Li Chunshi
Form 3
March 04, 2009

FORM 3

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

OMB APPROVAL

OMB Number:	3235-0104
Expires:	January 31, 2005
Estimated average burden hours per response...	0.5

INITIAL STATEMENT OF BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
Â Li Chunshi
(Last) (First) (Middle)

TONGLIAO ECO TECH DEVELOP ZONE YUSHAN ST,Â YUSHAN ST N., TONGLIAO CITY
(Street)

INNER MONGOLIA AUTO REGION,Â F4Â 028000
(City) (State) (Zip)

2. Date of Event Requiring Statement
(Month/Day/Year)
08/13/2007

3. Issuer Name **and** Ticker or Trading Symbol
CHINA YILI PETROLEUM CO [CYIP]

4. Relationship of Reporting Person(s) to Issuer
(Check all applicable)
__X__ Director __X__ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
Chairman/CEO

5. If Amendment, Date Original Filed(Month/Day/Year)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Beneficially Owned

1.Title of Security (Instr. 4)	2. Amount of Securities Beneficially Owned (Instr. 4)	3. Ownership Form: Direct (D) or Indirect (I) (Instr. 5)	4. Nature of Indirect Beneficial Ownership (Instr. 5)
common stock	6,431,194	D	Â

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

SEC 1473 (7-02)

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Table II - Derivative Securities Beneficially Owned (*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 4)	2. Date Exercisable and Expiration Date (Month/Day/Year)	3. Title and Amount of Securities Underlying Derivative Security	4. Conversion or Exercise	5. Ownership Form of	6. Nature of Indirect Beneficial Ownership (Instr. 5)

		(Instr. 4)			
Date Exercisable	Expiration Date	Title	Amount or Number of Shares	Price of Derivative Security	Derivative Security: Direct (D) or Indirect (I) (Instr. 5)

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
Li Chunshi TONGLIAO ECO TECH DEVELOP ZONE YUSHAN ST YUSHAN ST N., TONGLIAO CITY INNER MONGOLIA AUTO REGION,Â F4Â 028000	Â X	Â X	Â Chairman/CEO	Â

Signatures

Li Chunshi	03/04/2009
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 5(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *See* Instruction 6 for procedure.

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2007	High	Low	Dividend
First Quarter	**$35.22**	**$30.61**	**$0.10**
Second Quarter	**34.00**	**28.67**	**0.10**
Third Quarter	**32.25**	**23.99**	**0.15**
Fourth Quarter	**32.38**	**25.39**	**0.15**

2006	High	Low	Dividend
First Quarter	$ 39.94	$ 30.59	$ 0.09
Second Quarter	36.33	31.11	0.09
Third Quarter	32.90	28.40	0.10
Fourth Quarter	35.15	29.25	0.10

(1) Adjusted for stock splits.

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.

Purchases of Common Shares by the Company

The following table provides information with respect to purchases made by us of our common shares during the fourth quarter 2007:

Period	Total number of shares purchased[1]	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs
10/01/07 10/31/07	256,343	$ 27.62	256,343	3,650,657
11/01/07 11/30/07	388,175[2]	26.45	380,705	3,269,952
12/01/07 12/31/07	85,026[3]	27.27	83,482	3,186,470
Total	729,544	26.96	720,530	

(1) On August 17, 2007, State Auto Financial announced that its board of directors had authorized the repurchase, from time to time, of up to 4.0 million of its common shares, or approximately 10% of State Auto Financial s outstanding shares, over a period extending until

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December 31, 2009. State Auto Financial will repurchase shares from State Auto Mutual in amounts that are proportional to the respective current ownership percentages of State Auto Mutual, which is approximately 64%, and other shareholders.

(2) 7,470 shares acquired as a result of stock swap option exercises.

(3) 1,544 shares acquired as a result of stock swap option exercises.

Performance Graph

The line graph below compares the total return on $100 invested on December 31, 2002, 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.

	12/31/2002	12/31/2003	12/31/2004	12/31/2005	12/31/2006	**12/31/2007**
STFC	100.000	148.984	162.136	165.583	181.920	**197.280**
NASDAQ Index	100.000	122.725	149.000	166.399	188.819	**189.206**
NASDAQ Ins. Index	100.000	151.548	168.949	240.058	230.840	**178.389**

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Item 6. Selected Consolidated Financial Data

(dollars and shares in millions, except per share data) Year ended December 31:

	2007	2006	2005*	2004	2003
Statement of Income Data					
GAAP Basis:					
Earned premiums	**$ 1,011.6**	1,023.8	1,050.3	1,006.8	960.6
Net investment income	**$ 84.7**	83.1	78.7	71.8	64.6
Total revenues	**$ 1,113.4**	1,117.4	1,139.5	1,092.4	1,041.7
Net income	**$ 119.1**	120.4	125.9	110.0	63.6
Earned premium growth	**(1.2)%**	(2.5)	4.3	4.8	7.1
Return on average invested assets(1)	**4.3%**	4.4	4.3	4.5	4.6
Balance Sheet Data					
GAAP Basis:					
Total investments	**$ 2,021.2**	1,937.9	1,879.9	1,699.1	1,570.3
Total assets	**$ 2,337.9**	2,255.1	2,274.9	2,168.4	2,029.9
Total notes payable	**$ 118.0**	118.4	118.7	164.5	161.2
Total stockholders equity	**$ 935.5**	834.2	763.5	658.2	542.3
Common shares outstanding	**40.5**	41.0	40.5	40.1	39.6
Return on average equity(2)	**13.5%**	15.1	17.7	18.3	12.6
Debt to stockholders equity	**12.6%**	14.2	15.5	25.0	29.7
Per Common Share Data					
GAAP Basis:					
Basic EPS	**$ 2.90**	2.95	3.12	2.76	1.62
Diluted EPS	**$ 2.86**	2.90	3.06	2.70	1.58
Cash dividends per share	**$ 0.50**	0.38	0.27	0.17	0.15
Book value per share	**$ 23.10**	20.32	18.86	16.42	13.71
Common Share Price:					
High	**$ 35.22**	39.94	38.15	31.83	26.90
Low	**$ 23.99**	28.40	24.30	22.12	14.96
Close at December 31	**$ 26.30**	34.68	36.46	25.85	23.34
Close price to basic EPS	**9.07**	11.76	11.69	9.37	14.41
Close price to book value per share	**1.14**	1.71	1.93	1.57	1.70
GAAP Ratios:(3)					
Loss and LAE ratio	**58.4%**	57.4	58.4	61.5	67.8
Expense ratio	**34.4%**	34.0	31.7	30.2	30.4
Combined ratio	**92.8%**	91.4	90.1	91.7	98.2
Statutory Ratios:(3)					
Loss and LAE ratio	**57.9%**	56.8	58.4	61.6	67.9
Expense ratio	**33.2%**	32.9	31.6	30.6	30.7
Combined ratio	**91.1%**	89.7	90.0	92.2	98.6
Industry combined ratio(4)	**93.8%**	92.7	101.2	98.9	100.1
Net premiums written to surplus(5)	**1.1**	1.2	1.5	1.6	1.9

(1) Invested assets include investments and cash equivalents.

(2) Net income divided by average common stockholders equity.

(3) GAAP ratios are computed using earned premiums for both the loss and LAE ratio and the expense ratio, and include the effect of eliminations in consolidation. The statutory expense ratio is computed using net written premiums. We use the statutory combined ratio to compare our results to the industry statutory combined ratio as there is no industry GAAP combined ratio available.

(4) The industry combined ratios are from A.M. Best. The 2007 industry combined ratio is an estimate.

(5)

We use the statutory net premiums written to surplus ratio as there is no comparable GAAP measure. This ratio, also called the leverage ratio, measures our statutory surplus available to absorb losses.

* Reflects change in Pooling Arrangement, effective January 1, 2005.

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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.

OVERVIEW

State Auto Financial is a property and casualty insurance holding company primarily engaged in writing both personal and business lines of insurance. The State Auto Group markets a broad line of property and casualty insurance products through independent agencies in 33 states.

State Auto Financial s subsidiaries are State Auto P&C, Milbank, Farmers, SA Ohio and SA National, each of which is a property and casualty insurance company; Stateco, which provides investment management services to affiliated insurance companies; S.I.S., a developer and seller of insurance-related software; and 518 PML, which owns and leases property to affiliated companies. S.I.S. and 518 PML are not material to our total operations.

State Auto Mutual owns approximately 64% of State Auto Financial s outstanding common shares.

State Auto P&C, Milbank, Farmers and SA Ohio (STFC Pooled Companies) participate in a quota share reinsurance pooling arrangement (the Pooling Arrangement) with State Auto Mutual, SA Florida, SA Wisconsin, Meridian Security and Meridian Citizens Mutual, which together with STFC Pooled Companies are referred to as the Pooled Companies . The Pooled Companies provide a broad line of property and casualty insurance, such as standard personal and commercial automobile, homeowners and farmowners, commercial multi-peril, workers compensation, general liability and property insurance. SA National, which is not included in the Pooling Arrangement, provides nonstandard personal automobile insurance. Our Pooled Companies and SA National are rated A+ (Superior) by the A.M. Best Company.

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

As of January 1, 2005, the Pooling Arrangement was modified to add Meridian Security and Meridian Citizens Mutual as participants. In conjunction with this modification, the STFC Pooled Companies received $54.0 million in cash from these two companies which related to the additional net insurance liabilities assumed on January 1, 2005.

As of January 1, 2008, the Pooling Arrangement was further modified to add Patrons Mutual, Litchfield and Beacon National as participants and to include the middle market business insurance written by State Auto Mutual and Meridian Security. Concurrently with the addition of Patrons Mutual, Litchfield and Beacon National, the participating percentages of certain participants were adjusted as presented in the table below; however the STFC Pooled Companies continue to maintain an overall share of the pool at 80% and State Auto Mutual and its subsidiaries and affiliates continue to maintain 20%. In conjunction with this modification, the STFC Pooled Companies will receive approximately $92.0 million in cash from State Auto Mutual and its subsidiaries and affiliates.

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The following table sets forth a chronology of the participant and participation percentages for the Pooling Arrangement since January 1, 2005:

	2005-2007[1]	2008[1]
STFC Pooled Companies:		
State Auto P&C	59.0%	59.0%
Milbank	17.0	17.0
Farmers	3.0	3.0
SA Ohio	1.0	1.0
Subtotal	80.0	80.0
Mutual Pooled Companies:		
State Auto Mutual	19.5	19.0
SA Wisconsin	0.0	0.0
SA Florida	0.0	0.0
Meridian Security	0.0	0.0
Meridian Citizens Mutual	0.5	0.5
Beacon National	N/A	0.0
Patrons Mutual	N/A	0.4
Litchfield	N/A	0.1
Subtotal	20.0	20.0

(1) Time period is for the year ended December 31, except for 2008, which is as of January 1, 2008.

The remainder of this discussion refers to the Pooling Arrangement in effect prior to January 1, 2008, unless otherwise noted.

Prior to January 1, 2007, we operated in two significant reportable segments, a standard segment and a nonstandard segment. In 2006, we undertook initiatives to realign our internal organization, specifically our people, processes, internal reporting systems and compensation reward programs, to become more focused within the business and personal insurance markets. We established integrated personal and business insurance teams with product, profit and production responsibilities for their respective areas. Consequently, beginning with first quarter 2007, our significant reportable segments are personal insurance, business insurance (collectively the insurance segments or our insurance segments) and investment operations, and we have begun reporting to our principal operating decision makers on these bases, analyzing each segment separately, to support our risk-based pricing focus.

We evaluate the performance of our insurance segments using industry financial measurements determined based on Statutory Accounting Principles (SAP), which include loss and loss adjustment expense ratios, underwriting expense ratios, combined ratios, statutory underwriting gain (loss), net premiums earned and net written premiums. One of the most significant differences between SAP and Generally Accepted Accounting Principles (GAAP) is that SAP requires all underwriting expenses to be expensed immediately and not deferred over the same period the premium is earned. We evaluate our investment operations segment based on investment returns of assets. Financial information about our segments for 2007 is set forth in Note 15 to our Consolidated Financial Statements included in Item 8 of this Form 10-K. Prior period segment information has been restated to conform to current period presentation.

EXECUTIVE SUMMARY

The results of our operations from year-to-year and quarter-to-quarter are primarily driven by our ability to generate revenue through selecting and pricing risks in a manner that permits premium growth without adversely

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affecting underwriting profits, and disciplined investment strategy. We also recognize that our results will be periodically impacted, sometimes significantly, by the occurrence of catastrophic events, which are generally beyond our control.

Premium Growth/Underwriting Profitability: The property and casualty insurance industry is highly cyclical. Our industry 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 increased prices and more favorable underwriting terms. During periods of excess underwriting capacity, some property and casualty insurers attempt to generate additional top line growth by setting their prices at levels inappropriate for the risk underwritten. While in the short term this may result in additional revenues, this action compromises their long term underwriting profitability. Our strategy is to insure personal and small-to-medium business risks while adhering to disciplined and consistent underwriting principles through all market cycles.

Our underwriting principles include insistence on selecting and retaining business based on the merits of each account and a dedication to cost-based pricing, where each line of business is priced to generate a profit. It is our intention to set pricing levels so that no line of business, or classification within major lines, subsidizes another line or classification. We are committed to achieving an underwriting profit through all market cycles, even at the expense of periodic slowdowns in written and earned premiums. We will not compromise underwriting profitability for top line growth. We believe that we can implement periodic rate changes in most states and remain an attractive market to our policyholders and independent agents by stressing the strengths we bring to the marketplace. These strengths include stability, financial soundness, prompt and fair claims service, and technology which make it easier for the agent to do business with the State Auto Group and provide substantial value to our customers. We carefully monitor writing insurance in states that we believe present difficult legislative, judicial and/or regulatory environments for the insurance industry.

Investment Strategy: We have a disciplined approach to our investment strategy that emphasizes the quality of our fixed maturity portfolio, which comprised 86% of our total portfolio at fair value at December 31, 2007, and includes only investment grade securities. During the last year our strategy has included increasing our positions in tax-exempt fixed maturities in an effort to maximize after tax investment income in conjunction with diversifying into additional asset classes, such as treasury inflation protected securities. Our only investments in asset-backed securities are in federal agency pools and government guaranteed GNMAs. Our internally managed equity portfolio, which comprised approximately 13% at fair value of our total portfolio at December 31, 2007, emphasizes large-cap, dividend-paying companies selected based upon their potential for appreciation as well as ability to continue paying dividends. During the fourth quarter, 2007, we began to diversify our equity portfolio, and utilize outside managers to invest in U.S. small-cap equities and international instruments. By diversifying, we hope to achieve a greater total return with reduced volatility.

Loss Reserves: We maintain reserves for the eventual payment of losses and loss expenses for both reported claims and incurred claims that have not yet been reported. Loss reserves are management s best estimates at a given point in time of what we expect to pay to claimants, based on facts, circumstances and historical trends then known. Although management uses many resources to calculate reserves, there is no precise method for determining the ultimate liability. We do not discount loss reserves for financial statement purposes. Our objective is to set reserves that are adequate such that the amounts that we originally record as reserves reasonably approximate the ultimate liability for insured losses and loss expenses. We then periodically review and adjust loss reserves on a timely basis.

Catastrophic Events: We are exposed to claims arising out of catastrophic events. Catastrophe losses can and do cause substantial volatility in our financial results for any fiscal quarter or year. 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. The frequency and severity of catastrophes are inherently unpredictable. The extent of losses from a

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catastrophe is a function of both the total amount of insured exposure in the area affected by the event and the severity of the event. Many catastrophes are restricted to small geographic areas. However, hurricanes, earthquakes and other perils may produce significant damage in larger areas, especially those that are heavily populated. 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, other personal lines, allied lines and commercial multiple peril coverages. We deploy specific strategies designed to mitigate our exposure to catastrophe losses, which include obtaining reinsurance. We continually seek to diversify our business on a geographic basis. The number of states we operate in has increased from 17 states in 1991 to 33 states as of January 1, 2008. As we begin 2008, the concentration of our direct written premiums for our property and casualty operations in our largest state, Ohio, has decreased from 28% for the year ended December 31, 1991, to approximately 17% at January 1, 2008. Our underwriting guidelines are designed to limit exposures to high risk insurance matters such as asbestos and environmental claims. Our catastrophe management strategies are designed to mitigate our exposure to earthquakes and hurricanes.

In addition to our adherence to our cost-based pricing, investment and risk mitigation strategies discussed above, our management focuses on several other key areas with the intention of continually improving the results of our operations and financial results, including the following:

Claims Service: We believe an important element of our success is our focus on claims service. We expect our claim service to be fair, fast and friendly. The role of the claims division is to deliver the promise that we and the independent agent made to the insured. We have the capability of receiving claims 24 hours a day, seven days a week. Claims may be reported to our Claims Contact Center, to the policyholder s independent agent or via the Internet. We make a pledge to our policyholders to try and make contact with them within two hours of a claim being assigned to a claims handler (except in catastrophe loss situations). In 2007, we established claims catastrophe teams to enhance our response to policyholders in catastrophe loss situations.

Independent Insurance Agent Network: We offer our products through over 3,000 agencies in 33 states. We believe the success of our independent insurance agent network, which is our only distribution channel, grows out of our commitment to promote and foster close working relationships with our agents. We seek relationships with agencies where we will be one of their top three insurers, measured on the basis of direct premiums written, for the type of business we desire. Our agents compensation package includes competitive commission rates and other sales inducements designed to maintain and enhance relationships with existing independent agents as well as to attract new independent agents. We provide our agents with a co-operative advertising program, sales training programs, contingent commissions, travel incentives and agency recognition. We continually monitor our agencies for compatibility with us, taking into account factors such as loss ratio, premium volume, business profiles and relationship history. This allows us to be proactive in helping our agents grow their book of business with us profitably and, thus, enhance the long-term value of our relationship. Our senior management meets frequently with agents to encourage mutual growth and demonstrate our commitment. We believe each of these elements creates a relationship that has resulted in our independent insurance agents placing quality insurance business with us.

Technology: Our technology efforts are focused on making us as efficient and effective as possible. In 2007, our personal insurance segment technology leveraged past successes with our netXpress agency portal by putting emphasis on the integration between various third party technologies and netXpress. One such example was adding functionality to bridge data directly into our netXpress portal from comparative rating tools thus eliminating the re-keying effort and increasing the data quality level. Agency personnel have welcomed this functionality and rewarded us with increased quote opportunities and submissions. It has also positioned us to be more effective on book rollover opportunities. Other integration examples include agency management systems and services that dynamically order underwriting products like motor vehicle reports, credit reports, and geographic data used in our pricing algorithms.

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Our business insurance segment benefited by the introduction of our bizXpress^{SM} portal. The bizXpress^{SM} portal was deployed in all of our states of operation (except Florida) in 2007. During the course of 2007, several disciplines were more effectively used in our technology efforts. Quality assurance practices were formalized and used resulting in less defects in applications once deployed. Additionally, more project management rigor and application governance allowed our project delivery to be more predictable for all business segments. Finally, we implemented performance testing tools and application monitoring technologies so we can increase our responsiveness and operate our information systems infrastructure efficiently.

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.

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 as accumulated other comprehensive income, 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-temporary, an assessment that requires significant management judgment. Among the factors we consider are the nature of the investment, severity and length of decline in fair value, events impacting the issuer, overall market conditions and our intent and ability to hold securities until the value recovers. When a security in our investment portfolio 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 changed for subsequent recoveries in fair value. For a further discussion regarding our investments see 2007 Compared to 2006 and 2006 Compared to 2005 included in this Item 7.

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 premium to be earned, losses and loss expenses expected to be incurred, and certain other costs expected to be incurred as premium is earned. These amounts are based on estimates, and accordingly, the actual realizable value may vary from the estimated realizable value.

Losses and Loss Expenses Payable

Losses and loss expenses payable are management s best estimates at a given point in time of what we expect to pay claimants, based on known facts, circumstances and historical trends. Reserves for reported losses are established on either a case-by-case or formula basis depending on the type and circumstances of the loss.

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The case-by-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 policy provisions relating to types of loss. The formula reserves are based on historical data for similar claims with provision for trend changes caused by inflation. Case and formula basis loss 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.

Loss and loss expense reserves for incurred claims that have not yet been reported (IBNR) are estimated based on many variables including historical and statistical information, inflation, legal developments, storm loss estimates, and economic conditions. The process for calculating IBNR is to develop an estimate of the ultimate losses incurred, and then subtract all amounts already paid or held in tabular case reserves. Although we use many internal and external resources, as well as multiple established methodologies to calculate IBNR, there is no method for determining the exact ultimate liability. For a further discussion regarding our losses and loss expense reserves and our reserving methods see Other Loss and Loss Expense Reserves included in this Item 7.

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. For a further discussion regarding our pension and postretirement benefit obligations see Other Employee Benefit Plans included in this Item 7.

Share-Based Compensation

We have share-based compensation plans which authorize the granting of various equity-based incentives including stock options, restricted stock and restricted share units to employees and non-employee directors and agents. The expense for these equity-based incentives is based on their fair value at date of grant or each reporting date and amortized over their vesting period. The fair value of each stock option granted is estimated on the date of grant or each reporting date using the Black-Scholes closed-form pricing model. The pricing model requires assumptions such as the expected life of the option and expected volatility of our stock over the expected life of the option, which significantly impacts the assumed fair value. We use historical data to determine these assumptions and if these assumptions change significantly for future grants, share-based compensation expense will fluctuate in future periods.

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.

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RESULTS OF OPERATIONS

Summary

The following table summarizes certain key performance indicators used to manage our operations for the years ended December 31, 2007, 2006 and 2005, respectively:

($ millions, except per share data)	**2007**	2006	2005
GAAP Basis:			
Total revenues	**$ 1,113.4**	1,117.4	1,139.5
Net income	**$ 119.1**	120.4	125.9
Stockholders equity[1]	**$ 935.5**	834.2	763.5
Book value per share[1]	**$ 23.10**	20.32	18.86
Loss and LAE ratio[2]	**58.4**	57.4	58.4
Expense ratio[2]	**34.4**	34.0	31.7
Combined ratio	**92.8**	91.4	90.1
Catastrophe loss and LAE points[2]	**3.7%**	8.9	6.9
Premium written growth[3]	**0.0%**	(2.5)	5.0
Premium earned growth	**(1.2)%**	(2.5)	4.3
Investment yield	**4.3%**	4.4	4.3
SAP Basis:			
Loss and LAE ratio[4]	**57.9**	56.8	58.4
Expense ratio[4]	**33.2**	32.9	31.6
Combined ratio[4]	**91.1**	89.7	90.0
Net premiums written to surplus[5]	**1.1**	1.2	1.5

(1) At December 31, 2006, accumulated comprehensive income was reduced by $63.9 million and book value per share was reduced by $1.56, respectively, in connection with the initial adoption of SFAS 158 (defined below) at December 31, 2006. For a further discussion of the impact of SFAS 158, see Other Employee Benefit Plans included in this Item 7.

(2) See 2007 Compared to 2006 section below for definitions.

(3) 2.3 points of the increase for 2005 related to the $24.0 million of unearned premiums transferred to us in connection with the addition of the Meridian Security and Meridian Citizens Mutual to the Pooling Arrangement.

(4) SAP loss and LAE ratio is statutory losses and loss expenses as a percentage of net earned premium. SAP expense ratio is statutory underwriting expenses and miscellaneous expenses offset by miscellaneous income (underwriting expenses) as a percentage of net written premiums. SAP combined ratio is the sum of the SAP loss and LAE ratio and the SAP expense ratio.

(5) We use the statutory net premiums written to surplus ratio because there is no comparable GAAP measure. This ratio, also called the leverage ratio, measures our statutory surplus available to absorb losses.

2007 Compared to 2006

Income before federal income tax decreased $6.4 million (4.0%) to $155.3 million from 2006. The most significant factors contributing to this decrease related to a decline in our revenues, specifically our premiums, and an increase in our loss and loss expenses. Our GAAP loss and loss expense ratio for 2007 was 58.4% compared to 57.4% in 2006.

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. The more common financial measures used are loss and LAE ratio, underwriting expense ratio, combined ratio, net premiums written and net premiums earned. The combined ratio is the sum of the loss and LAE ratio and the underwriting expense ratio. When the

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combined ratio is less than 100%, the insurer is operating at an underwriting gain and when it is greater than 100%, the insurer is operating at an underwriting loss. Underwriting gain (loss) is determined by subtracting from net earned premiums, losses and loss expenses and underwriting expenses.

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 policy acquisition costs see Critical Accounting Policies Deferred Acquisition Costs included in this Form 10-K. The GAAP combined ratio is defined as the sum of the GAAP loss and LAE ratio (loss and loss expenses as a percentage of earned premiums) plus GAAP expense ratio (acquisition and operating expenses as a percentage of earned premiums). All references to financial measures or components thereof in this discussion are calculated on a GAAP basis, unless otherwise noted.

The following tables provide a summary of our insurance segments SAP underwriting gain and SAP combined ratio for the years ended December 31, 2007 and 2006:

($ millions)	2007					
		%		%		%
	Personal	**Ratio**	**Business**	**Ratio**	**Total**	**Ratio**
Written premiums	**$ 615.1**		**$ 404.7**		**$ 1,019.8**	
Earned premiums	**609.6**		**402.0**		**1,011.6**	
Losses and loss expenses	**378.4**	**62.1**	**207.2**	**51.5**	**585.6**	**57.9**
Underwriting expenses	**183.9**	**29.9**	**154.2**	**38.1**	**338.1**	**33.2**
SAP underwriting profit and SAP combined ratio	**$ 47.3**	**92.0**	**$ 40.6**	**89.6**	**$ 87.9**	**91.1**

($ millions)	2006					
		%		%		%
	Personal	Ratio	Business	Ratio	Total	Ratio
Written premiums	$ 612.8		$ 406.7		$ 1,019.5	
Earned premiums	614.8		409.0		1,023.8	
Losses and loss expenses	389.6	63.4	192.4	47.0	582.0	56.8
Underwriting expenses	180.4	29.4	155.1	38.1	335.5	32.9
SAP underwriting profit and SAP combined ratio	$ 44.8	92.8	$ 61.5	85.1	$ 106.3	89.7

Revenue

We measure our top-line growth for our insurance segments based on net written premiums, which represent the premiums on the policies we have issued for a period, net of reinsurance. Net written premiums 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. The unearned portion of written premiums, called unearned premiums, is reflected on our balance sheet as a liability and represents our obligation to provide coverage for the unexpired terms of the policy.

Personal Insurance Segment Revenue

Our personal insurance segment consists primarily of auto (standard and nonstandard) and homeowners products, with personal auto representing approximately 40% of our total consolidated net written premium in

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2007 and 2006. The following table provides 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, 2007 and 2006:

($ millions)	**2007**	2006	% Change
Personal Insurance Segment:			
Net Written Premium			
Standard auto	**$ 361.5**	361.7	(0.1)
Nonstandard auto	**42.7**	42.4	0.7
Homeowners	**187.7**	186.1	0.9
Other personal	**23.2**	22.6	2.7
Total personal	**$ 615.1**	612.8	0.4
Net Earned Premium			
Standard auto	**$ 357.3**	362.1	(1.3)
Nonstandard auto	**42.9**	44.8	(4.2)
Homeowners	**186.5**	185.2	0.7
Other personal	**22.9**	22.7	0.9
Total personal	**$ 609.6**	614.8	(0.8)

In total, the personal insurance segment net written premium increased from 2006 by 0.4%. While a modest increase, it does represent an improvement from 2006 which declined approximately 3.5% from 2005. In particular, competition remains intense within the personal auto market, which is contributing to our overall modest growth. It remains our strategy that rates be risk-based, reflecting the underlying loss and expense trends.

