 31, 2010, our investments in fixed maturities, equity securities and certain other invested assets were held as available-for-sale and carried at fair value. The unrealized holding gains or losses, net of applicable deferred taxes, are included as a separate component of stockholders equity as accumulated other comprehensive income (loss) and as such are not included in the determination of net income (loss).

Composition of Investment Portfolio

The following table sets forth the composition of our investment portfolio at carrying value at December 31, 2010 and 2009:

($ millions)	**December 31, 2010**	**% of Total**	December 31, 2009	% of Total
Cash and cash equivalents	**$ 88.3**	**3.7**	$ 90.3	4.0
Fixed maturities, at fair value:				
Fixed maturities	**1,705.2**	**71.2**	1,691.8	74.5
Treasury inflation-protected securities	**195.5**	**8.2**	140.0	6.2
Total fixed maturities	**1,900.7**	**79.4**	1,831.8	80.7
Notes receivable from affiliate (1)	**70.0**	**2.9**	70.0	3.1
Equity securities, at fair value:				
Large-cap securities	**211.1**	**8.8**	196.1	8.6
Small-cap securities	**45.1**	**1.9**	28.0	1.2
Total equity securities	**256.2**	**10.7**	224.1	9.8
Other invested assets, at fair value:				
International instruments	**75.3**	**3.1**	48.3	2.1
Other invested assets	**4.4**	**0.2**		