Net written premiums for our standard auto products decreased 0.1% in 2007 compared to 2006. The competitive marketplace combined with some rate reductions in 2007 contributed to this result. However, we have seen increasing new business production related to the introduction of our CustomFit[SM] product into new states. CustomFit[SM] uses a multi-variate rating approach that broadens the underwriting eligibility for new customers. In 2007, we began introducing the second generation of CustomFit[SM], which further improves our rating sophistication.

Net written premiums for nonstandard personal auto increased 0.7% in 2007 compared 2006. This represents a significant improvement compared to the 2006 premium result which declined 13.3% from 2005. Targeted rate decreases coupled with the introduction of new discounts and an increased marketing effort contributed to an increased level of new policy submissions leading to an increase in premiums.

We believe independent agents value ease of doing business and make it an important factor in their choice of insurance companies when quoting personal auto products to their customers. During 2007, we introduced in 17 states various real time comparative rating tools which can be used by our independent agents to prepare comparative rate quotes from multiple insurance companies by entering the rating information once. We believe our independent agents will quote and write more personal standard and nonstandard auto with us as a result of a more efficient quoting process.

Homeowners net written premium increased 0.9% in 2007 compared to 2006. In 2007, we introduced a home purchase discount and expanded our age of dwelling discounts to help attract new business which we believe contributed favorably to increased new homeowners policy submission levels.

During 2007, we continued to enhance our personal lines point of sale portal, netXpress, by adding several new integration options with a variety of third party tools used by our independent agents including a

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joint credit ordering tool, integrated report ordering, and the comparative rating tools mentioned above. We also have added a number of internal integration points through the use of web services technology. One example of this is real time integration with our enterprise billing system to provide accurate installment information via netXpress™ . The goal of these technology investments is to streamline quoting and policy issuance for our agents. We strive to be their carrier of choice and ease of doing business is a major driver toward that goal.

We have also focused on improving our policyholders ease of doing business with respect to bill payment and claim reporting and settlement. In 2006, we expanded our premium payment options to include credit and debit card via www.stateauto.com. In 2007, we deployed an Interactive Voice Response (IVR) solution to accept premium payments over the phone providing yet another option for policyholders. The IVR solution provides a more efficient business process for our payment services department and is expected to drive better policy retention results. During 2007, nearly 189,000 payments were made through self-service technologies such as these representing over $76 million of premium payments.

Additionally, we recently completed several strategic initiatives to enhance our claims handling ability and better manage major catastrophes. Field claims personnel are now equipped with mobile devices that permit adjusting property claims at the loss site. We believe that our professional claims service backed by reliable technology will continue to distinguish us from our competitors.

During the second quarter 2007, we filed an application with the Florida Department of Insurance to withdraw from the state s personal lines insurance market effective January 1, 2008. After a careful analysis of recent regulatory changes in Florida, we concluded that we could no longer operate our personal lines on a profitable basis in that state. Non-renewals on this business are in process. We will continue to write commercial lines business in Florida. During 2007, we wrote $12.5 million of personal lines premium in Florida.

Business Insurance Segment Revenue

We focus our business insurance sales on small to medium sized exposures and offer a broad range of both property and liability coverages such as commercial auto, commercial multi-peril, fire and allied lines, products liability and workers compensation. The following table provides a summary of written and earned premium, net of reinsurance, by major product line of business for our business insurance segment for the years ended December 31, 2007 and 2006:

($ millions)	**2007**	2006	% Change
Business Insurance Segment:			
Net Written Premium			
Commercial auto	**$ 95.8**	98.7	(2.9)
Commercial multi-peril	**86.6**	87.8	(1.4)
Fire & allied lines	**84.0**	83.1	1.1
Other & product liability	**75.6**	77.2	(2.1)
Workers compensation	**36.1**	34.3	5.2
Other commercial	**26.6**	25.6	3.9
Total business	**$ 404.7**	406.7	(0.5)
Net Earned Premium			
Commercial auto	**$ 96.9**	100.3	(3.4)
Commercial multi-peril	**86.8**	87.5	(0.8)
Fire & allied lines	**83.4**	84.2	(1.0)
Other & product liability	**75.5**	77.5	(2.6)
Workers compensation	**33.4**	33.8	(1.2)
Other commercial	**26.0**	25.7	1.2
Total business	**$ 402.0**	409.0	(1.7)

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The business insurance segment net written premium for 2007 decreased 0.5% from 2006. Business insurance continues to be impacted by rate competition and ease of doing business issues. We are seeking to balance our traditional underwriting discipline with new products and pricing tools that support the production of profitable new business.

In 2007, we began offering our business products in two new states Colorado and Texas and increased the number of business products offered in Arizona.

We also continue to enhance our back office systems which enable us to more effectively support our independent agents. We recently implemented the technology to provide real time functionality in our business insurance policy administration systems for quote and issuance transactions. Also known as straight through processing (STP), our associates are now able to more effectively and accurately handle typical business insurance processing. The policy service time has been greatly reduced as a result of this new technology.

To make it easier for our agents to submit business insurance accounts, in 2007, we introduced bizXpress^{SM}, our web-based quote and issuance system, to agents in all of our operating states except Florida. We currently utilize bizXpress^{SM} for businessowners policies. We are working to expand bizXpress^{SM} functionality to our business auto products in the first half of 2008, while we develop the same functionality for workers compensation business for introduction at a later date. This has been a highly collaborative initiative that has included agent focus group input throughout the project lifecycle. It also leverages the STP technology investment mentioned above. 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.

Losses and Expenses

Our GAAP loss and LAE ratio was 58.4% in 2007 compared to 57.4% in 2006. Loss results for the year have been mixed. Our core auto (personal and business) and other and product liability lines continue to perform well. On the property side, catastrophe losses for 2007 were lower than in 2006, but we experienced significantly higher frequency of large fire losses within our personal and business lines during 2007.

Losses and loss expenses for a calendar year represent the combined estimated ultimate liability for claims occurring in the current calendar year along with development of claims occurring in prior years. The following table presents the provision for losses and loss expenses for those claims occurring in the current calendar year and prior years, along with the GAAP loss and LAE ratio for the years 2007 and 2006, respectively:

($ millions)	**2007**	**% GAAP loss and LAE**	2006	% GAAP loss and LAE
Provision for losses and loss expenses occurring:				
Current year	**$ 645.5**	**62.7**	659.3	64.4
Prior years	**(54.7)**	**(4.3)**	(71.7)	(7.0)
Total losses and loss expenses	**$ 590.8**	**58.4**	587.6	57.4

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A tabular presentation of the 2007 $54.7 million favorable development broken down by accident year is shown below.

($ millions)

Accident year		Current year development of ultimate liability *Redundancy /(Deficiency)*
1997 and prior	$	(4.8)
1998		(0.1)
1999		0.2
2000		0.2
2001		1.8
2002		1.1
2003		4.3
2004		2.3
2005		20.2
2006		29.5
Total	$	54.7

Normal fluctuations and uncertainty associated with loss reserve development and claim settlement contributed to favorable development in the respective calendar years. The favorable development of $54.7 million in 2007 came primarily from accident years 2005-2006. The more notable items contributing to the 2007 development are:

Favorable development at the product level is primarily from the auto liability and other liability lines, where current loss projections using more mature claim data resulted in lower expected average claim severities than past projections. The impact is approximately $23.5 million for these two lines combined.

Adjusting and other expense reserves accounted for approximately $11.8 million of prior year reserve change. These expense reserves have a proportional relationship to the overall claim inventory and held reserves by accident year, as they move up or down in relation to carried loss reserves. Since reserves decreased for the prior accident years, the expense reserves declined in a similar fashion. (Allocated loss adjustment expenses (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. Unallocated loss adjustment expenses (ULAE) are those costs incurred in settling claims, such as in-house processing costs, for which no identification can be made to specific claims. Adjusting and other expenses are the components of ALAE and ULAE that relate to costs other than defense, litigation, and medical cost containment.)

We hold ceded loss reserves in anticipation of transferring liabilities to reinsurers and other pools and associations. Ceded loss reserves were above previously anticipated levels by approximately $10.0 million. Historically, we have had less ceded loss activity because our reinsurance retention levels are generally high enough to exclude most claims. This favorable development occurred primarily in the fire, auto liability and workers compensation lines.

Favorable catastrophe loss development of approximately $4.6 million is attributable to the 2006 accident year. This development occurred primarily within our homeowners, other personal and commercial multi-peril lines of business.

The remaining favorable development is spread across several lines of business and is generally the result of having fewer claims emerge and lower claim severity than anticipated in the estimates developed as of December 31, 2006.

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See discussion regarding the 2006 calendar year development at 2006 Compared to 2005 Losses and Expenses section included herein. See additional discussion regarding loss and loss expense reserves at the Other Loss and Loss Expense Reserves section included herein.

Catastrophe losses in 2007 totaled $37.1 million (3.7 loss ratio points) compared to $91.2 million (8.9 loss ratio points) in 2006. During 2007, our catastrophe losses resulted primarily from wind and hail in several Midwestern states and mostly impacted our homeowners business. Catastrophe activity in 2006 had a significant impact on both our personal and business insurance property lines. The discussion of catastrophe losses includes those which have been designated as such by ISO s Property Claim Services (PCS) unit, a nationally recognized industry service. PCS defines catastrophes as events resulting in $25.0 million or more in insured losses industry wide and affecting significant numbers of insureds and insurers.

The following table provides our insurance segments comparative SAP loss and LAE ratios (loss ratios) by major line of business for 2007 and 2006:

	2007	2006	Improve (Deteriorate)
Personal insurance segment:			
Standard auto	**61.5**	57.0	(4.5)
Nonstandard auto	**63.2**	60.0	(3.2)
Homeowners	**64.6**	78.1	13.5
Other personal	**48.2**	51.1	2.9
Total personal	**62.1**	63.4	1.3
Business insurance segment:			
Commercial auto	**52.2**	40.3	(11.9)
Commercial multi-peril	**59.3**	48.6	(10.7)
Fire & allied lines	**49.1**	58.3	9.2
Other & product liability	**43.5**	37.5	(6.0)
Workers compensation	**74.6**	57.5	(17.1)
Other commercial	**24.8**	46.3	21.5
Total business	**51.5**	47.0	(4.5)
Total SAP personal and business	**57.9**	56.8	(1.1)

The personal insurance segment loss ratio was 1.3 points lower in 2007 than in 2006. Catastrophes accounted for 5.0 loss ratio points in 2007 compared to 11.9 points in 2006 period. Excluding the impact of catastrophes, the personal lines loss ratio in 2007 was 5.5 points higher than in 2006 period. The increase in both the standard and nonstandard auto loss ratios can be attributed partially to rate reductions taken in 2006 and 2007. The improvement in the homeowners loss ratio can be attributed primarily to the reduction of catastrophe losses. In 2007, catastrophes added 14.2 points to the homeowners loss ratio compared to 32.2 points in 2006 period.

The business insurance segment s loss ratio for 2007 was 4.5 points higher than in 2006. Catastrophes accounted for 1.6 loss ratio points in 2007 compared to 4.3 points in 2006. Excluding the impact of catastrophes, the business lines loss ratio in 2007 was 7.2 points higher than in 2006. The overall increase reflects rate reductions in premium per exposure on business written in 2006 and 2007 and an increase in the number of large property losses. Workers compensation, which represents approximately 9.0% of our business insurance portfolio and less than 4.0% of our overall insurance segment portfolio, tends to be a more volatile line of business due to its size and risks written. We do not write mono-line workers compensation, but make our product available as part of the business package policy. The increase in the level of 2007 losses as compared to 2006 was driven largely by an increase in severity rather than frequency. We regularly monitor frequency and

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severity trends, as well as the overall construction of our workers compensation book of business. In addition, we promote the writing of the low-hazard risk types that have developed a consistent pattern of profitability.

Acquisition and operating expenses, as a percentage of earned premiums (GAAP expense ratio) were 34.4% in 2007 compared to 34.0% in 2006. The 2007 expense ratio was largely impacted by a lower premium base in 2007 compared to 2006.

Investment Operations Segment

Our investment portfolio and the investment portfolios of State Auto Mutual, and its subsidiaries and affiliates are managed by our subsidiary, Stateco. The Investment Committee of the Board of Directors of each of our insurers sets investment policies to be followed by Stateco.

At December 31, 2007, 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 loss and as such are not included in the determination of net income.

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.

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, 2007, we had no fixed maturity investments rated below investment grade. Our only investments in asset-backed securities are in federal agency pools and government guaranteed GNMAs.

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.

During the fourth quarter 2007, we began to diversify our equity portfolio and utilize outside money managers to invest in U.S. small-cap equities and international instruments. These managers are permitted to manage the portfolios according to their own respective portfolio objectives. In selecting our outside money 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. By further diversifying our portfolio into small-cap equities and international instruments, we hope to achieve a greater total return with reduced volatility.

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In August 2007, we completed a portfolio diversification study with the objective to reduce the volatility of the returns and improve our overall after-tax return while continuing to maintain a high-quality portfolio. Based on this study, the Committee (defined below) approved the following target asset allocation:

Cash and cash equivalents	**3.5%**
Core fixed maturities	**69.0**
Treasury inflation protected securities	**10.0**
Large-cap equities	**10.5**
Small-cap equities	**3.0**
International instruments	**4.0**
Total portfolio	**100.0%**

Composition of Investment Portfolio

Beginning in the fourth quarter of 2007, we began investing funds as they became available moving toward our targeted asset allocations over the next 12 to 18 months. The following table provides a breakdown of our investments relative to our targeted allocated percentages provided above at December 31, 2007. We measure our investment portfolio allocation with fixed maturities at amortized cost and equities and international instruments at fair value.

($ millions)		**% of Total**
Cash and cash equivalents	**$ 70.9**	**3.4**
Core fixed maturities	**1,710.0**	**82.6**
Treasury inflation protected securities	**12.9**	**0.6**
Large-cap equities	**242.7**	**11.7**
Small-cap equities	**11.5**	**0.6**
International instruments	**15.9**	**0.8**
Other invested assets	**5.7**	**0.3**
Total portfolio	**$ 2,069.6**	**100.0**

The following table provides the composition of our available-for-sale investment portfolio at December 31, 2007 and 2006, respectively:

($ millions)	**2007**		2006	
Fixed maturities	**$ 1,745.4**	**86.4%**	1,647.4	85.1
Equity securities	**254.2**	**12.6**	284.2	14.7
Other invested assets	**20.3**	**1.0**	4.5	0.2
Total investments, at fair value	**$ 2,019.9**	**100.0%**	1,936.1	100.0

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The amortized cost and fair value of fixed maturities at December 31, 2007, by contractual maturity, are as follows:

($ millions)	Amortized Cost	Fair Value
Due in 1 year or less	$ 16.9	16.9
Due after 1 year through 5 years	60.5	62.5
Due after 5 years through 10 years	437.5	451.1
Due after 10 years	1,019.4	1,025.4
U.S. government agencies mortgage-backed securities	188.6	189.5
Total	$ 1,722.9	1,745.4

Expected maturities may differ from contractual maturities as the issuers may have the right to call or prepay the obligations with or without call or prepayment penalties.

At December 31, 2007, our equity portfolio consisted of approximately 80 different large-cap stocks and 325 small-cap stocks. The largest single position was 3.2% of the equity portfolio based on fair value and the top ten positions were equal to approximately 25.1% of the equity portfolio.

Our equity portfolio consists primarily of large-cap, value-oriented stocks with a small allocation to small-cap equities. Therefore, when large-cap stocks and/or value-oriented stocks perform well our equity portfolio typically performs well compared to benchmarks. Conversely, when growth stocks outperform value and/or small- to mid-cap stocks outperform large-cap stocks, our equity portfolio does not perform as well compared to benchmarks. This is due to the significant overweighting in large-cap, value-oriented stocks versus small-cap and growth stocks in the portfolio.

The chart below shows the industry sector breakdown of our large-cap equity portfolio versus the S&P 500 Index based on fair value as of December 31, 2007.

	Equity Portfolio	S&P 500 Index
Industry Sector	**% of Fair Value**	**% of Fair Value**
Basic Materials	2.1	3.4
Communications	5.6	11.3
Consumer Cyclical	16.3	7.1
Consumer Non-cyclical	16.8	20.5
Energy	9.9	12.9
Financial	16.6	17.6
Industrial	24.4	11.8
Technology	8.3	11.8
Utilities		3.6
Total	100.0	100.0

In 2005, the Investment Committee of State Auto Financial s Board of Directors (the Committee) approved a targeted allocation of 70% tax-exempt fixed maturities, 15% taxable fixed maturities and 15% equities. This reallocation effort would result in lower pre-tax investment yields but higher after tax investment income than if we had continued under the then current allocation percentages.

In November 2006, the Committee approved a $50.0 million repositioning of the then-current taxable and tax-exempt holdings to reach our targeted percentage at a quicker pace than if we just used new monies. Based

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on this action, the sale of approximately $50.0 million of taxable securities was completed by December 31, 2006. Reinvestment into tax-exempt securities of the proceeds from these actions was completed during the first quarter 2007.

During the Committee s March 2007 meeting, the allocation status was reviewed and the Committee approved an additional $100.0 million repositioning of the then-current taxable and tax-exempt holdings. Based on this action, the sale of approximately $100.0 million of taxable securities was completed by March 31, 2007. Reinvestment into tax-exempt securities of the proceeds from these actions was completed during the 2007 second quarter. After completion of the targeted rebalancing, we assessed the securities held and confirmed our intent to hold the remaining securities until either recovery of fair value or maturity.

Market Risk

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 instruments; (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.

Our primary market risk exposures are to changes in market prices for equity securities and changes in interest rates and credit ratings for fixed maturity securities. Our fixed maturity securities are subject to interest rate risk whereby the value of the securities varies as market interest rates change. We manage this risk by closely monitoring the duration of the fixed maturity portfolio. The duration of the fixed maturity portfolio was approximately 5.10 and 5.35 as of December 31, 2007 and 2006, respectively. The table below summarizes our interest rate risk and shows the effects of a parallel change in interest rates on the fair value of the fixed maturity portfolio (excluding other debt securities) as of December 31, 2007:

Fair value *($ millions)*	$ 1,952.8	$ 1,849.1	$ 1,745.4	$ 1,641.7	$ 1,520.7
Change in interest rates *(bps)*	-200	-100	0	+100	+200
Value as % of original value	112%	106%	100%	94%	87%

This table summarizes only the effects that a parallel change in interest rates could have on the fixed maturity portfolio. This change in rates would also change the value of our liabilities and possibly other financial assets. We caution the reader that this analysis does not take into account nonparallel changes in interest rates. It is likely that some rates would increase or decrease more than others depending upon market conditions at the time of the change. This nonparallel change would alter the value of the fixed maturity portfolio. The analysis is also limited in that it does not take into account any actions that might be taken by us in response to these changes. As a result, the actual impact of a change in interest rates and the resulting fixed maturity values may differ significantly from what is shown in the table.

We believe that the fixed maturity portfolio s exposure to credit risk is minimal as greater than 94% of the bonds we own are rated AA or better and the remaining bonds are rated A. We do not intend to change our investment policy on the quality of our fixed maturity investments. The fixed maturity portfolio is managed in a laddered-maturity style and considers business mix and liability payout patterns to ensure adequate cash flow to meet claims as they are presented. We also manage liquidity risk by maintaining sufficient cash balances, owning some agency and U.S. Treasury securities at all times, purchasing bonds of major issuers, and purchasing bonds that are part of a medium or large issue. The fixed maturity portfolio does not have any direct exposure to either exchange rate risk or commodity risk. We do not rely on the use of derivative financial instruments. To provide us greater flexibility in order to manage our market risk exposures, we categorize our fixed maturities as available-for-sale. We do not maintain a trading portfolio. We have no asset-backed securities in our fixed maturity portfolio which may be labeled sub-prime mortgage-backed securities. We only invest in conventional mortgage backed securities issued by a federal agency or that are U.S. Government guaranteed. Specifically, our only investment in asset-backed securities (approximately $189.4 million or 9.4% of our available-for-sale

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investment portfolio) are in federal agency pool and government guaranteed GNMAs, of which 63.8% are GNMAs, which are guaranteed by the full faith and credit of the U.S. Government.

Our fixed maturity investment portfolio at December 31, 2007 included securities issued by numerous municipalities with a total carrying value of $1,452.0 million. Approximately $829.4 million or 57% of these securities were enhanced by third-party insurance (the Credit Enhancement) for the payment of principal and interest in the event of an issuer default. Such insurance generally results in a rating of AAA being assigned by independent ratings agencies to those securities. The downgrade of credit ratings of insurers of these securities could result in a corresponding downgrade in the ratings of the securities from AAA to the underlying rating of the respective security without giving effect to the benefit of the Credit Enhancement. Credit Enhancement is not a primary consideration to us when purchasing a municipality security as we consider the underlying credit rating of the security by Moody s and S&P as a more important factor in our evaluation process. Of the total $829 million of insured municipal securities in our investment portfolio, approximately 82% were rated AA or better, without the benefit of a Credit Enhancement. We do not believe that a loss of a Credit Enhancement would have a material adverse impact on our results of operations, financial position or liquidity, due to the underlying strength of the issuers of the securities, as well as our ability and intent to hold the securities.

As of December 31, 2007, our large-cap equity portfolio had a beta of 0.99 using the S&P 500 Index as a benchmark. Beta estimates the degree the portfolio s price will fluctuate based on a given movement in the market index. The table below reflects what changes might occur in the value of the large-cap equity portfolio given a change in the S&P 500 Index:

Fair value *($ millions)*	$ 290.8	$ 266.7	$ 242.7	$ 218.7	$ 194.6
Change in S&P 500 Index	+20%	+10%	0	-10%	-20%
Value as % of original value	120%	110%	100%	90%	80%

The above analysis is limited in that it does not take into account any actions that might be taken by us in response to these changes. As a result, the actual impact of a change in equity market prices and the resulting equity values may differ significantly from what is shown in the table. By investing in mostly large-cap issues we hope to limit liquidity risk in the equity portfolio. The equity portfolio does not have any direct exposure to exchange rate risk since we do not directly hold any foreign stocks. We constantly monitor the equity portfolio holdings for any credit risk issues that may arise. We do not invest in any commodity futures or commodity oriented mutual funds.

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Investment Operations Revenue

Net investment income for 2007 was $84.7 million compared to $83.1 million in 2006. In 2007 our average invested assets increased due to our insurance segments favorable underwriting cash flows. However, our pre-tax return on investments declined slightly as provided in the table below due largely to rebalancing our fixed maturity portfolio as described above toward tax-exempt bonds, which have a lower yield on a pre-tax basis. After tax, our net investment income for 2007 was $73.6 million (13.2% effective tax rate) compared to $69.8 million (16.1% effective tax rate) for 2006.

($ millions)	Year Ended December 31	
	2007	2006
Gross investment income:		
Fixed maturities	**$ 75.3**	73.6
Equity securities	**5.7**	5.1
Other	**5.5**	6.1
Total gross investment income	**86.5**	84.8
Less: Investment expenses	**1.8**	1.7
Net investment income	**$ 84.7**	83.1
Average invested assets (at cost)	**$ 1,987.1**	1,891.6
Annualized investment yield	**4.3%**	4.4
Annualized investment yield, after tax	**3.7%**	3.7

Realized gains and losses on investments for the years ended December 31, 2007 and 2006, respectively are summarized as follows:

($ millions)	**2007**		2006	
	Realized Gains (Losses)	**Proceeds Received on Sale**	Realized Gains (Losses)	Proceeds Received On Sale
Realized gains:				
Fixed maturities	**$ 0.8**	**$ 82.5**	$ 1.8	$ 130.1
Equity securities	**19.7**	**76.2**	15.6	72.0
Total realized gains	**20.5**	**158.7**	17.4	202.1
Realized losses:				
Fixed maturities	**(1.3)**	**72.7**	(4.8)	41.3
Equity securities	**(7.1)**	**30.8**	(7.0)	31.8
Total realized losses	**(8.4)**	**103.5**	(11.7)	73.1
Net realized gains on investments	**$ 12.1**	**$ 262.2**	$ 5.6	$ 275.2

Most of the realized gains in 2007 were derived from the equity segment of the portfolio. Equity sales were executed for various reasons, including the achievement of our price target and raising funds within two of our insurance subsidiaries to fund cash dividends to State Auto Financial. (See Other Capital Transactions section below.) The realized gains on the fixed maturity portfolio were achieved by selling shorter-term tax-exempt securities and subsequently reinvesting those funds into longer-term tax-exempt securities as well as selling taxable securities to reinvest the proceeds into the tax-exempt securities as described above. For the year ended December 31, 2007, realized losses of $1.3 million on the fixed maturities related primarily to selling taxable securities to support our shift into tax-exempt securities. Realized losses of $7.1 million on equity securities related primarily to the sale of equity positions where changes in government policy or business conditions, in our opinion, greatly diminished future business prospects.

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We regularly monitor our investment portfolio for declines in value that are other-than-temporary, an assessment which requires significant management judgment. Among the factors considered by management are the nature of the investment, severity and length of decline in fair value, events impacting the issuer, overall market conditions, and our intent and ability to hold securities until recovery. When a security in our investment portfolio 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 changed for subsequent recoveries in fair value. Future increases or decreases in fair value, if not other-than-temporary, are included in other comprehensive income.

For the year ended December 31, 2007, we recognized $1.9 million other-than-temporary impairments compared to $5.4 million for the same 2006 period. During 2007 we recognized no other-than-temporary impairments on our fixed maturity portfolio; however, we recognized $1.9 million in realized losses related to other-than-temporary impairments within our equity portfolio. Of the $1.9 million in realized losses, $1.1 million related to two equity positions within the consumer cyclical sector impacted by the downturn in the housing industry. The remaining $0.8 million in realized losses was limited to our externally managed U.S. small cap portfolio for which we were unable to make the assertion regarding our intent to hold particular securities that were currently valued below cost until recovery in the near term. The other-than-temporary impairments recognized in 2007 were limited to these securities, based on specific facts and judgments related to these particular issuers. The 2006 write-downs related primarily to our investment in certain subordinate income notes and principal protected units representing purchased beneficial interests in securitized financial assets. We reduced the estimate of future cash flows we expected to receive from these securities in light of actual default rates of the underlying collateral securities exceeding the assumed defaults.

Gross Unrealized Investment Gains and Losses

A review of our investment portfolio at December 31, 2007 determined there were no individual investments with an unrealized loss that had a fair value significantly below cost continually for more than one year. There were also no individual material securities with an unrealized holding loss at December 31, 2007.

The following table provides detailed information on our available-for-sale investment portfolio for our gross unrealized gains and losses at December 31, 2007.

($ millions, except number of positions)

Investment Category:	Cost or amortized cost	Gross unrealized holding gains	Number of gain positions	Gross unrealized holding losses	Number of loss positions	Fair Value
Fixed Maturities:						
U.S. Treasury securities	$ 90.9	$ 2.2	34	$ (0.1)	6	$ 93.0
States and political subdivisions	1,432.7	23.6	469	(4.3)	181	1,452.0
Corporate securities	10.7	0.3	11		1	11.0
Mortgage-backed securities of U.S. Gov. Agencies	188.6	2.6	23	(1.8)	48	189.4
Total fixed maturities	1,722.9	28.7	537	(6.2)	236	1,745.4
Equity Securities:						
Consumer	65.3	18.1	78	(1.7)	5	81.7
Technologies	24.7	5.4	71	(0.3)	2	29.8
Pharmaceuticals	8.4	0.6	9	(0.2)	2	8.8
Financial services	35.6	7.9	79	(0.7)	3	42.8
Manufacturing and other	76.2	15.4	149	(0.5)	4	91.1
Total equity securities	210.2	47.4	386	(3.4)	16	254.2
Other invested assets	20.1	0.3	2	(0.1)	2	20.3
Total investments	$ 1,953.2	$ 76.4	925	$ (9.7)	254	$ 2,019.9

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Other Income Statement Items

Interest expense on our debt was $7.6 million and $7.4 million for the years ended December 31, 2007 and 2006, respectively.

Our effective tax rate is largely affected by the amount of underwriting profit or loss and net realized investment gains or losses that are taxed at approximately 35% relative to the amount of net investment income at its effective tax rate. For the year ended December 31, 2007, the effective tax rate was 23.3% compared to 25.5% for the same 2006 period. As previously discussed, the effective tax rate on net investment income declined to 13.2% for 2007 versus 16.1% for 2006.

2006 Compared to 2005

Income before federal income taxes decreased $10.3 million (6.0%) to $161.7 million in 2006 from 2005. The most significant factors contributing to this decrease relate to a decline in our revenues, specifically our premiums, an increased level of catastrophe losses and the recognition of share-based compensation expenses beginning in 2006. Catastrophe losses in 2006 were $91.2 million compared to $72.7 million in 2005. Share-based compensation expense, which we began to recognize in 2006, was $6.6 million. Each of these components is discussed more fully below.

Insurance Segments

The following tables provide a summary of our insurance segments SAP underwriting gain and SAP combined ratio for the years ended December 31, 2006 and 2005:

($ millions)	2006					
	Personal	% Ratio	Business	% Ratio	Total	% Ratio
Written premiums	$ 612.8		$ 406.7		$ 1,019.5	
Earned premiums	614.8		409.0		1,023.8	
Losses and loss expenses	389.6	63.4	192.4	47.0	582.0	56.8
Underwriting expenses	180.4	29.4	155.1	38.1	335.5	32.9
SAP underwriting profit And SAP combined ratio	$ 44.8	92.8	$ 61.5	85.1	$ 106.3	89.7

($ millions)	2005					
	Personal	% Ratio	Business	% Ratio	Total	% Ratio
Written premiums[(1)]	$ 651.0		$ 418.6		$ 1,069.5	
Earned premiums	641.0		409.3		1,050.3	
Losses and loss expenses	383.7	59.9	230.2	56.1	613.8	58.5
Underwriting expenses	184.9	28.4	152.6	36.5	337.6	31.6
SAP underwriting profit And SAP combined ratio	$ 72.4	88.3	$ 26.5	92.6	$ 98.8	90.1

(1) Includes approximately $16.0 million and $8.0 million of unearned premium transferred on personal and business segments, respectively, in connection with the addition of the Meridian Security and Meridian Citizens Mutual to the Pooling Arrangement as of January 1, 2005.

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Revenue

Personal Insurance Segment Revenue

The following table provides 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, 2006 and 2005:

($ millions)	2006	2005[1]	% Change
Personal insurance segment:			
Net Written Premium			
Standard Auto	$ 361.7	379.7	(4.7)
Nonstandard Auto	42.4	48.9	(13.3)
Homeowners	186.1	183.2	1.6
Other personal	22.6	23.2	(2.6)
Total personal	$ 612.8	635.0	(3.5)
Net Earned Premium			
Standard auto	$ 362.1	385.7	(6.1)
Nonstandard auto	44.8	53.1	(15.6)
Homeowners	185.2	178.7	3.6
Other personal	22.7	23.5	(3.4)
Total personal	$ 614.8	641.0	(4.1)

(1) Net written premium amounts for 2005 have been adjusted to exclude the unearned premium transferred in connection with the addition of the Meridian Security and Meridian Citizens Mutual to the Pooling Arrangement as of January 1, 2005.

Competitive pressures within the standard personal auto market are impacting the writing of new and renewal business and putting downward pressure on our existing rates. Standard personal auto, which accounts for 35.5% of our book of business, continues to be our most profitable line of business. As a result of the competitive market, we reduced our rates approximately 2.7% during 2006 in order to remain competitive without significantly compromising our profitability.

We continue to focus on attracting new business to our standard personal auto line of business. The primary product contributing to new business in standard personal auto is our CustomFit℠ product which uses a multi-variate rating approach that broadens the underwriting and eligibility guidelines for new customers. Having price points for a larger percentage of the personal lines market is expected to improve new business opportunities. As of the end of 2006, we had implemented CustomFit℠ in 19 states, which represented approximately 80% of our standard personal auto written premium volume. Since introducing CustomFit℠ in December 2005, we have seen a significant improvement in our net written premium production trend for new business.

Net written premiums in nonstandard personal auto decreased $6.5 million (13.3%) in 2006. However, nonstandard personal auto is beginning to stabilize; in the fourth quarter of 2006, new business increased 14.6% compared to the same period in 2005. The impact of target rate decreases coupled with the introduction of new discounts has produced what appears to be an improving premium situation.

The personal auto market appears to be changing quickly and dramatically. Many companies are moving to a single auto product (such as our CustomFit℠) which can accommodate most personal auto risks. As a result, the delineation between standard and nonstandard auto insurance is becoming blurred. The new auto programs accepting a broader range of risks has limited and is expected to continue to limit the nonstandard auto market for us and other insurers.

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We believe independent agents value ease of doing business and make it an important factor in their choice of insurance companies when quoting personal auto products to their customers. To assist in this area, in 2006, we entered into agreements with two major comparative rating companies. These companies products allow agents to receive rate quotes from multiple insurance companies by entering the rating information only one time. We worked diligently in the fourth quarter with these two vendors with a launch date for implementation expected in early 2007. We believe agents will quote and write more personal standard and nonstandard auto with us as a result of a more efficient quoting process combined with more competitive rates resulting from the ongoing introduction of CustomFit^{SM} for standard auto and new policy discounts introduced in 2006 for nonstandard auto.

Homeowners net written premium grew 1.6% in 2006. We are undertaking new homeowners pricing and product initiatives, such as a new home purchase discount and an expanded new home discount that will complement our CustomFit^{SM} rollout and should position us well for the future. The competitive pressures that have impacted personal auto have also extended to homeowners. In general, our homeowner rate level was impacted (2.0) % due to downward rate changes.

During 2006, we enhanced our personal lines point of sale portal, netXpress^{SM}. This is the system our agencies use to send us business electronically. We now have real time, on-line information access capabilities that streamline the new business quote and issue process. Approximately 94% of our personal auto and homeowner lines new business was submitted electronically in 2006 compared to 84% in 2005. In addition in 2006, 78% of all personal auto and homeowner lines policy changes came to us electronically from agents.

Business Insurance Segment Revenue

The following table provides a summary of written and earned premium, net of reinsurance, by major product line for our business insurance segment for the years ended December 31, 2006 and 2005:

($ millions)	2006	2005[(1)]	% Change
Business insurance segment:			
New Written Premium			
Commercial auto	$ 98.7	102.2	(3.4)
Commercial multi-peril	87.8	86.6	1.4
Fire & allied lines	83.1	84.8	(2.0)
Other & product liability	77.2	76.9	0.4
Workers compensation	34.3	34.2	0.3
Other commercial	25.6	25.9	(1.2)
Total business	$ 406.7	410.6	(0.9)
Net Earned Premium			
Commercial auto	$ 100.3	103.2	(2.8)
Commercial multi-peril	87.5	84.6	3.4
Fire & allied lines	84.2	84.8	(0.7)
Other & product liability	77.5	76.7	1.0
Workers compensation	33.8	34.5	(2.0)
Other commercial	25.7	25.5	0.8
Total business	$ 409.0	409.3	(0.1)

(1) Net written premium amounts for 2005 have been adjusted to exclude the unearned premium transferred in connection with the addition of the Meridian Security and Meridian Citizens Mutual to the Pooling Arrangement as of January 1, 2005.

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Our business insurance book of business continues to be impacted by rate competition as well as ease of doing business issues. Commercial auto net written premiums decreased 3.4% in 2006. However, commercial multi-peril and workers compensation net written premiums reflected positive growth. In general, during 2006 the overall impact to net written premiums from business insurance line rate changes was a slight decrease.

We are pursuing initiatives that we anticipate will generate additional business insurance premium production over the long term. One of our current strategic priorities is to develop a web-based rating system for the three products that generate the most new business submissions. In addition, we are developing more sophisticated pricing models to further segment our business insurance accounts, which we anticipate will improve our growth opportunities while still achieving our profit targets. We are also emphasizing a total account underwriting approach in which we offer additional products to our existing accounts. We are developing product enhancements that we believe will result in increased sales while pursuing process efficiencies to deliver product and pricing developments to the market more quickly. During 2006, we focused on introducing a more marketable pricing structure without forfeiting underwriting profits. Finally, we increased field underwriting authority which quickens our response to our agents.

For both our personal and business products, we continue to emphasize that we will not compromise underwriting profitability for top line growth. We believe that we can implement periodic rate changes in most states and remain an attractive market to our policyholders and independent agents by stressing the strengths we bring to the marketplace. These strengths include stability, financial soundness, prompt and fair claims service, and user-friendly technology which help agents do business with us and provide substantial value to our customers.

Losses and Expenses

Our GAAP loss and LAE ratios were 57.4% and 58.4% for the years ended December 31, 2006 and 2005, respectively. Our auto and liability lines produced better loss results during 2006 while the property lines deteriorated due mostly to catastrophes. Our personal and commercial auto lines continued to produce favorable GAAP loss and LAE ratios benefiting from a combination of cumulative rate changes taken over the past several years along with improvement in claim frequency and severity.

The following table presents the provision for losses and loss expenses for those claims occurring in the current calendar year and prior years, along with the GAAP loss and LAE ratio for the years 2006 and 2005, respectively:

($ millions)	2006	% GAAP loss and LAE	2005	% GAAP loss and LAE
Provision for losses and loss expenses occurring:				
Current year	$ 659.3	64.4	$ 657.7	62.6
Prior years	(71.7)	(7.0)	(44.3)	(4.2)
Total losses and loss expenses	$ 587.6	57.4	$ 613.4	58.4

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A tabular presentation of the 2006 $71.7 million favorable development broken down by accident year is shown below.

($ millions) *Accident year*	Current year development of ultimate liability *Redundancy /(Deficiency)*	
1996 and prior	$	(2.8)
1997		(0.1)
1998		(0.1)
1999		0.8
2000		(3.9)
2001		1.3
2002		6.7
2003		11.8
2004		23.2
2005		34.8
Total	$	71.7

Normal fluctuations and uncertainty associated with loss reserve development and claim settlement contributed to favorable development in the respective calendar years. The favorable development of $71.7 million in 2006 came primarily from accident years 2003-2005. The following are the notable items contributing to the 2006 development:

We hold ceded loss reserves in anticipation of transferring liabilities to reinsurers and other pools and associations. In 2006, ceded loss reserves developed favorably by $23.7 million, meaning the actual ceded losses were above anticipated levels. Historically, we have had less ceded loss activity because our reinsurance retention levels are generally high enough to exclude most claims. This favorable development occurred primarily in the auto and commercial multi-peril lines.

Favorable development at the product level is primarily from the personal auto and commercial auto liability lines, where current loss projections using more mature claim data resulted in lower expected average claim severities than past projections. The impact is $24.7 million for these two lines combined.

Adjusting and other expense reserves accounted for approximately $13.5 million of prior year reserve change. These expense reserves have a proportional relationship to the overall claim inventory and held reserves by accident year, as they move up or down in relation to carried loss reserves. Since reserves decreased for the prior accident years, the expense reserves declined in a similar fashion.

The remaining favorable development is spread across several lines of business and is generally the result of having fewer claims emerge and lower claim severity, than anticipated in the estimates developed as of December 31, 2005.

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The following table provides our insurance segments comparative SAP loss and LAE ratios for the years ended December 31, 2006 and 2005:

	2006	2005	Improve (Deteriorate)
Personal insurance segment:			
Standard auto	57.0	59.3	2.3
Nonstandard auto	60.0	64.4	4.4
Homeowners	78.1	62.6	(15.5)
Other personal	51.1	40.6	(10.5)
Total personal	63.4	59.9	(3.5)
Business insurance segment:			
Commercial auto	40.3	54.2	13.9
Commercial multi-peril	48.6	59.8	11.2
Fire & allied lines	58.3	61.1	2.8
Other & product liability	37.5	48.6	11.1
Workers compensation	57.5	66.9	(9.4)
Other commercial	46.3	43.5	(2.8)
Total business	47.0	57.4	10.4
Total SAP personal and business	56.8	58.4	1.6

Catastrophes added 8.9 points ($91.2 million) to the 2006 loss ratio compared to 6.9 points ($72.7 million) for 2005. During 2006, catastrophe losses included $51.8 million (5.1 points) in losses relating to three major Midwestern storms that occurred in April. In 2005, hurricanes accounted for $42.9 million (4.1 points) of total catastrophe losses.

As of January 1, 2006, we began recognizing compensation expense associated with share-based awards granted to employees and non-employee directors within our financial statements in accordance with SFAS 123(R). Consequently, our 2006 expenses include additional share-based awards of $6.6 million associated with the adoption of SFAS 123(R). Prior to January 1, 2006, we accounted for these awards in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) and related Interpretations. We adopted the guidance provided by SFAS 123(R) under the modified prospective transition method. Under this transition method, share-based compensation expense in 2006 includes the portion vesting in the period for (1) all share-based awards granted prior to, but not vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of FASB Statement SFAS 123, Accounting for Stock-Based Compensation (SFAS 123), and (2) all share-based awards granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). Results for prior periods have not been restated.

Prior to January 1, 2006, we provided pro-forma disclosures as required under SFAS 123. The reader is referred to the complete disclosure on share-based awards in Note 12, Share-Based Awards, of the Notes to our Consolidated Financial Statements included in this Form 10-K. Our 2005 pro-forma earnings, as reported in December 31, 2005 Form 10-K, included $0.14 diluted per share of share-based compensation expense. For the year ended December 31, 2006, the comparable share-based awards are $0.12 diluted per share. The expense for our share-based awards is based on their fair value at date of grant and amortized over the vesting period. At December 31, 2006, there was $5.6 million of total unrecognized share-based compensation expense related to non-vested service based awards. This expense is expected to be recognized as follows: $3.5 million in 2007; $1.7 million in 2008; and $0.4 million in 2009. Unearned share-based compensation is amortized over the vesting period for the particular grant and is recognized as a component of loss and loss adjustment expenses and acquisition and operating expenses in a manner consistent with other employee compensation in the accompanying Consolidated Statements of Income.

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The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes closed-form pricing model. The pricing model requires assumptions such as the expected life of the option and expected volatility of our stock over the expected life of the option, which significantly impacts the assumed fair value. We use historical data to determine these assumptions and if these assumptions change significantly for future grants, share-based compensation expense will fluctuate in future periods.

The GAAP expense ratio was 34.0% and 31.7% for the years ended December 31, 2006 and 2005, respectively. The increase in our 2006 expense ratio is due in part to lower premiums in 2006 compared to 2005, expenses associated with share-based awards under SFAS 123(R) (see previous discussion above), as well as expenses related to our incentive programs, both agency and employee. These incentive programs are directly related to our loss experience. We do not anticipate meaningful reductions in our expense ratio during 2007 as it relates to our incentive compensation programs as well as our investment in new technologies and products as we position ourselves to be more competitive in the market place.

Investment Operations Segment

Composition of Investment Portfolio

The following table provides the composition of our available-for-sale investment portfolio at December 31, 2006 and 2005, respectively:

($ millions)	2006		2005	
Fixed maturities	$ 1,647.4	85.0%	$ 1,617.3	86.2%
Equity securities	284.2	14.7	255.6	13.6
Other invested assets	4.5	0.3	3.8	0.2
Total investments	$ 1,936.1	100.0%	$ 1,876.7	100.0%

The amortized cost and fair value of fixed maturities at December 31, 2006, by contractual maturity, are summarized as follows:

($ millions)	Amortized Cost	Fair Value
Due in 1 year or less	$ 8.4	8.3
Due after 1 year through 5 years	60.7	60.9
Due after 5 years through 10 years	380.5	388.7
Due after 10 years	976.1	987.1
Subtotal	1,425.7	1,445.0
Mortgage-backed securities	204.9	202.4
Total	$ 1,630.6	1,647.4

Expected maturities may differ from contractual maturities as the issuers may have the right to call or prepay the obligations with or without call or prepayment penalties.

In 2005 and part of 2006, we participated in a securities lending program whereby certain fixed maturity and equity securities from our investment portfolio were loaned to other institutions for short periods of time. We required collateral, equal to 102% of the market value of the loaned securities. The collateral was invested by the lending agent, in accordance with our guidelines, generating investment income, net of applicable fees. We accounted for this program as a secured borrowing and recorded the collateral held and corresponding liability to return the collateral on our balance sheet. During the second quarter of 2006, we terminated our participation in

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this program and there were no securities on loan or related collateral held as of September 30, 2006. At December 31, 2005, the amount of collateral held was approximately $99.0 million and the amount of securities lent was $96.0 million.

We manage our equity portfolio by investing in a large, but manageable, number of stocks from many different industries. This diversification across companies and industries reduces volatility in the value of the equity portfolio. We invest only in stocks that currently pay a dividend. As of December 31, 2006, our equity portfolio consisted of approximately 100 different stocks. The largest single position was 2.8% of the equity portfolio based on fair value and the top ten positions were equal to approximately 20% of the equity portfolio. The chart below shows the industry sector breakdown of our equity portfolio versus the S&P 500 Index based on fair value as of December 31, 2006.

	Equity Portfolio	S&P 500 Index
Industry Sector	% of Fair Value	% of Fair Value
Basic Materials	1.7	2.9
Communications	4.1	11.6
Consumer Cyclical	22.7	8.2
Consumer Non-cyclical	12.0	20.0
Energy	1.8	9.9
Financial	30.3	22.2
Industrial	20.5	11.1
Technology	6.9	10.6
Utilities		3.5
Total	100.0	100.0

Our equity portfolio consists of large-cap, value-oriented stocks. Therefore, when large-cap stocks and/or value-oriented stocks perform well our portfolio typically performs well. Conversely, when growth stocks outperform value stocks and/or small- to mid-cap stocks outperform large-cap stocks, our portfolio does not perform as well.

Investment Operations Revenue

Net investment income increased $4.4 million (5.6%) to $83.1 million in 2006 compared to the same 2005 period. Strong underwriting results in 2005 and 2006 contributed favorably to cash flows, which allowed us to increase the amount of our invested assets during 2006. Total cost of invested assets at December 31, 2006 and 2005 was $1,940.7 million and $1,856.5 million, respectively. Also impacting our 2006 results was the fact that STFC paid off its $45.5 million line of credit with State Auto Mutual at the end of 2005, which had the effect of decreasing net investment income for the year by approximately $2.0 million.

($ millions)	Year Ended December 31	
	2006	2005
Gross investment income:		
Fixed maturities	$ 73.6	72.8
Equity securities	5.1	4.0
Other	6.1	3.6
Total gross investment income	84.8	80.4
Less: Investment expenses	1.7	1.7
Net investment income	$ 83.1	78.7
Average invested assets (at cost)	$ 1,891.6	1,802.5

Annualized investment yield	4.4%	4.3
Annualized investment yield, after tax	3.7%	3.6

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We continue to allocate new monies and reinvestments to tax-exempt bonds, targeting an allocation of 70% of our total portfolio, in an effort to maximize our after tax investment income. During the fourth quarter of 2006, the Investment Committee of the Board of Directors of each of our insurance subsidiaries approved a $50.0 million repositioning of the current taxable and tax-exempt holdings intending to reach the targeted 70% tax-exempt allocation at a quicker pace. At December 31, 2006, tax-exempt bonds accounted for 62% of our total portfolio versus 58% at December 31, 2005. Our after tax net investment income grew to $69.8 million (16.1% effective tax rate) in 2006 compared to $65.2 million (17.3% effective tax rate) in 2005.

Realized gains and losses for the year ended December 31, 2006, are summarized as follows:

($ millions)	Realized Gains/Losses	Fair Value at Sale
Realized gains:		
Fixed maturities	$ 1.8	130.1
Equity securities	15.6	72.0
Total realized gains	17.4	202.1
Realized losses:		
Fixed maturities	4.8	41.3
Equity securities	7.0	31.8
Total realized losses	11.8	73.1
Net realized gains on investments	$ 5.6	275.2

Most of the realized gains during 2006 were derived from the equity segment of the portfolio. Equity sales were executed during this time for various reasons, including achieving our price target. The proceeds from these sales were mostly reinvested into equity securities of other companies. The realized gains on the fixed maturity portfolio were achieved by selling shorter-term municipal bonds and subsequently reinvesting those funds into longer term municipal bonds.

We recognized $5.4 million in other-than-temporary impairments in 2006 compared to $1.6 million in 2005. In 2006, we recognized $3.8 million of other-than-temporary impairments related to our investment in certain subordinate income notes and principal protected units representing purchased beneficial interests in securitized financial assets. We reduced our estimate of future cash flows we expect to receive from these securities in light of actual default rates of the underlying collateral securities in excess of assumed defaults. Our carrying value of these securities at December 31, 2006 was $1.6 million. We also recognized $1.6 million of other-than-temporary impairment related to four of our equity holdings within the consumer sector. All four of these equity positions were sold during 2006. The other-than-temporary impairments recognized in 2006 were limited to these securities, based on specific facts and judgments related to these particular issuers.

Gross Unrealized Investment Gains and Losses

A review of our investment portfolio at December 31, 2006 determined there were no individual investments with an unrealized holding loss that had a fair value significantly below cost continually for more than one year. There were also no individual material securities with an unrealized holding loss at December 31, 2006.

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The following table provides detailed information on our available-for-sale investment portfolio for our gross unrealized gains and losses, adjusted for investments with other-than-temporary impairment at December 31, 2006:

($ millions, except number of positions)

Investment Category	Cost or amortized cost	Gross unrealized holding gains	Gain number of positions	Gross unrealized holding losses	Loss number of positions	Fair value
Fixed Maturities:						
U.S. Treasury securities & Obligations	$ 180.1	$ 0.6	19	$ (2.8)	58	$ 177.9
States & political subdivisions	1,229.8	23.7	440	(2.5)	124	1,251.0
Corporate securities	15.8	0.4	11	(0.1)	2	16.1
Mortgage-backed securities of U.S. Gov. Agencies	204.9	1.7	12	(4.2)	59	202.4
Total fixed maturities	1,630.6	26.4	482	(9.6)	243	1,647.4
Equity Securities:						
Consumer	69.4	15.8	25	(0.2)	1	85.0
Technologies	23.3	3.2	7	(0.9)	3	25.6
Pharmaceuticals	6.6	0.4	4			7.0
Financial services	64.8	22.9	24	(0.1)	3	87.6
Manufacturing & other	66.7	12.3	24		2	79.0
Total equity securities	230.8	54.6	84	(1.2)	9	284.2
Other invested assets	4.0	0.5	4			4.5
Total	$ 1,865.4	$ 81.5	570	$ (10.8)	252	$ 1,936.1

Other Income Statement Items

Interest expense in 2006 was $7.4 million compared to $8.8 million in 2005. The decrease in interest expense was largely due to our repayment to State Auto Mutual of a $45.5 million note at the end of 2005. The amount of interest expense related to this $45.5 million note was $1.6 million in 2005. For a further discussion of our debt arrangements, see Liquidity And Capital Resources Borrowing Arrangements included in this Item 7.

The effective tax rate is largely affected by the amount of underwriting profit or loss and net realized investment gains or losses that are taxed at approximately 35% relative to the amount of net investment income at its effective tax rate. For 2006, the effective tax rate was 25.5% compared to 26.8% for 2005. As previously discussed, the effective tax rate on net investment income has declined to 16.1% in 2006 compared to 17.3% in 2005, primarily due to increasing our tax-exempt municipal bond holdings throughout 2006.

LIQUIDITY AND CAPITAL RESOURCES

General

Liquidity refers to our ability to generate adequate amounts of cash to meet our needs for both long-term and short-term cash obligations as they come due. Our significant sources of cash are premiums, investment income, investment sales and the maturity of fixed security investments, as well as funds available under our Credit Facility (as defined below). The significant outflows of cash are payments of claims, commissions, premium taxes, operating expenses, income taxes, dividends, interest and principal payments on debt and investment purchases. The cash outflows can vary due to uncertainties regarding settlement of large losses or catastrophe events. As a result, we continually monitor our investment and reinsurance programs to ensure they

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are appropriately structured to enable the insurance subsidiaries to meet anticipated short and long-term cash requirements without the need to sell investments to meet fluctuations in claim payments.

We maintain a portion of our investment portfolio in relatively short-term and highly liquid investments to ensure the immediate availability of funds to pay claims and expenses. At December 31, 2007 and 2006, we had $70.9 million and $73.4 million, respectively, in cash and cash equivalents, and $2,019.9 million and $1,936.1 million, respectively, of total available-for-sale investments at fair value. In addition, substantially all of our fixed maturity and equity securities are traded on public markets. For a further discussion regarding investments see Investments Operations Segment included in this Item 7.

Our insurance subsidiaries must have adequate liquidity to ensure that their cash obligations are met. However, because the STFC Pooled Companies participate in the Pooling Arrangement, they do not have the daily liquidity concerns normally associated with an insurance company. This is due to the fact that, under the terms of the Pooling Arrangement, State Auto Mutual receives all premiums and pays all losses and expenses associated with the insurance business produced by the pool participants and then settles the intercompany balances generated by these transactions with the participating companies within 45 days following each quarter end.

When settling the intercompany balances, State Auto Mutual provides the pool participants with full credit for the premiums written and net losses paid during the quarter and retains all receivable amounts from insureds and agents and reinsurance recoverable on paid losses from unaffiliated reinsurers. Any receivable amounts that are ultimately deemed to be uncollectible are charged-off by State Auto Mutual and allocated to the pool member on the basis of pool participation. As a result, we have an off-balance sheet credit risk related to the balances due to State Auto Mutual from insureds, agents and reinsurers, which are offset by the unearned premium from the respective policies. While the total amount due to State Auto Mutual from policyholders and agents is significant, the individual amounts due are relatively small at the policyholder and agency level. Based on historical data, this credit-risk exposure is not considered to be material to our financial position, though the impact to income on a quarterly basis may be material. The State Auto Group mitigates its exposure to this credit risk through its in-house collections unit for both personal and commercial accounts which is supplemented by third party collection service providers. The amounts deemed uncollectible by State Auto Mutual and allocated to the STFC Pooled Companies are included in Other Expenses in the accompanying Statements of Income.

The State Auto Group s reliance on ceded reinsurance is not significant in comparison to the State Auto Group s total statutory surplus or our total financial position. To minimize the risk of reinsurer default, the State Auto Group cedes only to third-party reinsurers who are rated A- or better by A.M. Best and also utilizes both domestic and international markets to diversify its credit risk. We utilize reinsurance to limit our loss exposure and contribute to our liquidity and capital resources. For a discussion of our reinsurance arrangements, see Reinsurance Arrangements included in this Item 7.

Net cash provided by operating activities was $121.7 million, $93.5 million and $226.9 million for 2007, 2006 and 2005, respectively. The significant sources of operating cash flows are derived from underwriting operations and investment income. The positive cash flows over the three year period is largely due to favorable underwriting and investment income cash flows, offset by increases in cash paid on estimated federal income taxes, interest expense and cash contributions to our defined benefit pension plan. Cash from operations in 2007 increased $28.2 million over 2006 primarily due to a reduction in claim payments from a lower level of catastrophe losses in 2007 compared to 2006 offset partially by an increase in taxes paid. Cash from operations for 2006 decreased from 2005 due to our decline in net written premiums as previously discussed along with an increase in the amount of loss and loss expenses paid from the increased level of catastrophe losses between the two years. In addition, 2005 benefited from the $54.0 million received by the STFC Pooled Companies in connection with adding Meridian Security and Meridian Citizens Mutual to the Pooling Arrangement. Over the last three years, operating cash flows have been sufficient to meet our operating needs while providing increased opportunities for investment. However, should our written premium decline or paid losses increase significantly our cash flows from operations could be impacted requiring us to liquidate investments.

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During 2007, 2006 and 2005, as permitted by regulations of the Internal Revenue Service, we made cash contributions of $11.5 million, $10.0 million and $7.5 million, respectively, to our defined benefit pension plan on behalf of our employees. The actuarially determined contribution to our defined benefit pension plan ranges from the minimum amount we would be required to contribute to the maximum amount that would be tax deductible. Amounts contributed in excess of the minimum are deemed voluntary while amounts in excess of the maximum would be subject to an excise tax and may not be deductible for tax purposes. Amounts paid in each of these three years were within the minimum and maximum funding amounts that would be deductible for tax purposes. The actuarially determined funding amount to the Pension Plan is generally not determined until the second quarter with respect to the contribution year, though we currently expect to make a cash contribution to our defined benefit pension plan of approximately $12.0 million during 2008. For a further discussion regarding our defined benefit pension plan see Employee Benefit Plans included in this Item 7.

Net cash used in investing activities was $86.1 million, $43.2 million and $212.5 million for 2007, 2006 and 2005, respectively.

The increase in 2007 versus 2006 is principally the result of:

- a greater amount of cash and cash equivalents available to invest at the beginning of 2007 versus 2006 ($73.4 million in 2007 compared to $28.7 million in 2006);
- an increase in the level of cash provided from operations between the two years.

The decline in 2006 versus 2005 is principally the result of:

- a lesser amount of cash and cash equivalents available to invest at the beginning of 2006 versus 2005 ($28.7 million in 2006 compared to $64.3 million in 2005);
- $54.0 million in cash available from operations in 2005 in connection with adding Meridian Security and Meridian Citizens Mutual to the Pooling Arrangement; and
- a decline in the 2006 level of cash provided by operating activities as described above.

Our financing activities for 2007, 2006 and 2005 produced net cash outflows of $38.0 million, $5.6 million, and $50.0 million, respectively. The following contributed to the fluctuations between years:

- In December 2005, we repaid a $45.5 million line of credit from State Auto Mutual.
- Dividends paid to shareholders totaled $20.5 million, $15.4 million and $8.6 million for 2007, 2006 and 2005, respectively.
- $22.1 million in cash used to repurchase common shares under our stock repurchase program. See Other Capital Transactions below.

The increase in dividends paid between the years is due to the following:

- In July 2005, State Auto Mutual s waiver of its receipt of STFC dividends expired and was not renewed. State Auto Mutual was paid $13.2 million, $12.4 million and $2.4 million in dividends for 2007, 2006 and 2005, respectively; and

Dividends paid per common share have increased over the three year period: $0.50 in 2007; $0.38 in 2006 and $0.27 in 2005.

Other Capital Transactions

On August 17, 2007, State Auto Financial s Board of Directors authorized the repurchase, from time to time, of up to 4.0 million of its common shares, or approximately 10% of State Auto Financial s outstanding shares, over a period extending to and through December 31, 2009. State Auto Financial will repurchase shares from State Auto Mutual in amounts that are proportional to the respective current ownership percentages of State

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Auto Mutual, which is approximately 64%, and other shareholders. Our total share repurchase activity in 2007 was 0.8 million common shares at an average repurchase price of $27.21 per share for a total of $22.1 million.

On March 7, 2008, the Board of Directors of State Auto Financial declared a quarterly cash dividend of $0.15 per common share, payable on March 31, 2008, to stockholders of record on March 17, 2008. This is the 67th consecutive quarterly cash dividend declared by State Auto Financial s Board since we had our initial public offering of common stock on June 28, 1991. We have increased cash dividends to stockholders for fifteen consecutive years.

To fund these capital transactions and provide additional working capital to State Auto Financial, on September 12, 2007, State Auto P&C and Milbank declared cash dividends of $40.0 million and $10.0 million, respectively, to State Auto Financial. The cash transfer of dividends was completed in October 2007.

Other Events

On February 14, 2008, we issued a press release announcing preliminary estimates of 2008 catastrophe storm activity through February 8, 2008. This press release disclosed our expectation that first quarter 2008 earnings will include between $32.0 and $36.0 million in pre-tax catastrophe losses related to unusual January and early February storm activity. Severe wind and tornado activity which impacted the Midwest during the first five weeks of this year are expected to contribute significantly more losses to our first quarter 2008 results than are normal. Over the past five years, we have experienced an average of $6.7 million in catastrophe losses during the first quarter. We reported $8.1 million in catastrophe losses for the first quarter of 2007. While the 2008 January and February catastrophe storm losses will be significant to our first quarter results, we do not expect these losses to have a significant impact on our overall financial position.

Borrowing Arrangements

The following provides an overview of our borrowing arrangements during 2007 and outstanding at December 31, 2007:

Credit Agreement

Through July 12, 2007, State Auto Financial had a credit agreement with a syndicate of lenders which provided for a $100.0 million five-year unsecured revolving credit facility. State Auto Financial did not borrow any funds under the credit facility.

On July 12, 2007, State Auto Financial terminated its then-current credit agreement and entered into a new credit agreement (Credit Agreement) with a syndicate of lenders which provides for a $200.0 million five-year unsecured revolving credit facility (Credit Facility). During the term of the Credit Facility, we have the right to increase the total facility to a maximum total facility amount of $250.0 million, provided that no event of default has occurred and is continuing. While the Credit Facility will be available for general corporate purposes, including working capital, acquisitions and liquidity purposes, we presently intend to keep $100.0 million of the Credit Facility available in the event there is a need to fund losses under the catastrophe reinsurance program with State Auto P&C. For a discussion of our catastrophe reinsurance arrangements, see the Reinsurance Arrangements section included in this Item 7. The Credit Facility provides for interest-only payments during its term, with principal due in full at maturity. Interest is based on either a London interbank market rate or a base rate plus a calculated margin amount. The Credit Agreement contains certain covenants, including financial covenants that require us to maintain a minimum net worth and not exceed a certain debt to capitalization ratio. As of December 31, 2007, State Auto Financial had not made any borrowings and was in compliance with all of the covenants under the Credit Agreement.

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Senior Notes

In 2003, State Auto Financial issued $100.0 million of unsecured Senior Notes due November 2013. The Senior Notes bear interest at a fixed rate of 6.25% per annum, which is payable each May 15 and November 15. The Senior Notes are general unsecured obligations ranking senior to all existing and future subordinated indebtedness and equal with all existing and future senior indebtedness. The Senior Notes are not guaranteed by any of our subsidiaries and thereby are effectively subordinated to all our subsidiaries existing and future indebtedness. As of December 31, 2007, we were in compliance with all covenants related to the Senior Notes.

Trust Securities

State Auto Financial s Delaware business trust subsidiary (the Capital Trust) issued $15.0 million liquidation amount of capital securities in 2003, due 2033. In connection with the Capital Trust s issuance of the capital securities and the related purchase by State Auto Financial of all of the Capital Trust s common securities (liquidation amount of $0.5 million), State Auto Financial issued to the Capital Trust $15.5 million aggregate principal amount of unsecured Floating Rate Junior Subordinated Debt Securities due 2033 (the Subordinated Debentures). The sole assets of the Capital Trust are the Subordinated Debentures and any interest accrued thereon. Interest on the Capital Trust s capital and common securities is payable quarterly at a rate equal to the three-month LIBOR rate plus 4.20%, adjusted quarterly. The applicable interest rates for the periods January 2005 through December 31, 2007 ranged from 8.61% to 9.78%.

Notes Payable Summary

At December 31, 2007, our notes payable are summarized as follows:

($ millions)	Carrying Value	Fair Value	Interest Rate
Senior Notes due 2013: issued $100.0 million, November 2003 with fixed interest	$ 102.5	$ 103.6	6.25%
Subordinated Debentures due 2033: issued $15.5 million, May 2003 with variable interest adjusting quarterly	15.5	15.5	9.32%
Total Notes Payable	$ 118.0	$ 119.1	

Related to our notes payable, our primary market risk exposure is to the change in interest rates and our credit rating. For a discussion regarding our credit ratings see Credit and Financial Strength Ratings included in this Item 7. Based upon the notes payable carrying value at December 31, 2007, we had $15.5 million notes payable with variable interest and $102.5 million notes payable with interest fixed at 6.25%, which equated to approximately 13.1% variable interest debt and 86.9% fixed interest debt. Our decision to obtain fixed versus variable interest rate debt is influenced primarily by the following factors: (a) current market interest rates (b) anticipated future market interest rates (c) availability of fixed versus variable interest instruments and (d) our currently existing notes payable fixed and variable interest rate position.

See our contractual obligations table included in Contractual Obligations .

Reinsurance Arrangements

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 for the full amount of limits applicable under their policies, it does make the assuming reinsurer liable to the extent of the reinsurance ceded.

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During 2007, the Beacon Group was added to the State Auto Group s reinsurance programs described below and as of January 1, 2008, the Patrons Group was added to these reinsurance programs.

The terms of the casualty excess of loss program provide that each company in the State Auto Group is responsible for the first $2.0 million of a covered loss. Coverage under the casualty excess of loss program was expanded as of July 1, 2007, so that reinsurers became responsible for 100% of a covered loss in excess of $2.0 million, up to $5.0 million of covered loss, compared to 95% under the previous program. Also, certain unusual claim situations involving bodily injury liability, property damage, uninsured motorist and personal injury protection are covered by an arrangement that provides for $10.0 million of coverage in excess of $5.0 million retention for each loss occurrence. This layer of reinsurance sits above the $3.0 million excess of $2.0 million arrangement. The rates for this reinsurance are negotiated annually.

Under our property per risk excess of loss program, each company within the our State Auto Group is responsible for the first $3.0 million of each covered loss and reinsurers are responsible for 100% of the excess over the retention up to $20.0 million of covered losses. The rates for this reinsurance are negotiated annually.

Under our property catastrophe excess of loss program, the State Auto Group retains the first $55.0 million of catastrophe loss per occurrence. Outside reinsures provide coverage for the next $80.0 million of covered loss with a 5% co-participation. The rates for this reinsurance are negotiated annually.

We also participate in an intercompany catastrophe reinsurance agreement by which State Auto P&C acts as the catastrophe reinsurer for the State Auto Group. The coverage attaches at $135.0 million of catastrophe loss per occurrence. Excess of the $135.0 million retention, this program continues to provide coverage for the next $100.0 million of covered loss. There have been no losses assumed under this agreement. The State Auto Group does not currently intend to renew this intercompany catastrophe reinsurance arrangement upon its expiration on July 1, 2008. The State Auto Group is considering other alternatives, which include securing replacement coverage from a third party reinsurer or relying upon the $100.0 million set aside under the Credit Agreement, discussed above, to fund this layer of catastrophe reinsurance.

In addition to the treaties described above, the State Auto Group is also party to treaties for workers compensation excess of loss and workers compensation catastrophe excess of loss. The terms of the workers compensation excess of loss program provide that each company in the State Auto Group is responsible for the first $2.0 million of covered loss. The reinsurers are responsible for 100% of the excess over $2.0 million up to $10.0 million of covered loss. Net retentions under this contract may be submitted to the casualty excess of loss program, subject to a limit of $2.0 million per loss occurrence. The rates for this reinsurance are negotiated annually.

The workers compensation catastrophe excess of loss treaty provides an additional layer of excess of loss reinsurance for workers compensation losses involving multiple workers. Subject to $10.0 million of retention, reinsurers are responsible for 100% of the excess over $10.0 million up to $20.0 million of covered loss. This coverage is subject to a Maximum Any One Life limit of $10.0 million. The rates for this reinsurance are negotiated annually.

The State Auto Group has also secured other reinsurance to limit the net cost of large loss events for certain types of coverage and certain companies. Included are umbrella liability losses which are reinsured up to a limit of $10.0 million with a maximum $0.6 million retention. The State Auto Group also makes use of facultative reinsurance for unique risk situations and participates in involuntary pools and associations in certain states. (Facultative reinsurance provides for a separate reinsurance agreement that is negotiated for a particular risk or insurance policy.)

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Contractual Obligations

Our significant contractual obligations as of December 31, 2007, were as follows:

($ millions)	Total	Due 1 year or less	Due 1-3 years	Due 3-5 years	Due after 5 years
Direct loss and reserves[1]	$ 697.5	275.7	230.6	85.7	105.5
Notes payable[2]:					
Senior Notes due 2013:					
issued $100.0, November 2003 with fixed interest[3]	$ 100.0				100.0
Subordinated Debentures due 2033:					
issued $15.5, May 2003 with variable interest[4] adjusting quarterly	15.5				15.5
Total notes payable	$ 115.5				115.5
Interest payable[2]:					
Senior Notes due 2013:					
issued $100.0, November 2003 with fixed interest[3]	$ 37.6	6.3	12.5	12.5	6.3
Subordinated Debentures due 2033:					
issued $15.5, May 2003 with variable interest[4] adjusting quarterly	35.2	1.4	2.8	2.8	28.2
Total interest payable	$ 72.8	7.7	15.3	15.3	34.5
Postretirement benefits	$ 59.5	4.0	9.0	10.8	35.7
Pension funding[5]	$ 83.7		20.8	20.5	42.4
Total	$ 1,029.0	287.4	275.7	132.3	333.6

(1) We derived expected payment patterns separately for the direct loss and ALAE reserves. Amounts included the STFC Pooled Companies net additional share of transactions assumed from State Auto Mutual through the Pooling Arrangement. For a reconciliation of management s best estimate see Loss and Loss Expense Reserves included in this Item 7. These patterns were applied to the December 31, 2007, loss and ALAE payable to generate estimated annual incremental loss and ALAE payments for each subsequent calendar year. These amounts are based on historical payment patterns and do not represent actual contractual obligations. The actual payment amounts and the related timing of those payments could differ significantly from these estimates.

(2) For a discussion of these debt instruments, see Liquidity and Capital Resources Borrowing Arrangements included in this Item 7.

(3) The Senior Notes bear interest at a fixed rate of 6.25% per annum, which is payable each May 15 and November 15.

(4) Interest on the subordinated debentures was calculated using an interest rate equal to the three-month LIBOR rate **at December 31, 2007 of 4.7025%** plus 4.20%, or 8.9025%.

(5) These amounts are estimates of ERISA minimum funding levels for our defined benefit pension plan and do not represent an estimate of our expected contributions. See Note 9, Pension and Postretirement Benefits Plans to our Consolidated Financial Statements included in Item 8 of this Form 10-K for a tabular presentation of expected benefit payments from the State Auto Group s defined benefit pension plan.

Lease and other purchase obligations of State Auto Mutual are allocated to us through the Pooling Arrangement.

Regulatory Considerations

At December 31, 2007, 2006 and 2005, each of our insurance subsidiaries was in compliance with statutory requirements relating to capital adequacy.

The National Association of Insurance Commissioners (NAIC) utilizes a collection of analytical tools designed to assist state insurance departments with an integrated approach to screening and analyzing the

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financial condition of insurance companies operating in their respective states. One such set of analytical tools is 12 key financial ratios that are known in the insurance industry as the IRIS ratios. IRIS ratios are derived from financial statements prepared on a statutory accounting basis, which are accounting practices prescribed or permitted by the insurance department with regulatory authority over our insurance subsidiaries. A defined range of results for each ratio has been established by the NAIC for solvency monitoring. While management utilizes each of these IRIS ratios in monitoring our insurance companies operating performance on a statutory accounting basis (each of our insurance subsidiaries operates within the defined range for the other measures), the net written premium to statutory surplus ratio (the leverage ratio) is monitored to ensure that each of our insurance subsidiaries continue to operate within the defined range of 3.0 to 1.0. The higher the leverage ratio, the more risk a company bears in relation to statutory surplus available to absorb losses. In considering this range, management also considers the distribution of net premiums between property and liability lines of business. A company with a larger portion of net premiums from liability lines should generally maintain a lower leverage ratio.

The statutory leverage ratios for our insurance subsidiaries at December 31, 2007, 2006 and 2005 were as follows:

Statutory Leverage Ratios[1]	**2007**	2006	2005
State Auto P&C	**1.2**	1.2	1.6
Milbank	**1.2**	1.2	1.6
Farmers	**1.0**	1.1	1.3
SA Ohio	**1.0**	1.0	1.2
SA National	**0.6**	0.6	0.8
Weighted Average	**1.1**	1.2	1.5

(1) We use the statutory leverage ratio as there is no comparable GAAP measure.

Our insurance subsidiaries pay dividends to State Auto Financial which in turn may be used by State Auto Financial to pay dividends to stockholders or to make principal and interest payments on debt. Individual states limit the amount of dividends that our insurance subsidiaries domiciled in those states can pay without prior approval. Under current law, at December 31, 2007, after adjustment for dividend payments made in the previous twelve month period, a total of $79.6 million is available in 2008 for payment as a dividend from our insurance subsidiaries to State Auto Financial, without prior approval from our respective domiciliary state insurance departments. In 2007, 2006, and 2005, State Auto Financial received $50 million, $0, and $40.5 million in dividends from its insurance subsidiaries, respectively. We are required to notify the insurance subsidiaries applicable state insurance commissioner within five business days after declaration of all such dividends and at least ten days prior to payment. Additionally, the domiciliary state commissioner of each insurance subsidiary has the authority to limit a dividend when the commissioner determines, based on factors set forth in the law, that an insurer s surplus is not reasonable in relation to the insurer s outstanding liabilities and adequate to meet its financial needs. Such restrictions are not expected to limit the capacity of State Auto Financial to meet its cash obligations.

State Auto Financial s insurance subsidiaries are subject to regulation and supervision by the states in which they do business. The NAIC has developed Risk-Based Capital (RBC) requirements. RBC attempts to relate an individual insurance company s statutory surplus to the risk inherent in its overall operations. RBC requires the calculation of a ratio of total adjusted statutory capital to authorized control level. Insurers with a ratio below 200% are subject to different levels of regulatory intervention and action. At December 31, 2007, the ratio of total adjusted statutory capital to authorized control level of State Auto Financial s insurance subsidiaries ranged from 969% to 1,859%.

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Credit and Financial Strength Ratings

The following table summarizes our credit and insurance company financial strength ratings at December 31, 2007:

	A.M. Best	Moody s	Standard & Poor s
STFC (credit rating)	a-	Baa1	BBB
STFC Pooled Companies (financial strength)	A+	A2	A
SA National (financial strength)	A+	n/a	A

We are reviewed regularly by the independent rating agencies listed in the table above. Ratings provide a meaningful way for policyholders, agents, creditors and stockholders to compare us to our competitors. The published credit ratings on State Auto Financial Senior Notes discussed above are opinions as to the ability of State Auto Financial to meet its ongoing obligations under the terms of the Senior Notes. Generally, credit ratings affect the cost, type and availability of debt financing. Higher rated securities receive more favorable pricing and terms relative to lower rated securities at the time of issue. State Auto Financial s Senior Notes have been rated investment grade by each agency.

The published financial strength ratings on the insurance company subsidiaries of State Auto Financial are opinions as to the ability of those companies to meet their ongoing obligations to their policyholders. The A.M. Best financial strength ratings influence our ability to write insurance business as agents and policyholders generally prefer higher rated companies. Lower rated companies may be required to compete for agents and policyholders by offering higher commissions or lower premiums and expanded coverage, or a combination thereof. State Auto Mutual is one of only 14 companies in the United States that have received A.M. Best s A+ or higher rating every year since 1954. The STFC Pooled Companies and the Mutual Pooled Companies are collectively assigned a pool rating by A.M. Best while SA National is rated by A. M. Best as a part of the total group.

Our ratings are influenced by many factors including operating and financial performance, asset quality, liquidity, financial leverage, exposure to catastrophe risks and operating leverage. At December 31, 2007, our A.M. Best, Moody s and Standard & Poor s ratings were assigned stable outlooks.

OTHER

Employee Benefit Plans

The State Auto Group has a defined benefit pension plan and a postretirement health care plan covering substantially all employees (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. We use a measurement date of September 30 as currently permitted under SFAS No. 87 Employers Accounting for Pensions (SFAS 87) and SFAS No. 106 Employers Accounting for Postretirement Benefits Other than Pensions (SFAS 106) when determining our liabilities at December 31.

To calculate the State Auto Group s December 31, 2007 pension projected benefit obligation (PBO) we used a discount rate of 6.25% based on an evaluation of the expected future benefit cash flows of our defined benefit pension plan used in conjunction with the Citigroup Pension Discount Curve at the measurement date. A lower discount rate results in, all else equal, a higher present value of the benefit obligation. We selected an expected long-term rate of return on our plan assets of 9.0% by considering the mix of investments and stability of investment portfolio along with actual investment experience during the lifetime of the plan. To calculate the net periodic benefit cost for the year ended December 31, 2007, a discount rate of 6.0% and an expected long-term rate of return on plan assets of 9.0% were used.

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The selected discount rate of 6.25% increased 0.25 points from the 6.00% rate used in 2006 which had the effect of decreasing the 2007 PBO and related unrecognized net actuarial loss by approximately $7.8 million. Cumulative unrecognized actuarial losses of approximately $62.6 million, which are now being recognized on our balance sheet pursuant to SFAS 158 (defined below), are being systematically recognized as an increase in net periodic cost over the average future service period of active participants. Unrecognized gains and losses arise from several factors including expected to actual demographic changes, assumption changes in the obligations and from the difference between expected and actual returns on plan assets.

The accumulated benefit obligation (ABO) of a defined benefit 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 PBO is the ABO plus a factor for future compensation levels. At December 31, 2007, the ABO and PBO were $194.3 million and $217.3 million, respectively. At December 31, 2007 the fair value of the assets of our defined benefit pension plan was $220.0 million, which resulted in an overfunding status within our balance sheet of $2.7 million. The State Auto Group has consistently targeted contributions to our defined benefit pension plan with the objective of maintaining a fully funded status on an ABO basis. Historically our plan assets have exceeded our ABO. The ABO, which considers current compensations level only, provides information about the obligation an employer would have if the plan were discontinued at the date of measurement date. This funding objective has served our plan participants well knowing that we were fully funded on a current basis as well as the fact that we have not had to recognize in 2006 or anytime prior an additional minimum liability as would have been previously required under SFAS 87.

Key assumptions used in determining the amount of the benefit obligation and related periodic cost recognized for postretirement benefits other than pensions under SFAS 106 include the discount rate and the assumed health care cost trend rate. To calculate the State Auto Group s 2007 benefit obligation for our health care plan, we increased our selected discount rate by 0.25 points to 6.25% from the 2006 discount rate to match the anticipated stream of future benefit payments. We assume that the relative increase in health care costs will generally trend downward over the next several years, reflecting assumed increases in efficiency in the health care system and cost containment initiatives. For 2007 the expected rate of increase in future health care costs was 10% for 2007, trending down 1% per year to 5% thereafter. The change in the discount rate and adjustment for the assumed health care cost trend rate had the effect of increasing the benefit obligation and related unrecognized net actuarial loss by approximately $0.6 million. The benefit obligation under our health care plan was $123.0 million at December 31, 2007 which exceeded the fair value of plan assets of $2.3 million, resulting in an underfunding status of $120.7 million in our balance sheet.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R) (SFAS 158) which requires employers with defined benefit pension and other postretirement benefit plans, such as health care, to recognize the funded status of its benefit plans on its balance sheet and measure the fair value of plan assets and benefit obligations as of the date of the fiscal year-end balance sheet date thereby eliminating the use of an earlier measurement date and to provide additional disclosures. The new measurement date requirement is not effective until fiscal years ending after December 15, 2008. Adopting SFAS 158 required us to recognize the funded status (i.e. the difference between the fair value of plan assets and the benefit obligations) on our balance sheet, with a corresponding adjustment to accumulated other comprehensive income, net of tax. The adoption of SFAS 158 at December 31, 2006 had the impact of decreasing accumulated comprehensive income by $63.9 million, net of tax, which was represented by the following:

For our pension plan: net unrecognized actuarial losses of $77.4 million ($50.3 million net of tax); unrecognized prior service costs of $3.4 million ($2.2 million net of tax); unrecognized transition asset remaining from the initial adoption of SFAS 87 of $3.0 million ($1.9 million net of tax), all of which were previously netted against the plan s funded status on our balance sheet pursuant to the provisions of SFAS 87. These amounts will be subsequently recognized as a component of our net periodic cost (benefit) pursuant to our historical accounting policy for amortizing and allocating such amounts.

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For our postretirement health care plan: net unrecognized actuarial losses of $23.6 million ($15.3 million net of tax); unrecognized prior service costs of $3.2 million ($2.1 million net of tax), all of which were previously netted against the plan s funded status in our balance sheet pursuant to the provisions of SFAS 106. These amounts will be subsequently recognized as a component of our net periodic cost (benefit) pursuant to our historical accounting policy for amortizing and allocating such amounts.

The following table provides the incremental effects of adopting the provisions of SFAS 158 on our balance sheet at December 31, 2006. The adoption of SFAS 158 had no effect on our consolidated statement of income for the year ended December 31, 2006, or for any prior period presented.

($ millions)	Prior to Adopting SFAS 158	Effect of Adopting SFAS 158	As Reported
Assets:			
Net prepaid pension expense	$ 61.8	$ (61.8)	$
Deferred federal income taxes	5.6	40.7	46.3
Liabilities:			
Postretirement benefits	98.1	26.7	124.8
Pension benefits		16.1	16.1
Stockholders Equity:			
Accumulated other comprehensive Income (loss)	46.6	(63.9)	(17.3)

With regard to the adoption of the new measurement guidelines, we are continuing to review the transition alternatives available to us but intend to adopt the required December 31 measurement at December 31, 2008. The adoption of SFAS 158 did not have an impact on our debt covenants.

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.

Loss and Loss Expense Reserves

Our loss and loss expense reserves include the accumulation of unpaid individual case estimates for claims that have been reported and estimates of claims that have been incurred but not reported (IBNR) as well as estimates of the expenses associated with processing and settling all reported and unreported claims. Our loss and loss expense reserves are not discounted to present value.

Losses and allocated loss expense reserves (Loss and ALAE Reserve) are management s best estimates (MBE) at a given point in time of what we expect to pay claimants, based on known facts, circumstances and historical trends. Reserves for reported losses are 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 by claims adjusters based on our reserving practices, which take into account the type of risk, the circumstances surrounding each claim and policy provisions relating to types of loss. The formula reserves are based on historical data for similar claims with provision for trend changes caused by inflation. Case and formula basis loss 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 and ALAE Reserve is to develop an estimate of the ultimate losses and allocated loss expenses incurred, and then subtract all amounts already paid and held in case and formula reserves.

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The ultimate determination of MBE 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 and ALAE 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 and ALAE Reserve, 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 the loss reserves.

We use a number of different methodologies to estimate the IBNR component of the Loss and ALAE Reserves. Our 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. 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-tailed contracts, the 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 (average 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 paid methods excludes the case reserve estimates, so only paid losses are utilized. With these methods, 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 might influence 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 the immature 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 value. Similarly, the incurred loss severities are projected to ultimate. 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-tailed contracts use the same methods listed above for short-tailed lines, 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 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 premium, 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 thin for traditional projections. 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 very 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 generally correlate well 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, given supplementary information like 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 that reflects our underwriting and claims risk.

Reserve ranges provide a quantification of the variability in the reserve projections. The primary determinant in estimating the reserve range boundaries are the variances measured within the historical reserving data for the various lines of business. Property lines typically have smaller variances, while liability lines can experience significant variability. MBE of loss reserves considers the expected variation to establish an appropriate position within a range. MBE for SA National and the STFC Pooled Companies share of the Pooled Companies Loss and ALAE Reserves at December 31, 2007 was $697.5 million, within a projected range of $640.6 million to $714.1 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 many of the other loss and loss expenses payable tables included elsewhere within this Form 10-K.)

The potential impact of the reserve variability on net income is quantifiable using the range end points and carried reserve amounts listed above. For example, if ultimate losses reach the high point of $714.1 million, the

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reserve increase of $16.5 million is an after-tax decrease of $10.7 million on net income. Likewise, should losses decline to the low end of $640.6 million, the $57.0 million reserve decrease would add $37.0 million of after-tax net income.

An important assumption underlying the 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, 2007, other 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 jump 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 liability is an increase of $54.2 million on reserves, or a $35.3 million after-tax reduction (assuming a tax rate of 35%) to net income. Inflation changes have much more impact on the longer tail commercial lines like other liability and workers compensation, and much less impact on the shorter tail personal lines reserves.

In addition to establishing Loss and ALAE Reserves, as described above, we establish reserves for loss adjustment expenses contemplating functions and costs that are not attributable to a specific claim, which is called Unallocated Loss Adjustment Expense (ULAE). Based on historical patterns, selected ratios of paid ULAE to paid losses are imposed on the current outstanding reserves. Consequently, this component of the loss expense reserve has a proportional relationship to the overall claim inventory and held reserves by accident year, as they move up or down in sync with carried reserves. The method uses a traditional assumption that 50% of the expenses are incurred when the claim is open, and the other 50% are incurred when the claim is closed, and also assumes that the underlying claims process and mix of business do not change drastically over time.

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The following table provides a reconciliation of MBE of our direct Loss and ALAE Reserve to our net loss and loss expenses payable at December 31, 2007 and 2006, respectively. The STFC Pooled Companies net additional share of transactions assumed from State Auto Mutual through the Pooling Arrangement for the years ended December 31, 2007 and 2006, respectively, has been reflected in the table below as assumed by STFC Pooled Companies:

($ millions)	**2007**	2006
Direct Loss and ALAE Reserve:		
STFC Pooled Companies and SA National	**$ 393.1**	$ 384.2
Assumed by STFC Pooled Companies	**304.4**	325.3
Total direct loss and ALAE reserve	**697.5**	709.5
Direct unallocated loss adjustment expense (ULAE)		
STFC Pooled Companies and SA National	**23.8**	23.5
Assumed by STFC Pooled Companies	**20.3**	21.7
Total direct ULAE	**44.1**	45.2
Direct salvage and subrogation recoverable:		
STFC Pooled Companies and SA National	**(20.9)**	(20.5)
Assumed by STFC Pooled Companies	**(8.4)**	(8.5)
Total direct salvage and subrogation recoverable	**(29.3)**	(29.0)
Reinsurance recoverable	**(11.2)**	(13.5)
Assumed reinsurance	**5.1**	5.6
Reinsurance assumed by STFC Pooled Companies	**(59.1)**	(56.8)
Total losses and loss expenses payable, net of reinsurance recoverable on losses and loss expenses payable of $11.2 in 2007 and $13.5 in 2006	**$ 647.1**	$ 661.0

The following tables present the loss and loss expenses payable by major line of business at December 31, 2007 and 2006, respectively:

($ in millions)	**Ending Loss & ALAE Case & Formula**	**Ending Loss & ALAE IBNR**	**Ending ULAE Bulk**	**Total Reserves**
December 31, 2007				
Personal insurance segment:				
Standard auto	**$ 120.4**	**$ 37.5**	**$ 11.2**	**$ 169.1**
Nonstandard auto	**13.9**	**3.0**	**1.4**	**18.3**
Homeowners	**36.4**	**15.3**	**1.7**	**53.4**
Other personal	**6.3**	**2.3**	**0.3**	**8.9**
Total personal	**177.0**	**58.1**	**14.6**	**249.7**
Business insurance segment:				
Commercial auto	**44.8**	**28.9**	**4.1**	**77.8**

Commercial multi-peril	**37.8**	**36.9**	**4.1**	**78.8**
Fire & allied lines	**18.7**	**1.0**	**0.6**	**20.3**
Product & other liability	**46.0**	**71.7**	**12.4**	**130.1**
Workers compensation	**38.3**	**39.4**	**7.8**	**85.5**
Other business	**2.0**	**2.4**	**0.5**	**4.9**
Total business	**187.6**	**180.3**	**29.5**	**397.4**
Total losses and loss expenses payable net of reinsurance recoverable on losses and loss expenses payable	**$ 364.6**	**$ 238.4**	**$ 44.1**	**$ 647.1**

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	Ending Loss & ALAE Case & Formula	Ending Loss & ALAE IBNR	Ending ULAE Bulk	Total Reserves
December 31, 2006				
Personal insurance segment:				
Standard auto	118.4	42.1	11.3	171.8
Nonstandard auto	16.0	4.0	1.6	21.6
Homeowners	38.6	16.6	1.9	57.1
Other personal	5.7	1.7	0.2	7.6
Total personal	178.7	64.4	15.0	258.1
Business insurance segment:				
Commercial auto	46.3	31.4	4.3	82.0
Commercial multi-peril	34.4	40.4	4.4	79.2
Fire & allied lines	19.3	1.8	0.7	21.8
Product & other liability	40.2	75.3	12.3	127.8
Workers compensation	37.7	40.2	7.7	85.6
Other business	2.5	3.3	0.7	6.5
Total business	180.4	192.4	30.1	402.9
Total losses and loss expenses payable net of reinsurance recoverable on losses and loss expenses payable	359.1	256.8	45.1	661.0

Net losses and loss expenses payable at December 31, 2007 decreased $13.9 million (2.1%) from 2006 due to a combination of the following:

Improved claim severity trends, primarily on the auto liability lines as previously discussed;

At the end of 2006, catastrophe loss reserves, primarily on homeowners and commercial multi- peril lines, remained in reserve status, but were paid during 2007 resulting in some of the reserve decreases.

The property and casualty industry has had significant loss experience from claims related to asbestos, environmental remediation, product liability, mold and other mass torts. Asbestos reserves are $3.2 million, and environmental reserves are $7.9 million, for a total of $11.1 million, or 1.7% of net losses and loss expenses payable. Our environmental reserves increased approximately $1.2 million from 2006 primarily from the state of Indiana where there was an adverse court ruling several years ago. Because we have insured primarily product retailers and distributors, we do not expect to incur the same level of liability as companies that have insured manufacturing risks.

The risks and uncertainties inherent in the estimates include, but are not limited to, actual settlement experience being different from historical data and 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. For an additional discussion relating to losses and loss expense reserves see Impact of Significant External Factors , included in this Item 7.

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New Accounting Standards:

Adoption of Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R) (SFAS 158) that requires employers with defined benefit pension and postretirement benefit plans other than pensions (collectively benefit plans) to recognize the funded status of their benefit plans in their balance sheet, measure the fair value of plan assets and benefit obligations as of the date of the fiscal year-end balance sheet date thereby eliminating the use of an earlier measurement date and provide additional disclosures. The new measurement date requirement is not effective until fiscal years ending after December 15, 2008. On December 31, 2006, the Company adopted the recognition and disclosure provisions of SFAS 158, which had no effect on the Company s consolidated statement of income for year ended December 31, 2006, or for any prior period presented in the 2006 Form 10-K, and it will not affect the Company s operating results in future periods. Adopting SFAS 158 required the Company to recognize the funded status (i.e. the difference between the fair value of plan assets and the benefit obligations) of its benefit plans in the December 31, 2006 balance sheet, with a corresponding adjustment to other comprehensive loss, net of tax of $63.9 million. The adoption did not have an impact on the Company s debt covenants. At December 31, 2007 and 2006, the Company continued to use the earlier measurement date of September 30, and is currently reviewing the transition alternatives available and the related impact.

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48), which was effective for fiscal years beginning after December 15, 2006. FIN 48 clarified the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provided guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company adopted the provisions of FIN 48, on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized no increase in the liability for unrecognized tax benefits. See Note 8 for additional required disclosures.

In February 2006, the FASB issued SFAS 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140 (SFAS 155), which was effective for all financial instruments acquired or issued after the beginning of an entity s fiscal year after September 15, 2006. SFAS 155 permits fair value re-measurement for any hybrid financial instruments that contain an embedded derivative that would otherwise require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133, establishes a requirement to evaluate interests in securitized financial assets in order to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and amends Statement 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. The Company adopted this guidance effective January 1, 2007 and there was no impact on the Company s financial statements.

In September 2005, the Accounting Standards Executive Committee issued Statement of Position 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection With Modifications or Exchanges of Insurance Contracts (SOP 05-1), which was effective for fiscal years beginning after December 15, 2006. SOP 05-1 provides guidance on accounting for deferred acquisition costs associated with modifications to or the internal replacement of insurance contracts. SOP 05-1 focuses on modifications to contracts with integrated product features and internal replacement of contracts in which the new contract offers product features not included in the old contract when both were priced together. The Company s insurance contracts include only nonintegrated contract features as defined in SOP 05-1, which are contract features that provide coverage that is underwritten and priced only for that incremental insurance coverage and that do not result in re-underwriting or re-pricing of other components of the contract. Nonintegrated contract features do not

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change the existing base contract and do not require further evaluation under SOP 05-1. The Company adopted this guidance effective January 1, 2007 and there was no impact on the Company s financial statements.

Pending Adoption of Accounting Pronouncements

In September 2006, the FASB issued SFAS 157, Fair Value Measurements (SFAS 157), which is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. SFAS 157 establishes a single authoritative definition of fair value, sets out a framework for measuring fair value, and requires additional disclosures about fair-value measurements. The statement imposes no new requirements for additional fair-value measures in financial statements. The Company adopted this guidance effective January 1, 2008.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 159 expands the standards under SFAS 157 to provide entities with a one-time election to measure existing financial instruments and certain other items at fair value at the date of adoption. SFAS 159 also amends SFAS No. 115 Accounting for Certain Investments in Debt and Equity Securities to require a specific presentation of investments categorized as available-for-sale. This statement is effective for the first fiscal year that begins after November 15, 2007. The Company adopted this guidance on January 1, 2008 and did not elect the fair value option for any of its eligible assets or liabilities as of this date.

In June 2007, the FASB issued EITF 06-11, Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards (EITF 06-11). EITF 06-11 addresses how a company should recognize the income tax benefit received on dividends that are (a) paid to employees holding equity-classified non-vested shares, equity-classified non-vested share units, or equity-classified outstanding share options, and (b) charged to retained earnings under FAS 123(R). The tax benefit received on dividends paid to employees associated with their share-based awards should be recorded in additional paid-in capital until the award is settled through exercise (if the award is an option) or vesting (if the award is non-vested stock). This will be effective for tax benefits of dividends declared in fiscal years beginning after December 15, 2007. The Company adopted this guidance effective January 1, 2008 and it had no material impact on the Company s financial statements.

Impact of Significant External Factors

Inflation can have a significant 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. General inflation, as measured by the Consumer Price Index, has been relatively modest over the last several years. However, price inflation on the goods and services purchased by insurance companies in settling claims has been steadily increasing. In particular, repair costs for homes, autos, commercial buildings, and medical care costs, have risen disproportionately over the last few years. Costs for building materials typically rise dramatically following substantial natural catastrophes such as the industry experienced in Florida and adjacent states in 2004 and in Mississippi and Alabama in 2005. We continue to adjust our pricing projections as loss cost trends change in order to ensure premiums keep pace with inflation in all lines of business.

We consider inflation when estimating liabilities for losses and loss expenses, particularly for claims having a long period between occurrence and settlement. The liabilities for losses and loss expenses are management s best estimates of the ultimate net cost of underlying claims and expenses and are not discounted for the time value of money. In times of high inflation, the normally higher yields on investment income may partially offset potentially higher claims and expenses.

In Loss and Loss Expenses Reserves, we include a discussion of certain factors management considers in estimating the ultimate liability for losses and loss expenses. With respect to the auto line of business, which represents approximately 40% of our total reserves, perhaps the most significant external variable is legal developments. Court decisions, as discussed below, have had significant impact on the property and casualty insurance industry. Some of these decisions have a more prospective effect, for example, when contract

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provisions relating to third party coverages are construed in ways not anticipated by us. Other court decisions may have more of a retroactive effect which may be seen more clearly in the auto insurance line. Auto insurance tends to be a line of business more regulated by statutes; consequently, the courts tend to have more of an opportunity to construe and apply those statutes to existing contracts. Uninsured motorists and underinsured motorists (collectively UM) are statutory coverages in almost every state where we do business. If a court construes a UM statute adversely to us and the industry, the decision typically has a retroactive effect with the court s interpretation being applied as if the UM statute has always been interpreted that way. This retroactive application is exacerbated in UM cases (and other first party coverage cases) because the statute of limitations applicable to UM claims and other first party coverages can be as long as 15 years. Claims that had been closed or not even presented, going back as long as fifteen years, can be restored by an adverse court decision. We consider the impact of adverse court decisions of which we have become aware when we set ultimate loss and loss expense reserves for auto insurance as well as other lines to the extent those lines may be retroactively affected by such matters.

The effect of court decisions is also apparent in the commercial lines of coverages such as commercial multi-peril and other liability and products liability. Courts can expand coverage or void exclusions which can increase our exposure to claims. Some of these third party claims may still be brought within the statute of limitations applicable to such third party claims and expose us to some retroactive liabilities. These liabilities are sought to be addressed by the ultimate loss and loss expense reserve that is our estimate of loss and loss expenses payable.

It is not feasible to quantify the impact of judicial decisions that may have retroactive effect because we cannot foresee, among the range of issues that are litigated every day in courts in each state in which we do business, which cases will be decided adversely and how such decisions will actually apply to us.

The reserve estimates do not contemplate substantial loss from any mass torts, including those already listed above, or others not known at this time. In addition, there is no provision in the reserves for a major retroactive expansion of coverage through judicial interpretation. If these assumptions prove to be incorrect, ultimate liabilities could increase substantially. Our claims, underwriting and actuarial staff track separately all claims within the family of mass torts, and respond accordingly as information becomes known.

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, 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 adversely affect an insurer. We may also be adversely affected by regulatory actions on matters within the jurisdiction of the various insurance departments where we do business or have entities domiciled.

For a discussion regarding the federal Terrorism Risk Insurance Act of 2002 and 2005 (collectively, the Terrorism Acts) see Regulation in Item 1 of this Form 10-K.

Item 7A. Qualitative and Quantitative Disclosures about Market Risk

Qualitative and Quantitative Disclosures about Market Risk are included in Item 7 of this Form 10-K under 2007 Compared to 2006 Investment Operations Segment Market Risk.

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Item 8. Financial Statements and Supplementary Data

The Consolidated Financial Statements, including the Notes to Consolidated Financial Statements and the Reports of Independent Registered Public Accounting Firm are as follows:

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of

State Auto Financial Corporation

We have audited the accompanying consolidated balance sheets of State Auto Financial Corporation and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of income, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2007. Our audits also included the financial statement schedules listed in the Index at Item 15(a)(2). These financial statements and schedules are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of State Auto Financial Corporation and subsidiaries at December 31, 2007 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, the Company changed its method of accounting for share-based compensation expense as of January 1, 2006, to adopt Financial Accounting Standards Board Statement No. 123(R), Share-Based Payment. As discussed in Note 1 to the consolidated financial statements, the Company also changed its method of accounting for defined benefit pension and other postretirement plans as of December 31, 2006, to adopt Financial Accounting Standards Board Statement No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), State Auto Financial Corporation s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 7, 2008 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Columbus, Ohio

March 7, 2008

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of

State Auto Financial Corporation

We have audited State Auto Financial Corporation s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). State Auto Financial Corporation s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management s Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, State Auto Financial Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of State Auto Financial Corporation as of December 31, 2007 and 2006, and the related consolidated statements of income, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2007 of State Auto Financial Corporation and our report dated March 7, 2008 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Columbus, Ohio

March 7, 2008

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Consolidated Balance Sheets

(in millions, except per share amounts)	December 31	
	2007	2006
Assets		
Fixed maturities, available-for-sale, at fair value (amortized cost $1,722.9 and $1,630.6 respectively)	**$ 1,745.4**	1,647.4
Equity securities, available-for-sale, at fair value (cost $210.2 and $230.8 respectively)	**254.2**	284.2
Other invested assets, available-for-sale, at fair value (cost $20.1 and $4.0 respectively)	**20.3**	4.5
Other invested assets	**1.3**	1.8
Total investments	**2,021.2**	1,937.9
Cash and cash equivalents	**70.9**	73.4
Accrued investment income and other assets	**42.1**	43.7
Deferred policy acquisition costs	**105.8**	104.0
Pension asset	**2.7**	
Reinsurance recoverable on losses and loss expenses payable (affiliates $1.2 and $2.7 respectively)	**11.2**	13.5
Prepaid reinsurance premiums (affiliates none)	**6.0**	6.0
Due from affiliate	**19.4**	17.9
Net deferred federal income taxes	**46.1**	46.3
Property and equipment, at cost, (net of accumulated depreciation of $5.6 and $5.1, respectively)	**12.5**	12.4
Total assets	**$ 2,337.9**	2,255.1
Liabilities and Stockholders Equity		
Losses and loss expenses payable (affiliates $257.2 and $281.7, respectively)	**$ 658.3**	674.5
Unearned premiums (affiliates $119.5 and $118.4, respectively)	**436.0**	428.8
Notes payable (affiliates $15.5 and $15.5, respectively)	**118.0**	118.4
Postretirement and pension benefits	**125.2**	140.9
Current federal income taxes	**7.8**	7.2
Other liabilities	**57.1**	51.1
Total liabilities	**1,402.4**	1,420.9
Stockholders equity:		
Class A Preferred stock (nonvoting), without par value. Authorized 2.5 shares; none issued		
Class B Preferred stock, without par value. Authorized 2.5 shares; none issued		
Common stock, without par value. Authorized 100.0 shares; 46.0 and 45.7 shares issued, respectively, at stated value of $2.50 per share	**115.0**	114.3
Treasury stock, 5.5 and 4.7 shares, respectively, at cost	**(81.0)**	(58.1)
Additional paid-in capital	**98.2**	87.3
Accumulated other comprehensive loss	**(3.3)**	(17.3)
Retained earnings	**806.6**	708.0
Total stockholders equity	**935.5**	834.2

Total liabilities and stockholders equity	**$ 2,337.9**	2,255.1

See accompanying notes to consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Consolidated Statements of Income

($ millions, except per share amounts)	Year ended December 31		
	2007	2006	2005
Earned premiums (ceded to affiliate $695.7, $687.8 and $683.4, respectively)	**$ 1,011.6**	1,023.8	1,050.3
Net investment income	**84.7**	83.1	78.7
Net realized gains on investments	**12.1**	5.6	5.6
Other income (affiliates $3.3, $3.0 and $2.9, respectively)	**5.0**	4.9	4.9
Total revenues	**1,113.4**	1,117.4	1,139.5
Losses and loss expenses			
(ceded to affiliate $405.0, $389.1 and $428.2, respectively)	**590.8**	587.6	613.4
Acquisition and operating expenses	**347.9**	348.0	332.9
Interest expense (affiliates $1.5, $1.5 and $2.8, respectively)	**7.6**	7.4	8.8
Other expenses	**11.8**	12.7	12.4
Total expenses	**958.1**	955.7	967.5
Income before federal income taxes	**155.3**	161.7	172.0
Federal income tax expense (benefit):			
Current	**43.5**	43.5	49.3
Deferred	**(7.3)**	(2.2)	(3.2)
Total federal income taxes	**36.2**	41.3	46.1
Net income	**$ 119.1**	120.4	125.9
Earnings per common share:			
Basic	**$ 2.90**	2.95	3.12
Diluted	**$ 2.86**	2.90	3.06
Dividends paid per common share	**$ 0.50**	0.38	0.27

See accompanying notes to consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Consolidated Statements of Stockholders Equity

(in millions)	Year ended December 31		
	2007	2006	2005
Common shares:			
Balance at beginning of year	**45.7**	45.1	44.7
Issuance of shares	**0.3**	0.6	0.4
Balance at end of year	**46.0**	45.7	45.1
Treasury shares:			
Balance at beginning of year	**(4.7)**	(4.6)	(4.6)
Shares acquired on stock option exercises		(0.1)	
Shares acquired under repurchase program	**(0.8)**		
Balance at end of year	**(5.5)**	(4.7)	(4.6)
Common stock:			
Balance at beginning of year	**$ 114.3**	112.8	111.8
Issuance of shares	**0.7**	1.5	1.0
Balance at end of year	**115.0**	114.3	112.8
Treasury stock:			
Balance at beginning of year	**(58.1)**	(56.8)	(56.5)
Shares acquired on stock option exercises	**(0.8)**	(1.3)	(0.3)
Shares acquired under repurchase program	**(22.1)**		
Balance at end of year	**(81.0)**	(58.1)	(56.8)
Additional paid-in capital:			
Balance at beginning of year	**87.3**	70.2	64.1
Issuance of common stock	**4.4**	7.2	4.0
Tax benefit from stock options exercises	**0.7**	3.2	1.8
Stock options granted	**5.8**	6.7	0.3
Balance at end of year	**98.2**	87.3	70.2
Accumulated other comprehensive (loss) income:			
Balance at beginning of year	**(17.3)**	34.3	53.1
Change in unrealized (losses) gains on investments, net of tax and reclassification adjustment	**(2.6)**	12.4	(18.7)
Amortization of gain on derivative used in cash flow hedge	**(0.1)**	(0.1)	(0.1)
Change in unrecognized benefit plan obligations, net of tax and reclassification adjustment	**16.7**		

Accumulated other comprehensive (loss) income before SFAS No. 158 adjustment	**(3.3)**	46.6	34.3
Cumulative effect of adoption of SFAS No. 158, net of tax		(63.9)	
Balance at end of year	**(3.3)**	(17.3)	34.3
Retained earnings:			
Balance at beginning of year	**708.0**	603.0	485.7
Net income	**119.1**	120.4	125.9
Cash dividends paid	**(20.5)**	(15.4)	(8.6)
Balance at end of year	**806.6**	708.0	603.0
Total stockholders equity at end of year	**$ 935.5**	834.2	763.5

See accompanying notes to consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Consolidated Statements of Cash Flows

($ millions)	Year ended December 31		
	2007	2006	2005
Cash flows from operating activities:			
Net income	**$ 119.1**	120.4	125.9
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization, net	**11.0**	9.6	9.3
Share-based compensation	**6.0**	7.0	0.6
Net realized gains on investments	**(12.1)**	(5.6)	(5.6)
Changes in operating assets and liabilities:			
Deferred policy acquisition costs	**(1.7)**	2.0	(3.2)
Accrued investment income and other assets	**1.0**	1.6	4.4
Postretirement and pension benefits (assets)	**7.3**	6.2	4.8
Reinsurance recoverable on losses and loss expenses payable and prepaid reinsurance premiums	**2.3**	4.0	10.7
Other liabilities and due to/from affiliates, net	**4.0**	(2.8)	26.3
Losses and loss expenses payable	**(16.2)**	(54.2)	11.6
Unearned premiums	**7.2**	(4.1)	(6.1)
Excess tax benefits on share-based awards	**0.4**	(2.4)	
Federal income taxes	**(6.7)**	11.8	(5.8)
Cash provided from adding Meridian Security Insurance Company and Meridian Citizens Mutual Insurance Company business to the reinsurance pool, effective January 1, 2005			54.0
Net cash provided by operating activities	**121.6**	93.5	226.9
Cash flows from investing activities:			
Purchases of fixed maturities available-for-sale	**(331.6)**	(293.8)	(539.1)
Purchases of equity securities available-for-sale	**(73.7)**	(101.2)	(109.2)
Purchases of other invested assets	**(17.1)**	(0.9)	(3.0)
Maturities, calls and pay downs of fixed maturities available-for-sale	**73.1**	76.0	98.5
Sales of fixed maturities available-for-sale	**155.2**	171.4	290.9
Sales of equity securities available-for-sale	**107.0**	103.8	49.2
Sales of other invested assets	**1.8**	1.7	
Net (additions) disposals of property and equipment	**(0.8)**	(0.2)	0.2
Net cash used in investing activities	**(86.1)**	(43.2)	(212.5)
Cash flows from financing activities:			
Proceeds from issuance of common stock	**4.3**	7.4	4.1
Payments to acquire treasury shares	**(22.1)**		
Excess tax benefits on share-based awards	**0.3**	2.4	
Payments of dividends	**(20.5)**	(15.4)	(8.6)
Change in securities lending collateral		99.0	45.7
Change in securities lending obligation		(99.0)	(45.7)
Payment of debt			(45.5)

Net cash used in financing activities	**(38.0)**	(5.6)	(50.0)
Net (decrease) increase in cash and cash equivalents	**(2.5)**	44.7	(35.6)
Cash and cash equivalents at beginning of year	**73.4**	28.7	64.3
Cash and cash equivalents at end of year	**$ 70.9**	73.4	28.7
Supplemental disclosures:			
Interest paid (affiliates $1.5, $1.4 and $2.7 respectively)	**$ 7.8**	7.7	9.0
Federal income taxes paid	**$ 42.3**	29.4	51.9

See accompanying notes to consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

a. Principles of Consolidation

The consolidated financial statements include State Auto Financial Corporation (State Auto Financial) and its wholly-owned subsidiaries:

State Auto Property and Casualty Insurance Company (State Auto P&C), an Iowa corporation

Milbank Insurance Company (Milbank), a South Dakota corporation

Farmers Casualty Insurance Company (Farmers), an Iowa corporation

State Auto Insurance Company of Ohio (SA Ohio), an Ohio corporation

State Auto National Insurance Company (SA National), an Ohio corporation

Stateco Financial Services, Inc. (Stateco), an Ohio corporation

Strategic Insurance Software, Inc. (S.I.S.), an Ohio corporation

The financial statements include the operations and financial position of 518 Property Management and Leasing, LLC (518 PML), whose members are State Auto P&C and Stateco.

State Auto Financial, an Ohio corporation, is a majority-owned subsidiary of State Automobile Mutual Insurance Company (State Auto Mutual), an Ohio corporation. State Auto Financial and subsidiaries are referred to herein as the Companies or the Company. All significant intercompany balances and transactions have been eliminated in consolidation.

b. Description of Business

The Company, through State Auto P&C, Milbank, Farmers and SA Ohio, provides standard personal and business insurance to its policyholders. The Company s principal lines of insurance include personal and commercial automobile, homeowners, commercial multi-peril, workers compensation, general liability and fire insurance. SA National provides nonstandard automobile insurance. State Auto P&C, Milbank, Farmers, SA Ohio and SA National operate primarily in the central and eastern United States, excluding New York, New Jersey and the New England states, through an independent insurance agency system. State Auto P&C, Milbank, Farmers, SA Ohio and SA National are chartered and licensed property and casualty insurers. As such, they are subject to the regulations of the applicable Departments of Insurance of their respective states of domicile (the Departments) and the regulations of each state in which they operate. These property and casualty insurance companies undergo periodic financial examination by the Departments and insurance regulatory agencies of the states that choose to participate. A large portion of the Company s revenues are derived from a reinsurance pooling agreement with State Auto Mutual and its affiliates. The nature of the underlying policies and geographical distribution of State Auto Mutual s and its affiliates underwriting activity is similar to the Company.

Through State Auto P&C, the Company provides management and operation services under management agreements for all insurance and non-insurance affiliates.

Through Stateco, the Company provides investment management services to affiliated companies.

The Company, through S.I.S., develops and sells software for the processing of insurance transactions, database management for insurance agents and electronic interfacing of information between insurance

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Consolidated Financial Statements, Continued

companies and agencies. S.I.S. sells services and products to insurance agencies and nonaffiliated insurers and their agencies. S.I.S. also delivers services and sells products to affiliated entities.

518 PML, an Ohio limited liability company, was formed to engage in the business of owning and leasing property to the Company s affiliates.

c. Basis of Presentation

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States, which vary in certain respects from statutory accounting principles followed by State Auto P&C, Milbank, Farmers, SA Ohio and SA National that are prescribed or permitted by the Departments.

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 periods then ended, and 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 herein.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of losses and loss expenses payable. In connection with the determination of this estimate, management uses historical data, current business conditions and assumptions about future conditions to formulate estimates of the ultimate cost to settle claims. These estimates by their nature are subject to uncertainties for various reasons. The Company s results of operations and financial condition could be materially impacted in future periods should the ultimate payments required to settle claims vary from the amount of the liability currently provided.

Certain reclassifications have been made to the 2006 and 2005 financial statements to conform to the 2007 presentation. This includes reclassifications in the consolidated balance sheet that consist of separately presenting certain other invested assets that are included in the Company s available-for-sale portfolio from all other invested assets as well as aggregating the Company s benefit plans where permitted, namely postretirement and pension liability or asset presentation. Consistent with balance sheet reclassifications, 2006 and 2005 line items in the consolidated statement of cash flows have been combined to conform with balance sheet presentation, specifically postretirement and pension benefits (assets).

d. Investments

Investments in fixed maturities, equity securities and certain other invested assets are classified as available-for-sale and, therefore, are carried at fair value. The unrealized holding gains or losses, net of applicable deferred taxes, are shown as a separate component of stockholders equity as a part of accumulated other comprehensive (loss) income and, as such, are not included in the determination of net income. Realized gains and losses on the sales of investments are computed using the first-in, first-out method.

The Company regularly monitors its investments that have fair values less than cost or amortized cost for signs of other-than-temporary impairment. Among the factors that management considers are market conditions, the amount, timing and length of decline in fair value, events impacting the issuer and the Company s positive intent and ability to hold the security until anticipated recovery or maturity. For declines in value that are not

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Consolidated Financial Statements, Continued

solely attributable to interest rate movements, the Company considers positive evidence indicating that the cost of the investment is recoverable within a reasonable period of time and evidence to the contrary in considering the severity and duration of the impairment in relation to the anticipated market price recovery. When a decline in fair value is deemed to be other-than-temporary, the investment cost is written down to fair value on the date the determination is made and a realized loss is recorded. The cost is not adjusted for any subsequent recovery in fair value.

e. Cash Equivalents

The Company considers all highly liquid debt instruments with a maturity of three months or less to be cash equivalents.

f. Deferred Policy Acquisition Costs

Acquisition costs, consisting of commissions, premium taxes and certain underwriting expenses that relate to and vary with the production of new and renewal property and casualty business, are deferred and amortized ratably over the contract period. The method followed in computing deferred policy 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 premium to be earned, losses and loss expenses to be incurred, and certain other costs expected to be incurred as premium is earned. These amounts are based on estimates and accordingly, the actual realizable value may vary from the estimated realizable value. Net deferred policy acquisition costs for the years ended December 31 are:

($ millions)	**2007**	2006	2005
Balance, beginning of year	**$ 104.0**	106.0	97.5
Effect of January 1, 2005 pooling change (Note 6)			5.3
Acquisition costs deferred	**244.5**	246.1	255.0
Amortized to expense	**(242.7)**	(248.1)	(251.8)
Balance, end of year	**$ 105.8**	104.0	106.0

g. Federal Income Taxes

The Company files a consolidated federal income tax return, and pursuant to a written tax sharing agreement, each entity within the consolidated group pays its share of federal income taxes based on separate return calculations.

Income taxes are accounted for using the liability method. Using this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

Interest and penalties related to unrecognized tax obligations are recorded in the balance sheet as other liabilities, and recognized in the income statement as other expenses.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Consolidated Financial Statements, Continued

h. Losses and Loss Expenses Payable

Losses and loss expenses payable are based on formula and case-basis estimates for reported claims and on estimates, based on experience and perceived trends, for unreported claims and loss expenses. The liability for unpaid losses and loss expenses, net of estimated salvage and subrogation recoverable of $29.3 million and $29.0 million at December 31, 2007 and 2006, respectively, has been established to cover the estimated ultimate cost to settle insured losses. The amounts are necessarily based on estimates of future rates of inflation and other factors, and accordingly, there can be no assurance that the ultimate liability will not vary materially from such estimates. The estimates are continually reviewed and adjusted as necessary; such adjustments are included in current operations (see Note 4). Anticipated salvage and subrogation is estimated using historical experience. As such, losses and loss expenses payable represent management s best estimate of the ultimate liability related to reported and unreported claims.

i. Premiums

Premiums are recognized as earned in proportion to the insurance protection provided using the monthly pro rata method over the contract period. Unearned premiums represent the portion of premiums written relative to the unexpired terms of coverage.

j. Comprehensive Income (Loss)

Comprehensive income (loss) is defined as all changes in an enterprise s equity during a period other than those resulting from investments by owners and distributions to owners. Comprehensive income (loss) includes net income and other comprehensive income (loss). Other comprehensive income (loss) includes all other non-owner related changes to equity and includes net unrealized gains and losses on available-for-sale investments, derivative instruments and unrecognized benefit plan obligations, adjusted for deferred federal income taxes.

k. Share-Based Compensation

See Note 12 Share-Based Compensation regarding the Company s adoption of SFAS 123(R) Share-Based Payment (SFAS 123(R)) on January 1, 2006. The Company s share-based compensation plans authorize the granting of various equity-based incentives including stock options, restricted stock and restricted share units to employees and non-employee directors and agents. The expense for these equity-based incentives is based on their fair value at date of grant and amortized over their vesting period. The fair value of each stock option is estimated on the date of grant using the Black-Scholes closed-form pricing model. The pricing model requires assumptions such as the expected life of the option and expected volatility of the Company s stock over the expected life of the option, which significantly impacts the assumed fair value. The Company uses historical data to determine these assumptions and if these assumptions change significantly for future grants, share-based compensation expense will fluctuate in future periods.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Consolidated Financial Statements, Continued

Prior to January 1, 2006, the Company accounted for share-based compensation plans for employees and non-employee directors under the measurement and recognition provisions of Accounting Principles Board Opinion 25, Accounting for Stock Issued to Employees (APB 25) and related Interpretations, as permitted by Statement of Financial Accounting Standards 123, Accounting for Stock-Based Compensation (SFAS 123). Had compensation cost of the employee and non-employee directors plans for 2005 been determined based on the fair values at the grant dates consistent with the method of SFAS 123, the Company s pro-forma net earnings and net earnings per share information would have been as follows:

Pro-forma Fair Value Method:

($ millions, except per share amounts)	2005
Net income as reported	$ 125.9
Less pro-forma stock compensation expense, net of tax	(3.5)
Pro-forma net income	$ 122.4
Pro-forma net earnings per common share	
Basic	$ 3.04
Diluted	$ 2.92

The fair value of stock option awards granted to employees and directors in 2005 were estimated at the date of grant using the Black-Scholes option-pricing model. The weighted average fair values and related assumptions for options granted were as follows:

	2005
Fair value	$ 10.38
Expected dividend yield	0.77%
Risk free interest rate	3.8%
Expected volatility factor	35.8%
Expected life in years	6.7

l. New Accounting Standards

Adoption of Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R) (SFAS 158) that requires employers with defined benefit pension and postretirement benefit plans other than pensions (collectively benefit plans) to recognize the funded status of their benefit plans in their balance sheet, measure the fair value of plan assets and benefit obligations as of the date of the fiscal year-end balance sheet date thereby eliminating the use of an earlier measurement date and provide additional disclosures. The new measurement date requirement is not effective until fiscal years ending after December 15, 2008. On December 31, 2006, the Company adopted the recognition and disclosure provisions of SFAS 158, which had no effect on the Company s consolidated statement of income for year ended December 31, 2006, or for any prior period presented in the 2006 Form 10-K, and it will not affect the Company s operating results in future periods. Adopting SFAS 158 required the Company to recognize the

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funded status (i.e. the difference between the fair value of plan assets and the benefit obligations) of its benefit plans in the December 31, 2006 balance sheet, with a corresponding adjustment to other comprehensive loss, net of tax of $63.9 million. The adoption did not have an impact on the Company s debt covenants. At December 31, 2007 and 2006, the Company continued to use the earlier measurement date of September 30, and is currently reviewing the transition alternatives available and the related impact.

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48), which was effective for fiscal years beginning after December 15, 2006. FIN 48 clarified the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company adopted the provisions of FIN 48, on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized no increase in the liability for unrecognized tax benefits. See Note 8 for additional required disclosures.

In February 2006, the FASB issued SFAS 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140 (SFAS 155), which was effective for all financial instruments acquired or issued after the beginning of an entity s fiscal year after September 15, 2006. SFAS 155 permits fair value re-measurement for any hybrid financial instruments that contain an embedded derivative that would otherwise require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133, establishes a requirement to evaluate interests in securitized financial assets in order to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and amends Statement 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. The Company adopted this guidance effective January 1, 2007 and there was no impact on the Company s financial statements.

In September 2005, the Accounting Standards Executive Committee issued Statement of Position 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection With Modifications or Exchanges of Insurance Contracts (SOP 05-1), which was effective for fiscal years beginning after December 15, 2006. SOP 05-1 provides guidance on accounting for deferred acquisition costs associated with modifications to or the internal replacement of insurance contracts. SOP 05-1 focuses on modifications to contracts with integrated product features and internal replacement of contracts in which the new contract offers product features not included in the old contract when both were priced together. The Company s insurance contracts include only nonintegrated contract features as defined in SOP 05-1, which are contract features that provide coverage that is underwritten and priced only for that incremental insurance coverage and that do not result in re-underwriting or re-pricing of other components of the contract. Nonintegrated contract features do not change the existing base contract and do not require further evaluation under SOP 05-1. The Company adopted this guidance effective January 1, 2007 and there was no impact on the Company s financial statements.

Pending Adoption of Accounting Pronouncements

In September 2006, the FASB issued SFAS 157, Fair Value Measurements (SFAS 157), which is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. SFAS 157 establishes a single authoritative definition of fair value, sets out a framework for measuring fair value, and requires additional disclosures about fair-value measurements. The statement imposes no new requirements for additional fair-value measures in financial statements. The Company adopted this guidance effective January 1, 2008.

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In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 159 expands the standards under SFAS 157 to provide entities with a one-time election to measure existing financial instruments and certain other items at fair value at the date of adoption. SFAS 159 also amends SFAS No. 115 Accounting for Certain Investments in Debt and Equity Securities to require a specific presentation of investments categorized as available-for-sale. This statement is effective for the first fiscal year that begins after November 15, 2007. The Company adopted this guidance on January 1, 2008 and did not elect the fair value option for any of its eligible assets or liabilities as of this date.

In June 2007, the FASB issued EITF 06-11, Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards (EITF 06-11). EITF 06-11 addresses how a company should recognize the income tax benefit received on dividends that are (a) paid to employees holding equity-classified non-vested shares, equity-classified non-vested share units, or equity-classified outstanding share options, and (b) charged to retained earnings under FAS 123(R). The tax benefit received on dividends paid to employees associated with their share-based awards should be recorded in additional paid-in capital until the award is settled through exercise (if the award is an option) or vesting (if the award is non-vested stock). This will be effective for tax benefits of dividends declared in fiscal years beginning after December 15, 2007. The Company adopted this guidance effective January 1, 2008 and it had no material impact on the Company s financial statements.

2. Investments

The following tables summarize the cost or amortized cost of available-for-sale securities at December 2007 and 2006:

($ millions)	Cost or amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
Available-for-sale at December 31, 2007:				
U.S. treasury securities and obligations of U.S. government agencies	**$ 90.9**	**$ 2.2**	**$ (0.1)**	**$ 93.0**
Obligations of states and political subdivisions	**1,432.7**	**23.6**	**(4.3)**	**1,452.0**
Corporate securities	**10.7**	**0.3**		**11.0**
U.S. government agencies mortgage-backed securities	**188.6**	**2.6**	**(1.8)**	**189.4**
Total fixed maturities	**1,722.9**	**28.7**	**(6.2)**	**1,745.4**
Equity securities	**210.2**	**47.4**	**(3.4)**	**254.2**
Other invested assets	**20.1**	**0.3**	**(0.1)**	**20.3**
Total	**$ 1,953.2**	**$ 76.4**	**$ (9.7)**	**$ 2,019.9**

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($ millions)	Cost or amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
Available-for-sale at December 31, 2006:				
U.S. treasury securities and obligations of U.S. government agencies	$ 180.1	$ 0.6	$ (2.8)	$ 177.9
Obligations of states and political subdivisions	1,229.8	23.7	(2.5)	1,251.0
Corporate securities	15.8	0.4	(0.1)	16.1
U.S. government agencies mortgage-backed securities	204.9	1.7	(4.2)	202.4
Total fixed maturities	1,630.6	26.4	(9.6)	1,647.4
Equity securities	230.8	54.6	(1.2)	284.2
Other invested assets	4.0	0.5		4.5
Total	$ 1,865.4	$ 81.5	$ (10.8)	$ 1,936.1

Deferred federal income taxes on the net unrealized holding gains for available-for-sale investments were $23.3 million and $24.7 million at December 31, 2007 and 2006, respectively.

At December 31, 2007 and 2006, there were no individual investments reflected in the tables below with an unrealized holding loss that had a fair value significantly below cost continually for more than one year. There are no individual material securities with an unrealized holding loss at December 31, 2007 and 2006. The following tables reflect the Company s gross unrealized losses and fair value on its investments, aggregated by investment category and length of time for individual securities that have been in a continuous unrealized loss position, at December 31, 2007 and 2006:

At December 31, 2007	Less than 12 months			12 months or more			Total		
Description of Securities	Fair Value	Unrealized Losses	Number of Positions	Fair Value	Unrealized Losses	Number of Positions	Fair Value	Unrealized Losses	Number of Positions
($ millions)									
U.S. treasury securities and obligations of U.S. government agencies	**$ 5.4**	**$**	**2**	**$ 6.5**	**$ (0.1)**	**4**	**$ 11.9**	**$ (0.1)**	**6**
Obligations of states and political subdivisions	**204.1**	**(1.8)**	**75**	**283.2**	**(2.5)**	**106**	**487.3**	**(4.3)**	**181**
Corporate securities				**1.0**		**1**	**1.0**		**1**
U.S. government agencies mortgage backed securities	**2.8**	**(0.1)**	**2**	**101.2**	**(1.7)**	**46**	**104.0**	**(1.8)**	**48**

Total fixed maturities	**212.3**	**(1.9)**	**79**	**391.9**	**(4.3)**	**157**	**604.2**	**(6.2)**	**236**
Equity securities	**36.6**	**(3.4)**	**16**				**36.6**	**(3.4)**	**16**
Other invested assets	**15.9**	**(0.1)**	**2**				**15.9**	**(0.1)**	**2**
Total temporarily impaired securities	**$ 264.8**	**$ (5.4)**	**97**	**$ 391.9**	**$ (4.3)**	**157**	**$ 656.7**	**$ (9.7)**	**254**

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At December 31, 2006	Less than 12 months			12 months or more			Total		
Description of Securities	Fair Value	Unrealized Losses	Number of Positions	Fair Value	Unrealized Losses	Number of Positions	Fair Value	Unrealized Losses	Number of Positions
($ millions)									
U.S. treasury securities and obligations of U.S. government agencies	$ 11.9	$ (0.1)	7	$ 111.3	$ (2.7)	51	$ 123.2	$ (2.8)	58
Obligations of states and political subdivisions	90.0	(0.6)	35	232.8	(1.9)	89	322.8	(2.5)	124
Corporate securities				3.0	(0.1)	2	3.0	(0.1)	2
U.S. government agencies mortgage backed securities	17.2	(0.4)	8	135.2	(3.8)	51	152.4	(4.2)	59
Total fixed maturities	119.1	(1.1)	50	482.3	(8.5)	193	601.4	(9.6)	243
Equity securities	21.6	(1.2)	9				21.6	(1.2)	9
Total temporarily impaired securities	$ 140.7	$ (2.3)	59	$ 482.3	$ (8.5)	193	$ 623.0	$ (10.8)	252

The amortized cost and fair value of available-for-sale fixed maturities at December 31, 2007, by contractual maturity, are summarized as follows:

($ millions)	Amortized cost	Fair value
Due in 1 year or less	**$ 16.9**	**$ 16.9**
Due after 1 year through 5 years	**60.5**	**62.5**
Due after 5 years through 10 years	**437.5**	**451.1**
Due after 10 years	**1,019.4**	**1,025.5**
U.S. Government agencies mortgage-backed securities	**188.6**	**189.4**
Total	**$ 1,722.9**	**$ 1,745.4**

Expected maturities may differ from contractual maturities because the issuers may have the right to call or prepay the obligations with or without call or prepayment penalties.

Fixed maturities with fair values of approximately $55.1 million and $52.5 million were on deposit with regulators as required by law or specific escrow agreement at December 31, 2007 and 2006, respectively.

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Components of net investment income for the year ended December 31 are summarized as follows:

($ millions)	**2007**	2006	2005
Fixed maturities	**$ 75.3**	73.6	72.8
Equity securities	**5.7**	5.1	4.0
Cash and cash equivalents, and other	**5.5**	6.1	3.6
Investment income	**86.5**	84.8	80.4
Investment expenses	**1.8**	1.7	1.7
Net investment income	**$ 84.7**	83.1	78.7

The Company s current investment strategy does not rely on the use of derivative financial instruments. See Note 3 for additional fair value disclosures.

The Company recognized realized losses on other-than-temporary impairments of $0, $3.8 million and $0.6 million on its fixed maturity portfolio in 2007, 2006 and 2005, respectively. The Company recognized realized losses on other-than-temporary impairments of $1.9 million, $1.6 million and $1.0 million in 2007, 2006 and 2005, respectively on its equity security portfolio. During 2007 the Company outsourced a segment of its investment portfolio to external money managers. When assessing other-than-temporary impairment on this segment of the investment portfolio, management considers its inability to make the assertion regarding its intent to hold a particular security that is currently valued below cost until recovery in the near term. The Company reviewed its investments at December 31, 2007, and determined no additional other-than-temporary impairment exists in the gross unrealized holding losses due to the evidence that would indicate only temporary impairment.

Proceeds on sales of available-for-sale securities in 2007, 2006, and 2005 were $262.2 million, $275.2 million and $340.1 million, respectively.

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Realized and unrealized gains and losses for the years ended December 31 are summarized as follows:

($ millions)	**2007**	2006	2005
Realized gains:			
Fixed maturities	**$ 0.8**	1.8	5.9
Equity securities	**19.7**	15.6	6.7
Total realized gains	**20.5**	17.4	12.6
Realized losses:			
Fixed maturities	**1.3**	4.8	1.7
Equity securities	**7.1**	7.0	5.3
Total realized losses	**8.4**	11.8	7.0
Net realized gains on investments	**$ 12.1**	5.6	5.6
Change in unrealized gains (losses):			
Increase (decrease) in unrealized holding gains fixed maturity securities	**$ 5.7**	(3.2)	(30.2)
(Decrease) increase in unrealized holding gains equity securities	**(9.4)**	22.6	0.6
(Decrease) increase in unrealized holding gains other invested assets	**(0.3)**	(0.3)	0.6
Deferred federal income taxes (benefits) thereon	**1.4**	(6.7)	10.3
(Decrease) increase in net unrealized holding gains	**$ (2.6)**	12.4	(18.7)

3. Fair Value of Financial Instruments

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

Investment securities: Fair values for investments in fixed maturities are based on quoted market prices, where available. For fixed maturities not actively traded, fair values are estimated using values obtained from independent pricing services. The fair values for equity securities are based on quoted market prices.

Cash and cash equivalents: The carrying amounts reported for these instruments approximate their fair value.

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Notes payable: The carrying amount of the Trust Preferred note (defined in Note 6b) in the consolidated balance sheets approximates its fair value as the interest rate adjusts quarterly. The $100.0 million, 6.25% Senior Notes (defined in Note 7) have a fair value of $103.6 million and $99.1 million at December 31, 2007 and 2006, respectively. The fair value of the Senior Notes is based on the quoted market price at December 31, 2007 and 2006, respectively.

($ millions)	**December 31, 2007**		December 31, 2006	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Fixed maturities	**$ 1,745.4**	**$ 1,745.4**	$ 1,647.4	$ 1,647.4
Equity securities	**254.2**	**254.2**	284.2	284.2
Other invested assets	**21.6**	**21.6**	6.3	6.3
Cash and cash equivalents	**70.9**	**70.9**	73.4	73.4
Notes payable	**118.0**	**119.1**	118.4	114.6

4. Losses and Loss Expenses Payable

Activity in the liability for losses and loss expenses for the year ended December 31 is summarized as follows:

($ millions)	**2007**	2006	2005
Losses and loss expenses payable, at beginning of year	**$ 674.5**	728.7	681.8
Less: reinsurance recoverable on losses and loss expenses payable	**13.5**	17.4	25.9
Net balance at beginning of year	**661.0**	711.3	655.9
Incurred related to:			
Current year	**645.5**	659.3	657.7
Prior years	**(54.7)**	(71.7)	(44.3)
Total incurred	**590.8**	587.6	613.4
Paid related to:			
Current year	**368.7**	389.4	350.5
Prior years	**236.0**	248.5	242.8
Total paid	**604.7**	637.9	593.3

Impact of pooling change, January 1, 2005 (Note 6a)			35.3
Net balance at end of year	**647.1**	661.0	711.3
Plus: reinsurance recoverable on losses and loss expenses payable	**11.2**	13.5	17.4
Losses and loss expenses payable, at end of year (affiliate $257.2, $281.7 and $302.6, respectively)	**$ 658.3**	674.5	728.7

The Company recorded favorable loss and loss expense reserve development in 2007, 2006, and 2005 of $54.7 million, $71.7 million and $44.3 million, respectively. The favorable development in 2007 was primarily due to auto liability and other liability losses being approximately $23.5 million less than anticipated as current loss projections using more mature claim data resulted in lower claim severity than in past projections, loss adjustment expenses being approximately $11.8 million lower than anticipated in proportion to losses and ceded

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losses being above previously anticipated levels by approximately $10.0 million. The favorable development in 2006 was largely due to ceded reserves being above previously anticipated levels by $23.7 million, auto liability losses being $24.7 million less than anticipated as current loss projections using more mature claim data resulted in lower average claim severities than in past projections, and loss adjustment expenses declining by $13.5 million in proportion to losses. The favorable development in 2005 was largely due to ceded reserves being above previously anticipated levels by $14.8 million, catastrophe losses associated with the 2004 hurricanes developing $5.8 million better than previous estimates, and loss adjustment expenses developing favorably by $13.7 million in proportion to losses.

5. Reinsurance

In the ordinary course of business, the Company assumes and cedes reinsurance with other insurers and reinsurers and is a member in various pools and associations. See Note 6a for discussion of reinsurance with affiliates. The voluntary arrangements provide greater diversification of business and limit the maximum net loss potential arising from large risks and catastrophes. Most of the ceded reinsurance is effected under reinsurance contracts known as treaties; the remainder is by negotiation on individual risks. Although the ceding of reinsurance does not discharge the original insurer from its primary liability to its policyholder, the insurance company that assumes the coverage assumes the related liability.

Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured business. The recoverability of these assets depends on the reinsurers ability to perform under the reinsurance agreements. The Company evaluates and monitors the financial condition and concentrations of credit risk associated with its reinsurers under voluntary reinsurance arrangements to minimize its exposure to significant losses from reinsurer insolvencies. The Company has reported ceded losses and loss expenses payable and prepaid reinsurance premiums with other insurers and reinsurers as assets. All reinsurance contracts provide for indemnification against loss or liability relating to insurance risk and have been accounted for as reinsurance.

Prior to the reinsurance transaction with State Auto Mutual under the Pooling Arrangement, as discussed in Note 6a, the effect of the Company s external reinsurance on its balance sheets and income statements is summarized as follows:

($ millions)	December 31	
	2007	2006
Losses and loss expenses payable:		
Direct	**$ 396.0**	387.2
Assumed	**5.1**	5.6
Ceded	**(10.1)**	(10.8)
Net losses and loss expenses payable	**$ 391.0**	382.0
Unearned premiums:		
Direct	**$ 315.3**	309.2
Assumed	**1.2**	1.2
Ceded	**(6.0)**	(6.0)
Net unearned premiums	**$ 310.5**	304.4

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($ millions)	Year ended December 31		
	2007	2006	2005
Written premiums:			
Direct	**$ 757.4**	748.8	749.5
Assumed	**6.5**	7.1	6.0
Ceded	**(18.8)**	(17.7)	(16.9)
Net written premiums	**$ 745.1**	738.2	738.6
Earned premiums:			
Direct	**$ 751.0**	743.1	746.9
Assumed	**6.5**	7.1	6.1
Ceded	**(18.8)**	(17.6)	(16.4)
Net earned premiums	**$ 738.7**	732.6	736.6
Losses and loss expenses incurred:			
Direct	**$ 438.5**	415.0	455.7
Assumed	**2.0**	10.8	14.6
Ceded	**(2.9)**	(3.5)	(8.2)
Net losses and loss expenses incurred	**$ 437.6**	422.3	462.1

6. Transactions with Affiliates

a. Reinsurance

Prior to 2005, State Auto P&C, Milbank, Farmers, SA Ohio (the STFC Pooled Companies), State Auto Insurance Company of Wisconsin (SA Wisconsin) and State Auto Florida Insurance Company (SA Florida) participated in a quota share reinsurance pooling arrangement (the Pooling Arrangement) with State Auto Mutual. Effective January 1, 2005, the Pooling Arrangement was amended to add as participants Meridian Security Insurance Company (Meridian Security) and Meridian Citizens Mutual Insurance Company (Meridian Citizens), Indiana domiciled property and casualty insurers. Meridian Security is a wholly-owned subsidiary of Meridian Insurance Group, Inc. (MIGI), which is wholly-owned by State Auto Mutual. MIGI is party to an affiliation agreement with Meridian Citizens. Meridian Security and Meridian Citizens Mutual are hereafter referred to collectively as the MIGI Insurers and together with MIGI as the MIGI Companies. SA Wisconsin and SA Florida are wholly owned subsidiaries of State Auto Mutual.

In conjunction with the Pooling Arrangement amendment, the STFC Pooled Companies received $54.0 million in cash from the MIGI Insurers which related to the additional net insurance liabilities assumed on January 1, 2005.

In general, under the Pooling Arrangement, the STFC Pooled Companies, SA Wisconsin, SA Florida and the MIGI Insurers cede to State Auto Mutual all of their insurance business and assume from State Auto Mutual an amount equal to their respective participation percentages in the

Pooling Arrangement. The STFC Pooled Companies pooling participation percentage remained at 80% under the amended pooling arrangement effective January 1, 2005. All premiums, losses and loss expenses and underwriting expenses are allocated among the participants on the basis of each Company s participation percentage in the Pooling Arrangement. The Pooling Arrangement provides indemnification against loss or liability relating to insurance risk and has been accounted for as reinsurance.

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The Pooling Arrangement does not relieve each individual pooled subsidiary of its primary liability as the originating insurer; consequently, there is a concentration of credit risk arising from business ceded to State Auto Mutual. As the Pooling Arrangement provides for the right of offset, the Company has reported losses and loss expenses payable and prepaid reinsurance premiums to State Auto Mutual as assets only in situations when net amounts ceded to State Auto Mutual exceed net amounts assumed. The STFC Pooled Companies pooling percentage has remained at an 80% participation level since 2001. All parties that participate in the Pooling Arrangement have an A.M. Best rating of A+ (Superior).

The following provides a summary of the reinsurance transactions on the Company s balance sheets and income statements for the Pooling Arrangement between the STFC Pooled Companies and State Auto Mutual:

($ millions)	December 31	
	2007	2006
Losses and loss expenses payable:		
Ceded	**$ (371.6)**	(358.2)
Assumed	**628.8**	639.9
Net assumed	**$ 257.2**	281.7
Unearned premiums:		
Ceded	**$ (298.6)**	(292.3)
Assumed	**418.1**	410.7
Net assumed	**$ 119.5**	118.4

($ millions)	Year ended December 31		
	2007	2006	2005
Written premiums:			
Ceded	**$ (702.3)**	(695.7)	(685.8)
Assumed	**973.9**	974.1	993.9
Earned premiums:			
Ceded	**$ (695.7)**	(687.6)	(676.8)
Assumed	**965.5**	976.0	994.4
Losses and loss expenses incurred:			
Ceded	**$ (405.6)**	(388.4)	(423.4)
Assumed	**558.2**	554.4	579.5

The STFC Pooled Companies, SA National, State Auto Mutual, SA Wisconsin, SA Florida and the MIGI Insurers are collectively referred to as the State Auto Group.

State Auto P&C assumes catastrophe reinsurance from the State Auto Group and Beacon National Insurance Company (Beacon National), a subsidiary of State Auto Mutual, in the amount of $100.0 million excess of $135.0 million in exchange for a premium paid by each reinsured company. Under this agreement, the Company has assumed from State Auto Mutual and its affiliates premiums written and earned of $3.1 million, $3.0 million and $2.7 million for 2007, 2006 and 2005, respectively. There have been no losses assumed under this agreement. The catastrophe reinsurance program with State Auto P&C has been excluded from the Pooling Arrangement.

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As of July 1, 2005, SA National and State Auto Mutual terminated a reinsurance agreement between the parties that included excess of loss and quota share coverages. SA National and State Auto Mutual mutually agreed to terminate the reinsurance agreement because of SA National s stronger surplus position, relative to the commencement date of the agreement, which makes it more efficient for SA National to retain such exposures rather than to reinsure them. Under the terms of the termination, State Auto Mutual will continue to be liable, with respect to policies in force at the termination date, for occurrences until the expiration, cancellation or next anniversary, not to exceed one year.

The following provides a summary of the ceded reinsurance transactions on the Company s balance sheet and income statement for the reinsurance agreement between SA National and State Auto Mutual:

($ millions)	**2007**	2006
Balance sheet:		
Losses and loss expenses payable	**$ 1.1**	2.7

($ millions)	**2007**	2006	2005
Income statement:			
Written premiums	**$**		3.8
Earned premiums	**$**	0.2	6.6
Losses and loss expenses incurred	**$ (0.6)**	0.7	4.8

Intercompany Balances

Pursuant to the Pooling Arrangement, State Auto Mutual receives all premiums and pays all losses and expenses associated with the insurance business produced by the pool participants and then settles the intercompany balances generated by these transactions with the participating companies on a quarterly basis within 45 days following each quarter end. No interest is paid on this balance. When settling the intercompany balances, State Auto Mutual provides the pool participants with full credit for the premiums written and net losses paid during the quarter and retains all receivable amounts from insureds and agents and reinsurance recoverable on paid losses from unaffiliated reinsurers. Any receivable amounts that are ultimately deemed to be uncollectible are charged-off by State Auto Mutual and allocated to the pool member on the basis of pool participation. As a result, the Company has an off-balance sheet credit risk related to the balances due to State Auto Mutual from insurers, agents and reinsurers, which are offset by the unearned premium from the respective policies. The Company s share of the premium balances due to State Auto Mutual from agents and insureds at December 31, 2007 and 2006 is approximately $266.9 million and $250.3 million, respectively.

b. Notes Payable

In May 2003, State Auto Financial formed a Delaware business trust (the Capital Trust) that issued $15.0 million mandatorily redeemable preferred capital securities to a third party and $0.5 million of its common securities representing all outstanding common securities to State Auto Financial (collectively, the capital and common securities are referred to as the Trust Securities). The Capital Trust loaned $15.5 million in proceeds from the issuance of its Trust Securities to State Auto Financial in the form of a Floating Rate Junior Subordinated Debt Securities due in 2033 (the Subordinated Debentures). The Subordinated Debentures are the Capital Trust s only assets along with any interest accrued thereon.

Interest on the Trust Securities are payable

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quarterly at a rate equal to the three-month LIBOR rate plus 4.20% adjusted quarterly (total 9.32% at December 31, 2007). Prior to May 2008, the interest rate may not exceed 12.5% per annum. The interest rate and interest payment dates on the Subordinated Debentures are the same as the interest rate and interest payment dates on the Trust Securities, thereby payments from the Subordinated Debentures finance the distributions paid on the Trust Securities. State Auto Financial has the right to redeem the Subordinated Debentures, in whole or in part, on or after May 23, 2008. In accordance with FASB Interpretation No. 46(R), (and related amendments and interpretations) Consolidation of Variable Interest Entities, State Auto Financial determined that the business trust is a variable interest entity for which it is not the primary beneficiary and therefore, does not consolidate the Capital Trust with the Company. State Auto Financial has unconditionally and irrevocably guaranteed payment of any required distributions on the capital securities, the redemption price when the capital securities are redeemed, and any amounts due if the Capital Trust is liquidated or terminated. State Auto Financial s equity interest in the Capital Trust is included in other invested assets.

In December 2005, State Auto Financial repaid a $45.5 million line of credit it had with State Auto Mutual. This repayment was funded through dividends from State Auto Financial s insurance subsidiaries. The interest rate under this line of credit was 3.50% for 2005.

c. Management Services

Stateco provides State Auto Mutual and its affiliates investment management services. Investment management income is recognized quarterly based on a percentage of the average fair value of investable assets and the equity portfolio performance of each company managed. Revenue related to these services amounted to $2.8 million, $2.5 million and $2.3 million in 2007, 2006 and 2005, respectively, and is included in other income (affiliates).

7. Notes Payable and Credit Facility

In 2003, State Auto Financial issued $100.0 million of unsecured Senior Notes due November 2013. The Senior Notes bear interest at a fixed rate of 6.25% per annum, which is payable each May 15 and November 15. The Senior Notes are general unsecured obligations ranking senior to all existing and future subordinated indebtedness and equal with all existing and future senior indebtedness. The Senior Notes are not guaranteed by any of State Auto Financial s subsidiaries and thereby are effectively subordinated to all subsidiaries existing and future indebtedness. As of December 31, 2007, State Auto Financial was in compliance with all covenants related to the Senior Notes. State Auto Financial incurred $1.5 million in issuance costs related to the Senior Notes, which is recorded in other assets and is being amortized into interest expense ($0.1 million each for 2007, 2006 and 2005) as the underlying interest expense is recognized on the Senior Notes.

On July 12, 2007, State Auto Financial terminated its previous credit agreement which provided for a $100.0 million five-year unsecured revolving credit facility and entered into a new credit agreement (Credit Agreement) with a syndicate of lenders which provides for a $200.0 million five-year unsecured revolving credit facility (Credit Facility). State Auto did not borrow any funds under the previous credit agreement. During the term of the Credit Facility, the Company has the right to increase the total facility to a maximum total facility amount of $250.0 million, provided that no event of default has occurred and is continuing. While the Credit Facility will be available for general corporate purposes, including working capital, acquisitions and liquidity purposes, the Company presently intends to keep $100.0 million of the Credit Facility available in the event there is a need to fund losses under the catastrophe reinsurance program with State Auto P&C. The Credit Facility provides for interest-only payments during its term, with principal due in full at maturity. Interest is

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based on either a London interbank market rate or a base rate plus a calculated margin amount. The Credit Agreement contains certain covenants, including financial covenants that require the Company to maintain a minimum net worth and not exceed a certain debt to capitalization ratio. As of December 31, 2007, State Auto Financial had not made any borrowings and was in compliance with all of the covenants under the Credit Agreement. State Auto Financial incurred $0.5 million in issuance costs related to the Credit Agreement, which is recorded in other assets and is being amortized into expense ($0.1 million for 2007) over the life of the Credit Agreement.

See discussion of affiliate notes payable at Note 6c. Notes payable at December 31 consisted of the following:

($ millions, except interest rates)	**2007** Carrying Value	Fair Value	Interest Rate	2006 Carrying Value	Fair Value	Interest Rate
Senior Notes due 2013: issued $100.0, November 2003 with fixed interest	**$ 102.5**	**$ 103.6**	**6.25%**	$ 102.9	$ 99.1	6.25%
Affiliate subordinated debentures due 2033: issued $15.5, May 2003 with variable interest (see Note 6c)	**15.5**	**15.5**	**9.32**	15.5	15.5	9.57
Total Notes Payable	**$ 118.0**	**$ 119.1**		$ 118.4	$ 114.6	

8. Federal Income Taxes

At December 31, 2007, the Company carried no balance for uncertain tax positions.

The Company had no accrual for the payment of interest and penalties at December 31, 2007 or 2006.

The Company is currently not under audit by either the Internal Revenue Service or any state jurisdiction for income tax purposes and all prior audits have been settled. Tax years 2004 through 2006 remain open for audit for federal income tax purposes.

The reconciliation between actual federal income tax expense (benefit) and the amount computed at the indicated statutory rate for the year ended December 31 is summarized as follows:

($ millions)	**2007**	%	2006	%	2005	%
Amount at statutory rate	**$ 54.4**	35	$ 56.6	35	$ 60.2	35
Tax-free interest and dividends received deduction	**(18.5)**	(12)	(15.7)	(10)	(14.0)	(8)
Other, net	**0.3**		0.4		(0.1)	

Federal income tax expense and rate	**$ 36.2**	23	$ 41.3	25	$ 46.1	27

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The tax effects of temporary differences that give rise to significant portions of deferred tax assets and deferred tax liabilities as of December 31 are presented below:

($ millions)	**2007**	2006
Deferred tax assets:		
Unearned premiums not currently deductible	**$ 29.6**	28.8
Losses and loss expenses payable discounting	**20.1**	20.7
Postretirement and pension benefits	**42.4**	47.9
Other	**14.3**	10.0
Total deferred tax assets	**106.4**	107.4
Deferred tax liabilities:		
Deferral of policy acquisition costs	**37.0**	36.4
Unrealized holding gains on investments	**23.3**	24.7
Total deferred tax liabilities	**60.3**	61.1
Net deferred federal income taxes	**$ 46.1**	46.3

The Company is required to establish a valuation allowance for any portion of the deferred tax asset that management believes will not be realized. In the opinion of management, it is more likely than not that the Company will realize the benefit of the deferred tax assets and, therefore, no such valuation allowance has been established at December 31, 2007 or 2006.

9. Pension and Postretirement Benefit Plans

All Company personnel are employees of State Auto P&C. The Company, through State Auto P&C, provides management and operation services under management agreements for all insurance and non-insurance affiliates. The annual periodic costs related to the Company s benefit plans are allocated to affiliated companies based on allocations pursuant to intercompany management agreements.

The Company provides a defined benefit pension plan for its eligible employees. Substantially all Company employees become eligible to participate the year after becoming 20 years of age and vest with 5 years of credited service or attained age 65. The Company s policy is to fund pension costs in accordance with the requirements of the Employee Retirement Income Security Act of 1974. Benefits are determined by applying factors specified in the plan to a participant s defined average annual compensation.

In addition to the defined benefit pension plan, the Company provides a postretirement benefit plan including certain health care and life insurance benefits for its eligible retired employees. Substantially all of the Company s employees may become eligible for these postretirement benefits if they retire between age 55 and 65 with 15 years or more of service or if they retire at age 65 or later with 5 years or more of service. The defined benefit pension and postretirement benefit plans are referred to herein as the benefit plans.

On December 31, 2006, the Company adopted the recognition and disclosure provisions of SFAS 158. SFAS 158 required the Company to recognize the funded status of its benefit plans in the December 31, 2006 balance sheet, with a corresponding adjustment to accumulated other comprehensive income, net of tax. The adjustment to accumulated other comprehensive income at adoption represents the net unrecognized actuarial losses, unrecognized prior service costs, and unrecognized transition assets remaining from the initial adoption of

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SFAS 87 and SFAS 106, all of which were previously netted against the plans funded status in the Company s balance sheet pursuant to the provisions of SFAS 87 and SFAS 106. These amounts will be subsequently recognized as net periodic cost pursuant to the Company s historical accounting policy for amortizing such amounts. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic cost in the same periods will be recognized as a component of other comprehensive income. Those amounts will be subsequently recognized as a component of net periodic cost on the same basis as the amounts recognized in accumulated other comprehensive income at adoption of SFAS 158.

The following table provides the incremental effects of adopting the provisions of SFAS 158 on the Company s balance sheet at December 31, 2006. The adoption of SFAS 158 had no effect on the Company s consolidated statement of income for the year ended December 31, 2006, or for any prior period presented.

($ millions)	Prior to Adopting SFAS 158	Effect of Adopting SFAS 158	As Reported
Assets:			
Net prepaid pension expense	$ 61.8	$ (61.8)	$
Deferred federal income taxes	5.6	40.7	46.3
Liabilities:			
Postretirement benefits	98.1	26.7	124.8
Pension benefits		16.1	16.1
Stockholders Equity:			
Accumulated other comprehensive income (loss)	46.6	(63.9)	(17.3)

The Company uses September 30 as its measurement date to determine its pension and postretirement benefit obligations.

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Information regarding the Company s pension and postretirement benefit plans change in benefit obligation, plan assets and funded status as of December 31 are as follows:

($ millions)	Pension		Postretirement	
	2007	2006	**2007**	2006
Change in benefit obligation:				
Benefit obligation at beginning of year	**$ 213.4**	206.8	**122.7**	109.2
Service cost	**9.0**	10.0	**5.6**	4.9
Interest cost	**12.5**	11.7	**7.3**	6.2
Actuarial (gain) loss	**(5.6)**	(4.3)	**(9.7)**	5.5
Contributions			**(2.9)**	(3.1)
Benefits paid	**(12.0)**	(10.8)		
Benefit obligation at end of year	**$ 217.3**	213.4	**123.0**	122.7
Change in plan assets:				
Fair value of plan assets at beginning of year	**$ 197.3**	183.4	**2.2**	2.1
Employer contribution	**11.5**	10.0		
Actual return on plan assets	**23.2**	14.7	**0.1**	0.1
Benefits paid	**(12.0)**	(10.8)		
Fair value of plan assets at end of year	**$ 220.0**	197.3	**2.3**	2.2
Contribution received during fourth quarter			**(0.2)**	
SERP (defined below)			**(4.3)**	(4.3)
Funded status at end of year	**$ 2.7**	(16.1)	**(125.2)**	(124.8)
Accumulated benefit obligation end of year	**$ 194.3**	190.9		

No assets are expected to be returned during the fiscal year-ended December 31, 2008. The Company had no additional minimum liability included in other comprehensive income for the pension plan for 2006 (prior to adoption of SFAS 158) and 2005.

Included in accumulated other comprehensive loss are the following amounts that have not been recognized in net periodic cost:

($ millions)	December 31	
	2007	2006
Net actuarial loss	$ 75.7	101.0

Prior service cost	5.7	6.6
Transition asset	(2.4)	(3.0)
Total	$ 79.0	104.6

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The amount of amortization expected to be recognized during the fiscal year ending December 31, 2008 for the State Auto Group is as follows:

($ millions)	2008
Net actuarial loss	$ 3.2
Prior service cost	0.9
Transition asset	(0.6)
Total	$ 3.5

Information regarding the State Auto Group s pension and postretirement benefit plans components of net periodic cost for the year ended December 31 is as follows:

($ millions)	**Pension**			**Postretirement**		
	2007	2006	2005	**2007**	2006	2005
Components of net periodic cost:						
Service cost	**$ 9.0**	10.0	8.0	**5.6**	4.9	4.4
Interest cost	**12.5**	11.7	11.2	**7.3**	6.2	6.5
Expected return on plan assets	**(17.8)**	(17.0)	(16.9)	**(0.2)**	(0.2)	(0.2)
Amortization of prior service cost	**0.4**	0.4	0.4	**0.5**	0.5	0.5
Amortization of transition asset	**(0.6)**	(0.6)	(0.6)			
Amortization of net gain	**3.9**	2.9	1.1	**0.8**	0.6	0.6
Net periodic cost	**$ 7.4**	7.4	3.2	**14.0**	12.0	11.8

The following benefit payments, which reflect expected future service, are expected to be paid:

($ millions)	Pension	Postretirement
2008	**$ 9.0**	**$ 4.0**
2009	**9.3**	**4.3**
2010	**9.7**	**4.7**
2011	**10.2**	**5.2**
2012	**11.2**	**5.6**
2013 - 2017	**72.9**	**35.7**

The Company s share of the 2007, 2006, and 2005 net periodic costs for the defined benefit plan were $7.4 million, $7.4 million, and $3.2 million, respectively. For postretirement benefits other than pensions, the Company s share of the 2007, 2006 and 2005 net periodic costs were $11.6 million, $10.3 million and $10.2 million, respectively.

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Summarized in the following table are the weighted average assumptions used to determine the Company s benefit obligations for the year ended December 31:

	Pension		Postretirement	
	2007	2006	**2007**	2006
Benefit obligations weighted-average assumptions:				
Discount rate	**6.25%**	6.00%	**6.25%**	6.00%
Rates of increase in compensation levels	**4.00**	4.00		

Summarized in the following table are the weighted average assumptions used to determine the Company s net periodic cost:

	Pension			Postretirement		
	2007	2006	2005	**2007**	2006	2005
Weighted-average assumptions:						
Discount rate	**6.00%**	5.75%	6.50%	**6.00%**	5.75%	6.50%
Expected long-term rate of return on assets	**9.00**	9.00	9.00	**9.00**	9.00	9.00
Rates of increase in compensation levels	**4.00**	5.00	5.00			

The Company s benefit plan obligations are long-term in nature and consequently the investment strategies have a long-term time horizon. In establishing the long-term rate of return assumption on plan assets, management, along with its pension consulting actuary, reviews the historical performance of the plan assets and the stability in the mix of the investment portfolio. The expected inflation rate and expected real rates of return of applicable asset classes are then determined to assist in setting appropriate assumptions.

The assumed health care cost trend rates used for the year ended December 31 are as follows:

	Postretirement		
	2007	2006	2005
Assumed health care cost trend rates:			
Health care cost trend rate assumed for the next year	**10.00%**	10.00%	10.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	**5.00%**	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	**2012**	2011	2010

The assumed health care cost trend rates have a significant effect on the amounts reported for the postretirement plan. A one percentage point change in assumed health care cost trend rates would have the following effects for the year ended December 31, 2007:

($ millions)	Postretirement	
	Increase	(Decrease)
One percentage point change:		
Effect on total service and interest cost	**$ 3.1**	**$ (2.4)**
Effect on accumulated postretirement benefit obligation	**23.3**	**(18.6)**

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The Company also has a supplemental executive retirement plan (SERP) for certain executives for which the accrued obligation at December 31, 2007 and 2006 was $4.3 million that is included as a component in postretirement and pension benefits liability in the accompanying consolidated balance sheets.

The Company s benefit plans weighted average asset allocations by asset category at the plans measurement date of September 30 are as follows:

	Pension		Postretirement	
	2007	2006	**2007**	2006
Asset Category:				
Fixed maturity	**37.9%**	35.4%	**100.0%**	100.0%
U.S. large cap equity	**40.3**	64.6		
U.S. small cap equities	**12.4**			
International	**9.4**			
Total	**100.0**	100.0	**100.0**	100.0

The benefit plan s investment policy objective is to preserve the investment principal while generating income and appreciation in fair value to meet the benefit plans obligations. The benefit plans investment strategy and risk tolerance is balanced between meeting cash obligation requirements and a long term relatively high risk tolerance. Since the nature and timing of the benefit plans liabilities and cash requirements are predictable, the liquidity requirements are somewhat moderate. During 2007, the following asset allocation targets, as a percentage of total fair value, were approved. Management is in the process of moving towards these allocation targets as funds become available.

	Asset Allocation Target (0 to 100%)
Asset Category:	
Fixed maturity	23
U.S. large cap equity	43
U.S. small/mid cap equity	14
Treasury inflation protected securities	10
International	10

The actuarially prepared funding amount to the pension plan ranges from the minimum amount the Company would be required to contribute to the maximum amount that would be deductible for tax purposes. Contributed amounts in excess of the minimum amounts are deemed voluntary. Amounts in excess of the maximum amount would be subject to an excise tax and may not be deductible for tax purposes. This range is generally not determined until the second quarter with respect to the contribution year. The Company expects to contribute approximately $12.0 million during 2008 to its pension plan, depending on the actuarially calculated funding requirements of such plan. Postretirement and SERP plan payments are deductible for tax purposes when paid.

The Company maintains a defined contribution plan that covers substantially all employees of the Company. The Company matches the first 2% of contributions of participants salary at the rate of 75 cents for each dollar

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contributed. Participant contributions of 3% to 6% are matched at a rate of 50 cents for each dollar contributed. The Company s share of the expense under the plan totaled $2.6 million, $2.5 million and $2.4 million for the years 2007, 2006 and 2005, respectively.

10. Stockholders Equity

a. Treasury Shares

On August 17, 2007, State Auto Financial s board of directors authorized a plan to repurchase, from time to time, up to 4.0 million of its common shares, or approximately 10% of State Auto Financial s outstanding shares, over a period extending to and through December 31, 2009 (the Repurchase Plan). Under the Repurchase Plan, State Auto Financial may repurchase shares from State Auto Mutual in amounts that are proportional to the respective current ownership percentages of State Auto Mutual, which is approximately 64%, and other shareholders. State Auto Financial s total share repurchase activity in 2007 was approximately 0.8 million common shares at an average repurchase price of $27.21 per share for a total of $22.1 million.

b. Dividend Restrictions and Statutory Financial Information

State Auto P&C, Milbank, Farmers, SA Ohio and SA National are subject to regulations and restrictions under which payment of dividends from statutory earned surplus can be made to State Auto Financial during the year without prior approval of regulatory authorities. Pursuant to these rules, at December 31, 2007, adjusted for dividend payments made in the previous twelve-month period, approximately $79.6 million is available for payment to State Auto Financial from its insurance subsidiaries in 2008 without prior approval. In 2007 State Auto Financial received dividends of $50.0 million from its insurance subsidiaries, $0 in 2006, and $40.5 million in 2005.

Reconciliations of statutory capital and surplus and net income, as determined using statutory accounting principles, to the amounts included in the accompanying consolidated financial statements as of December 31 are as follows:

($ millions)	**2007**	2006
Statutory capital and surplus of insurance subsidiaries	**$ 916.4**	856.2
Net liabilities of non-insurance parent and affiliates	**(59.5)**	(71.4)
	856.9	784.8
Increases (decreases):		
Deferred policy acquisition costs	**105.8**	104.0
Postretirement and pension obligations	**(22.1)**	(38.2)
Deferred federal income taxes	**(33.6)**	(38.8)
Fixed maturities at fair value	**22.5**	16.8
Other, net	**6.0**	5.6
Stockholders equity per accompanying consolidated financial statements	**$ 935.5**	834.2

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($ millions)	Year ended December 31		
	2007	2006	2005
Statutory net income of insurance subsidiaries	**$ 129.5**	140.1	123.7
Net income (loss) of non-insurance parent and affiliates	**0.5**	(0.1)	(2.1)
	130.0	140.0	121.6
Increases (decreases):			
Deferred policy acquisition costs	**1.7**	(2.0)	8.5
Postretirement and pension benefit	**(12.0)**	(11.8)	(7.1)
Deferred federal income taxes	**5.4**	0.3	2.7
Share-based compensation expense	**(5.5)**	(6.5)	
Other, net	**(0.5)**	0.4	0.2
Net income per accompanying consolidated financial statements	**$ 119.1**	120.4	125.9

11. Preferred Stock

State Auto Financial has authorized two classes of preferred stock. For both classes, upon issuance, the Board of Directors has authority to fix and determine the significant features of the shares issued, including, among other things, the dividend rate, redemption price, redemption rights, conversion features and liquidation price payable in the event of any liquidation, dissolution, or winding up of the affairs of State Auto Financial.

The Class A preferred stock is not entitled to voting rights until, for any period, dividends are in arrears in the amount of six or more quarterly dividends.

12. Share-Based Compensation

Prior to January 1, 2006, the Company accounted for share-based compensation plans for employees and non-employee directors under the measurement and recognition provisions of Accounting Principles Board Opinion 25, Accounting for Stock Issued to Employees, and related Interpretations, as permitted by Statement of Financial Accounting Standards 123, Accounting for Stock-Based Compensation (SFAS 123). Accordingly, share-based compensation was included as a pro forma disclosure in the financial statement footnotes (See Note 1k Share-Based Compensation). For share-based awards granted to the Company s independent insurance agencies, the Company recognized share-based compensation within its financial statements in accordance with SFAS 123 and related Interpretations.

The Company maintains share-based compensation plans for its key employees and outside, or non-employee, directors. The share-based compensation plan for key employees is the Amended and Restated Equity Incentive Compensation Plan (the Equity Plan). In May 2005, the Company s shareholders approved amendments to, and a restatement of, the Equity Plan, which was formerly called the 2000 Stock Option Plan. The stock-based compensation plan for outside directors is the Outside Directors Restricted Share Unit Plan (the Outside Directors RSU Plan), which was approved by the Company s shareholders in May 2005. The Outside Directors RSU Plan replaced the 2000 Directors Stock Option Plan for outside directors (the Outside Directors Stock Option Plan).

Equity Plan

The 2000 Stock Option Plan provided only for the award of qualified and nonqualified stock options. The Equity Plan now provides for the award of qualified and nonqualified stock options, restricted shares,

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performance shares, performance units and other stock-based awards. The Company has reserved 3.5 million common shares under the Equity Plan. As of December 31, 2007, a total of 1.1 million common shares were available for issuance under the Equity Plan. The Equity Plan provides that (i) no more than 33% of the common shares authorized for issuance under the Equity Plan may be granted in the form of awards other than stock options, (ii) the maximum number of common shares subject to awards of stock options, restricted shares and performance shares that may be granted in any calendar year is equal to 1.5% of the total number of common shares of the Company outstanding as of December 31 of the prior year, and (iii) the maximum number of common shares subject to awards of stock options, restricted shares and performance shares that may be granted in any calendar year to any individual is 250,000 shares. The Equity Plan automatically terminates on July 1, 2010.

The Equity Plan provides that qualified stock options may be granted at an option price not less than the fair market value of the common shares at the date of grant and that nonqualified stock options may be granted at any price determined by the Compensation Committee of the Board of Directors. Options granted generally vest over a three-year period, with one-third of the options vesting on each anniversary of the grant date, and must be exercised no later than ten years from the date of grant. Stock options granted under the Equity Plan for 2007, 2006 and 2005 were 0.4 million, 0.3 million and 0.4 million, respectively.

The Equity Plan provides for the granting of restricted shares subject to a vesting schedule based on the employee s continued employment (Restriction Period), for which vesting is generally on the third anniversary after the date of grant. The Company recognizes compensation expense based on the number of restricted shares granted at the then grant date fair value over the Restriction Period. Restricted shares granted for 2007 and 2006 were 32,000 and 10,500, respectively, with a weighted average grant date fair value of $29.98 and $31.94, respectively. There were no restricted shares granted prior to January 1, 2006.

A summary of the status of the Company s non-vested restricted shares and changes for the year ended December 31 is as follows:

	2007		2006	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Outstanding, beginning of year	**10,500**	**$ 31.94**		
Granted	**32,000**	**29.98**	10,500	$ 31.94
Outstanding, end of year	**42,500**	**30.46**	10,500	31.94

As of December 31, 2007, there was $1.0 million of total unrecognized compensation cost related to non-vested restricted share compensation arrangements. The remaining cost is expected to be recognized over a period of 2.75 years. No shares vested during the years ended December 31, 2007 and 2006.

Employee Stock Purchase Plan

The Company also has a broad-based employee stock purchase plan, under which employees of the Company may choose at two different specified time intervals each year to have up to 6% of their annual base earnings withheld to purchase the Company s common shares. The purchase price of the common shares is 85%

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of the lower of its beginning-of-interval or end-of-interval market price. The Company has reserved 3.4 million common shares under this plan. As of December 31, 2007, a total of 2.4 million common shares have been purchased under this plan. This plan remains in effect until terminated by the board of directors.

Outside Directors Plan

The Outside Directors RSU Plan is an unfunded deferred compensation plan which provides each outside director with an award of 1,400 restricted share units (the RSU award) following each annual meeting of shareholders, however, the amount of the award may change from year to year, based on the provision described below. The RSU awards are fully vested upon grant. RSU awards are not common shares of the Company and, as such, no participant has any rights as a holder of common shares under the Outside Directors RSU Plan. RSU awards represent the right to receive an amount, payable in cash or common shares of the Company, as previously elected by the outside director, equal to the value of a specified number of common shares of the Company at the end of the restricted period. Such election may be changed within the constraints set forth in the RSU Plan. The restricted period for the RSU awards begins on the date of grant and expires on the date the outside director retires from or otherwise terminates service as a director of the Company. During the restricted period, outside directors are credited with dividends, equivalent in value to those declared and paid on the Company s common shares, on all RSU awards granted to them. At the end of the restricted period, outside directors receive distributions of their RSU awards either (i) in a single lump sum payment, or (ii) in annual installment payments over a five- or ten-year period, as previously elected by the outside director. The administrative committee for the Outside Directors RSU Plan (currently the Company s Compensation Committee) retains the right to increase the annual number of RSU awards granted to each outside director to as many as 5,000 or to decrease such annual number to not less than 500, without seeking shareholder approval, if such increase or decrease is deemed appropriate by the administrative committee to maintain director compensation at appropriate levels. The Outside Directors RSU Plan automatically terminates on May 31, 2015. The Company accounts for the Outside Directors RSU Plan as a liability plan. There were 11,200 and 9,800 RSUs granted in 2007 and 2006, respectively. There were no RSUs granted by the Company prior to January 1, 2006.

During 2007 and 2006, common shares valued at approximately $9,000 and $60,000, respectively, were distributed by the Company under the Outside Directors RSU Plan. No distributions were made in 2005.

Under the Outside Directors Stock Option Plan, following each annual meeting of shareholders, outside directors received nonqualified options to purchase 4,200 common shares at an option price equal to the fair market value of the common shares at the close of business on the last trading day immediately prior to the date of the annual meeting. These nonqualified options vested upon grant and are exercisable for 10 years from the date of grant. On May 11, 2005 (the date of the Company s 2005 annual meeting of shareholders), the Outside Directors Stock Option Plan was amended to prohibit the grant of further options under the plan.

Agent Stock Option Plan

The Company has a stock option incentive plan for certain designated independent insurance agencies (Agent Stock Option Plan) that represent the Company and its affiliates. The Company has reserved 0.4 million shares of common stock under this plan. As of December 31, 2007, a total of 0.2 million shares were available for issuance under the Agent Stock Option Plan. The plan provides that the options become exercisable on the first day of the calendar year following the agency s achievement of specific production and profitability requirements over a period not greater than two calendar years from the date of grant or a portion thereof in the

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Notes to Consolidated Financial Statements, Continued

first calendar year in which an agency commences participation under the plan. Options granted under this plan have a ten-year term. Stock options granted for the years 2007, 2006 and 2005 were 15,862, 16,452 and 29,505, respectively. The Agent Stock Option Plan terminates May 27, 2008.

Stock Options

The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes closed-form pricing model. The following tables present the weighted-average assumptions used in the option pricing model for options granted to employees and non-employees (independent insurance agencies) during 2007, 2006, and 2005. The expected life of the options for employees represents the period of time the options are expected to be outstanding and is based on historical trends. For non-employees the expected life of the option approximates the remaining contractual term of the option. The expected stock price volatility is based on the historical volatility of the Company s stock for a period approximating the expected life and the expected dividend yield is based on the Company s most recent period s dividend payout. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant and has a term equal to the expected life.

The fair value of the independent agent options granted was estimated at the reporting date or vesting date using the Black-Scholes option-pricing model. The weighted average fair value and related assumptions are as follows:

	2007	2006	2005
Fair value per share	**$ 7.10**	16.61	18.24
Dividend yield	**2.28%**	1.15%	0.99%
Risk free interest rate	**3.9%**	4.7%	4.3%
Expected volatility factor	**33.8%**	34.7%	33.6%
Expected life in years	**8.5**	8.4	6.4

The fair value of share-based awards granted to employees in 2007 and 2006 was estimated at the date of grant using the Black-Scholes option-pricing model. The weighted average fair values and related assumptions for options granted were as follows:

	2007	2006
Fair value per share	**$ 10.82**	12.41
Expected dividend yield	**1.46%**	1.12%
Risk free interest rate	**4.5%**	5.1%
Expected volatility factor	**33.4%**	32.4%
Expected life in years	**6.4**	6.4

As of December 31, 2007, there was $5.4 million of total unrecognized compensation cost related to option-based compensation arrangements granted under the plans. The remaining cost is expected to be recognized over a period of three years.

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A summary of the Company s total stock option activity and related information for these plans for the years ended December 31, follows:

($ millions, except per share amounts)	**2007**		2006		2005	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding, beginning of year	**2.4**	**$ 22.09**	2.6	$ 18.76	2.6	$ 16.46
Granted	**0.4**	**29.55**	0.3	33.49	0.4	26.48
Exercised	**(0.1)**	**15.48**	(0.5)	12.35	(0.4)	9.88
Canceled		**31.91**		27.14		23.34
Outstanding, end of year	**2.7**	**$ 23.78**	2.4	$ 22.09	2.6	$ 18.76

Intrinsic value for stock options is defined as the difference between the current market value and the grant price. For the years ended December 31, 2007, 2006 and 2005, the total intrinsic value of stock options exercised was $2.6 million, $11.9 million and $6.0 million, respectively. The tax benefit for tax deductions from share-based awards totaled $0.7 million, $3.2 million and $1.8 million for the years ended December 31, 2007, 2006 and 2005, respectively.

A summary of information pertaining to the total options outstanding and exercisable as of December 31, 2007 follows:

($ millions, except per share amounts)	Options Outstanding			Options Exercisable	
	Number	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number	Weighted-Average Exercise Price
Range of Exercise Prices:					
Less than $10.00		**2.0**	**$ 9.30**		**$ 9.30**
$10.01 $20.00	**1.1**	**3.5**	**15.40**	**1.1**	**15.40**
$20.01 $30.00	**0.9**	**8.4**	**27.94**	**0.3**	**26.43**
Greater than $30.01	**0.7**	**7.4**	**32.11**	**0.5**	**31.60**
	2.7	**6.0**	**$ 23.78**	**1.9**	**$ 21.39**

Aggregate intrinsic value for total options outstanding at December 31, 2007 is $12.3 million. Aggregate intrinsic value for total options exercisable at December 31, 2007 is $12.3 million.

Compensation expense recognized during 2007, 2006 and 2005 was $6.0 million, $7.0 million and $0.3, respectively. See Note 1(k) for a discussion of share based compensation expense prior to the adoption of FAS 123(R) on January 1, 2006. Share-based compensation is recognized as a component of loss and loss adjustment expense and acquisition and operating expense in a manner consistent with other employee compensation. As of December 31, 2007, there was $6.1 million of total unrecognized compensation cost related to option-based compensation arrangements granted under the plans. The remaining cost is expected to be recognized over a period of three years.

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Notes to Consolidated Financial Statements, Continued

13. Net Earnings Per Common Share

The following table sets forth the compilation of basic and diluted net earnings per common share for the year ended December 31:

($ millions, except per share amounts)	**2007**	2006	2005
Numerator:			
Net earnings for basic net earnings per common share	**$ 119.1**	120.4	125.9
Effect of dilutive share-based awards	**0.1**		
Adjusted net earnings for dilutive net earnings per common share	**$ 119.2**	120.4	125.9
Denominator:			
Weighted average shares for basic net earnings per common share	**41.0**	40.9	40.3
Effect of dilutive share-based awards	**0.6**	0.7	0.8
Adjusted weighted average shares for diluted net earnings per common share	**41.6**	41.6	41.1
Basic net earnings per common share	**$ 2.90**	2.95	3.12
Diluted net earnings per common share	**$ 2.86**	2.90	3.06

The following options to purchase shares of common stock were not included in the computation of diluted earnings per share because the exercise price of the options was greater than the average market price for the year ended December 31:

(in millions)	**2007**	2006	2005
Number of options	**0.7**	0.3	0.4

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14. Comprehensive Income

A reconciliation of each component of comprehensive income (loss) and the related federal income tax effect for the year ended December 31, is as follows:

($ millions)	Before-Tax Amount	Tax (Expense) or Benefit	Net-of-Tax Amount
2007:			
Net income	**$ 155.3**	**(36.2)**	**119.1**
Other comprehensive income:			
Net unrealized holding loss on investments:			
Unrealized holding loss arising during the year	**8.1**	**(2.8)**	**5.3**
Reclassification adjustments for gains realized in net income	**(12.1)**	**4.2**	**(7.9)**
	(4.0)	**1.4**	**(2.6)**
Amortization of gain on derivative used in cash flow hedge	**(0.1)**		**(0.1)**
Net unrecognized benefit plan obligations:			
Net actuarial gain arising during period	**20.6**	**(6.9)**	**13.7**
Reclassification adjustments for amortization to net income:			
Transition asset	**(0.6)**	**0.2**	**(0.4)**
Net actuarial loss	**4.7**	**(1.9)**	**2.8**
Prior service cost	**0.9**	**(0.3)**	**0.6**
	25.6	**(8.9)**	**16.7**
Other comprehensive income	**21.5**	**(7.5)**	**14.0**
Comprehensive income	**$ 176.8**	**(43.7)**	**133.1**

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Notes to Consolidated Financial Statements, Continued

($ millions)	Before-Tax Amount	Tax (Expense) or Benefit	Net-of-Tax Amount
2006:			
Net income	$ 161.7	(41.3)	120.4
Other comprehensive income:			
Net unrealized holding gain on investments:			
Unrealized holding loss arising during the year	24.7	(8.7)	16.0
Reclassification adjustments for gains realized in net income	(5.6)	2.0	(3.6)
	19.1	(6.7)	12.4
Amortization of gain on derivative used in cash flow hedge	(0.1)		(0.1)
Other comprehensive income	19.0	(6.7)	12.3
Comprehensive income	$ 180.7	(48.0)	132.7
2005:			
Net income	$ 172.0	(46.1)	125.9
Other comprehensive loss:			
Net unrealized holding loss on investments:			
Unrealized holding gains arising during the year	(23.4)	8.3	(15.1)
Reclassification adjustments for gains realized in net income	(5.6)	2.0	(3.6)
	(29.0)	10.3	(18.7)
Amortization of gain on derivative used in cash flow hedge	(0.1)		(0.1)
Other comprehensive loss	(29.1)	10.3	(18.8)
Comprehensive income	$ 142.9	(35.8)	107.1

15. Reportable Segments

Due to internal reorganization efforts which occurred throughout most of 2006, that included realigning people, processes, systems and compensation programs, the Company changed its significant reportable segments from standard insurance and nonstandard insurance to the new segments described below, effective January 1, 2007. Prior reporting periods have been restated to conform to the new segment presentation

The Company has three significant reportable segments: personal insurance, business insurance, and investment operations. The reportable insurance segments are business units managed separately because of the differences in the type of customers they serve or products they provide or services they offer. The insurance segments operate primarily in the central and eastern United States, excluding New York, New Jersey, and New England states, distributing products through the independent insurance agency system. The personal insurance segment provides primarily personal auto (standard and nonstandard) and homeowners to the personal insurance market. The business insurance segment provides primarily commercial auto, commercial multi-peril, fire and allied lines, other and product liability and workers compensation insurance to small to medium sized businesses within the commercial insurance market. The investment operations segment, managed by Stateco, provides investment services for the Company s invested assets.

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The Company evaluates the performance of its insurance segments using industry financial measurements determined based on Statutory Accounting Principles (SAP), which include loss and loss adjustment expense ratios, underwriting expense ratios, combined ratios, statutory underwriting gain (loss), net premiums earned and net written premiums. One of the most significant differences between SAP and GAAP is that SAP requires all underwriting expenses to be expensed immediately and not deferred and amortized over the same period the premium is earned as under GAAP.

Asset information by segment is not reported for the insurance segments because the Company does not produce such information internally. The investment operations segment is evaluated based on investment returns of assets managed by Stateco.

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The following provides financial information regarding the Company s reportable segments for the year ended December 31:

($ millions)	**2007**	2006	2005
Revenues from external customers:			
Insurance segments			
Personal insurance	**$ 609.6**	614.8	641.0
Business insurance	**402.0**	409.0	409.3
Total insurance segments	**1,011.6**	1,023.8	1,050.3
Investment operations segment			
Net investment income	**84.7**	83.1	78.7
Net realized gains on investments	**12.1**	5.6	5.6
Total investment operations segment	**96.8**	88.7	84.3
All other	**5.0**	4.9	4.9
Total revenues from external sources	**1,113.4**	1,117.4	1,139.5
Intersegment revenues:	**9.4**	9.0	9.0
Total revenues	**1,122.8**	1,126.4	1,148.5
Reconciling items:			
Eliminate intersegment revenues	**(9.4)**	(9.0)	(9.0)
Total consolidated revenue	**$ 1,113.4**	1,117.4	1,139.5
Segment income (loss) before federal income tax:			
Insurance segments:			
Personal insurance SAP underwriting gain	**$ 47.3**	44.9	72.4
Business insurance SAP underwriting gain	**40.6**	61.5	26.5
Total insurance segments	**87.9**	106.4	98.9
Investment operations segment:			
Net investment income	**84.7**	83.1	78.7
Net realized gains on investments	**12.1**	5.6	5.6
Total investment operations segment	**96.8**	88.7	84.3
All other segments (loss)	**(2.6)**	(2.3)	(1.1)

Reconciling items:			
GAAP adjustments	**(17.3)**	(21.7)	0.6
Interest expense on corporate debt	**(7.6)**	(7.4)	(8.8)
Corporate expenses	**(1.9)**	(2.0)	(1.9)
Total consolidated income before federal income taxes	**$ 155.3**	161.7	172.0

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Notes to Consolidated Financial Statements, Continued

($ millions)	December 31	
	2007	2006
Segment assets:		
Investment operations segment	**$ 2,092.1**	$ 2,011.3
Total segment assets	**2,092.1**	2,011.3
Reconciling items:		
Corporate assets	**245.8**	243.8
Total consolidated assets	**$ 2,337.9**	$ 2,255.1

Assets attributed to the Investment Operations segment include the Total investments and Cash and cash equivalent categories from the balance sheet. All other assets are corporate assets and are not assigned to a segment.

Revenues from external sources for reportable segments include the following products and services for the year ended December 31:

($ millions)	**2007**	2006	2005
Earned premiums:			
Personal insurance:			
Standard auto	**$ 357.3**	362.1	385.7
Nonstandard auto	**42.9**	44.8	53.0
Homeowners	**186.5**	185.2	178.7
Other personal	**22.9**	22.7	23.6
Total personal insurance earned premiums	**609.6**	614.8	641.0
Business insurance:			
Commercial auto	**96.9**	100.3	103.2
Commercial multi-peril	**86.8**	87.5	84.6
Fire & allied lines	**83.4**	84.2	84.8
Other & product liability	**75.5**	77.5	76.7
Workers compensation	**33.4**	33.8	34.4
Other business	**26.0**	25.7	25.6
Total business insurance earned premiums	**402.0**	409.0	409.3
Total earned premiums	**1,011.6**	1,023.8	1,050.3
Investment operations:			
Net investment income	**84.7**	83.1	78.7
Realized gains	**12.1**	5.6	5.6

Total investment operations	**96.8**	88.7	84.3
Total revenues from significant reportable segments	**$ 1,108.4**	1,112.5	1,134.6

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Notes to Consolidated Financial Statements, Continued

16. Quarterly Financial Data (unaudited)

($ millions, except per share amounts)	**2007** For three months ended			
	March 31	June 30	September 30	December 31
Total revenues	**$ 275.5**	**278.7**	**280.9**	**278.3**
Income before federal income taxes	**40.9**	**28.8**	**28.6**	**57.0**
Net income	**30.9**	**23.3**	**23.2**	**41.7**
Net earnings per common share:				
Basic	**$ 0.75**	**0.57**	**0.56**	**1.02**
Diluted	**$ 0.74**	**0.56**	**0.55**	**1.01**

($ millions, except per share amounts)	2006 For three months ended			
	March 31	June 30	September 30	December 31
Total revenues	$ 276.8	280.0	279.6	281.0
Income (loss) before federal income taxes	56.7	(0.2)	42.4	62.8
Net income	40.2	4.1	31.2	44.9
Net earnings per common share:				
Basic	$ 0.99	0.10	0.76	1.10
Diluted	$ 0.97	0.10	0.75	1.08

17. Contingencies

The Company s insurance subsidiaries are involved in litigation and may become involved in potential litigation arising in the ordinary course of business. Additionally, the insurance subsidiaries may be impacted by adverse regulatory actions and adverse court decisions where insurance coverages are expanded beyond the scope originally contemplated in the policies at December 31, 2007. In the opinion of management, the effects, if any, of such litigation and published court decisions are not expected to be material to the consolidated financial statements.

18. Subsequent Event (unaudited)

Effective January 1, 2008, the Pooling Arrangement, described in Note 6a, was further amended to add Patrons Mutual Insurance Company of Connecticut (Patrons Mutual), Litchfield Mutual Fire Insurance Company (Litchfield) and Beacon National as participants and the middle market business of State Auto Mutual and Meridian Security to the pool. Patrons Mutual and Litchfield are affiliate companies of State Auto Mutual. Concurrently with the addition of the three companies, certain individual participant percentages of State Auto Mutual and its subsidiaries and affiliates were adjusted but continue to maintain an overall 20% participation percentage; STFC s insurance subsidiaries will maintain its 80% participation percentage.

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In conjunction with the Pooling Arrangement amendment, the STFC Pooled Companies will receive approximately $92.0 million in cash, for additional net insurance liabilities assumed on January 1, 2008. All parties that participate in the Pooling Arrangement, effective January 1, 2008, have an A.M. Best rating of A+ (Superior). The following table presents an estimate of the impact on the Company s balance sheet at January 1, 2008, for additional net insurance liabilities.

($ millions)	
Losses and loss expense payable	$ 51.3
Unearned premiums	53.6
Deferred policy acquisition costs	(12.9)
Net cash received	$ 92.0

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Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Management s Annual Report on Internal Control Over Financial Reporting

Our management s annual report on internal control over financial reporting required by Item 308(a) of Regulation S-K follows. The attestation report of our independent registered public accounting firm required by Item 308(b) of Regulation S-K is found under the caption Report of the Independent Registered Public Accounting Firm in Item 8 of this Form 10-K.

The following report is provided by our management on the Company s internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act):

1. Our management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company.

2. Our management has used the Committee Of Sponsoring Organizations of the Treadway Commission (COSO) framework to evaluate the effectiveness of our internal control over financial reporting. Our management believes that the COSO framework is a suitable framework for its evaluation of our internal control over financial reporting because it is free from bias, permits reasonably qualitative and quantitative measurements of our internal controls, is sufficiently complete so that those relevant factors that would alter a conclusion about the effectiveness of our internal controls are not omitted and is relevant to an evaluation of internal control over financial reporting.

3. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can only provide reasonable assurance with respect to financial reporting.

4. Our management has assessed the effectiveness of our internal control over financial reporting as of December 31, 2007, and has concluded that such internal control over financial reporting is effective. There are no material weaknesses in our internal control over financial reporting that have been identified by our management.

Disclosure Controls and Procedures

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company s periodic filings with the Securities and Exchange Commission.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other information

None.

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PART III

Item 10. Directors and Executive Officers of the Registrant

Information regarding our directors required by Items 401(a) and (d)-(f) of Regulation S-K will be found under the caption Proposal One: Election of Directors in our 2008 Proxy Statement, which information is incorporated herein by reference. Information regarding our executive officers required by Items 401(b) and (d)-(f) of Regulation S-K is found under the caption Executive Officers of the Registrant at the end of Item 1 of our Form 10-K, which information is also incorporated by reference into this Item 10.

We have a separately-designated standing Audit Committee established in accordance with Section 3(a)(58)(A) of the Exchange Act. As of March 3, 2008, the members of our Audit Committee were Richard K. Smith, David J. D Antoni, David R. Meuse, Thomas E. Markert and Paul S. Williams. Mr. Smith is Chairman of our Audit Committee. Our Board of Directors has determined that Mr. Smith is an audit committee financial expert, as that term is defined in Item 407(d)(5)of Regulation S-K, and independent, as that term is defined in Rule 10A-3 of the Exchange Act.

Information regarding the filing of reports of ownership under Section 16(a) of the Exchange Act by our officers and directors and persons owning more than 10% of a registered class of our equity securities required by Item 405 of Regulation S-K will be found under the caption Section 16(a) Beneficial Ownership Reporting Compliance in our 2008 Proxy Statement, which information is incorporated herein by reference.

Information concerning the procedures by which stockholders may recommend nominees to our Board of Directors will be found under the caption Corporate Governance Nomination of Directors in our 2008 Proxy Statement. There has been no material change to the nomination procedures previously disclosed by the Company in its proxy statement for its 2007 annual meeting of stockholders.

Our Board of Directors has adopted a code of ethics that applies to our principal executive officer, principal financial officer, principal accounting officer, controller, and persons performing similar functions. This code of ethics has been posted on our website at www.stfc.com under Investors then Corporate Governance. Any amendment (other than any technical, administrative or other non-substantive amendment) to, or waiver from, a provision of this code will be posted on our website described above within four business days following its occurrence.

Item 11. Executive Compensation

Our 2008 Proxy Statement will contain information regarding the following matters: information regarding executive compensation required by Item 402 of Regulation S-K will be found under the captions Board of Directors and Board Committees Compensation of Directors and Director Compensation Table and Compensation Discussion and Analysis ; information required by Item 407(e)(4) of Regulation S-K will be found under the caption Compensation Committee Interlocks and Insider Participation ; information required by Item 407(e)(5) of Regulation S-K will be found under the caption Compensation Committee Report . This information is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information regarding security ownership of certain beneficial owners and management required by Item 403 of Regulation S-K will be found under the caption Proposal One: Election of Directors and Principal Holders of Voting Securities in our 2008 Proxy Statement, which information is incorporated herein by reference.

Information regarding equity compensation plan information required by Item 201(d) of Regulation S-K will be found under the caption Equity Compensation Plan Information in our 2008 Proxy Statement, which information is incorporated herein by reference.

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Item 13. Certain Relationships and Related Transactions, and Director Independence

Information regarding certain relationships and related transactions required by Item 404 of Regulation S-K will be found under the caption Related Party Transactions in our 2008 Proxy Statement, which information is incorporated herein by reference.

Information regarding the independence of our directors required by Item 407(a) of Regulation S-K will be found under the caption Corporate Governance Director Independence in our 2008 Proxy Statement, which is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

Information regarding principal accountant fees and services required by Item 9(e) of Schedule 14A will be found under the caption Independent Registered Public Accounting Firm in our 2008 Proxy Statement, which information is incorporated herein by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a)(1) LISTING OF FINANCIAL STATEMENTS

The following consolidated financial statements of the Company are filed as part of this Form 10-K and are included in Item 8:

Reports of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of December 31, 2007 and 2006

Consolidated Statements of Income for each of the three years in the period ended December 31, 2007

Consolidated Statements of Stockholders Equity for each of the three years in the period ended December 31, 2007

Consolidated Statements of Cash Flows for each of the three years in the period ended December 31, 2007

Notes to Consolidated Financial Statements

(a)(2) LISTING OF FINANCIAL STATEMENT SCHEDULES

The following financial statement schedules of the Company for the years 2007, 2006 and 2005 are included in Item 14(d) following the signatures and should be read in conjunction with our consolidated financial statements contained in our Form 10-K.

Schedule

Schedule Number	
I.	Summary of Investments Other Than Investments in Related Parties
II.	Condensed Financial Information of Registrant
III.	Supplementary Insurance Information
IV.	Reinsurance

All other schedules and footnotes are omitted because they are not applicable or the required information is included in the consolidated financial statements or notes thereto.

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(a)(3) LISTING OF EXHIBITS

Exhibit No.	Description of Exhibit	If incorporated by reference document with which Exhibit was previously filed with SEC
3.01	State Auto Financial Corporation s Amended and Restated Articles of Incorporation	1933 Act Registration Statement No. 33-40643 on Form S-1 (see Exhibit 3(a) therein)
3.02	State Auto Financial Corporation s Amendment to the Amended and Restated Articles of Incorporation	1933 Act Registration Statement No. 33-89400 on Form S-8 (see Exhibit 4(b) therein)
3.03	State Auto Financial Corporation Certificate of Amendment to the Amended and Restated Articles of Incorporation as of June 2, 1998	Form 10-K Annual Report for the year ended December 31, 1998 (see Exhibit 3(A)(3) therein)
3.04	State Auto Financial Corporation s Amended and Restated Code of Regulations	1933 Act Registration Statement No. 33-40643 on Form S-1 (see Exhibit 3(b) therein)
10.01	Guaranty Agreement between State Automobile Mutual Insurance Company and State Auto Property and Casualty Insurance Company dated as of May 16, 1991	1933 Act Registration Statement No. 33-40643 on Form S-1 (see Exhibit 10 (d) therein)
10.02	Form of Indemnification Agreement between State Auto Financial Corporation and each of its directors	1933 Act Registration Statement No. 33-40643 on Form S-1 (see Exhibit 10 (e) therein)
10.03*	1991 Stock Option Plan	1933 Act Registration Statement No. 33-40643 on Form S-1 (see Exhibit 10 (h) therein)
10.04*	Amendment Number 1 to the 1991 Stock Option Plan	1933 Act Registration Statement No. 33-89400 on Form S-8 (see Exhibit 4 (a) therein)
10.05*	Amendment Number 2 to the 1991 Stock Option Plan	Form 10-K Annual Report for the year ended December 31, 1996 (see Exhibit 10(DD) therein)
10.06*	Amendment No. 3 to 1991 Stock Option Plan Effective January 1, 2001	Form 10-Q Quarterly Report for the period ended September 30, 2003 (see 10.01) therein)
10.07*	1991 Directors Stock Option Plan	1933 Act Registration Statement No. 33-40643 on Form S-1 (see Exhibit 10 (i) therein)
10.08*	Amendment Number 1 to the 1991 Directors Stock Option Plan	Form 10-K Annual Report for the year ended December 31, 1996 (see Exhibit 10(EE) therein)
10.09*	Second Amendment to 1991 Directors Stock Option Plan	Form 10-Q Quarterly Report for the period ended September 30, 2001 (see Exhibit 10(JJ) therein)
10.10*	2000 Directors Stock Option Plan	Definitive Proxy Statement on Form DEF 14A, File No. 000-19289, for Annual Meeting of Shareholders held on May 26, 2000 (see Appendix B therein)
10.11*	First Amendment to 2000 Directors Stock Option Plan	Form 10-Q Quarterly Report for the period ended March 31, 2001 (see Exhibit 10(HH) therein)
10.12*	Second Amendment to 2000 Directors Stock Option Plan	Form 10-Q Quarterly Report for the period ended September 30, 2001 (see Exhibit 10(KK) therein)

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Exhibit No.	Description of Exhibit	If incorporated by reference document with which Exhibit was previously filed with SEC
10.13*	Third Amendment to 2000 Directors Stock Option Plan	Form 10-K Annual Report for the year ended December 31, 2001 (see Exhibit 10(EE) therein)
10.14*	Fourth Amendment to 2000 Directors Stock Option Plan	Form 10-K Annual Report for year ended 12-31-02 (see Exhibit 10(UU) therein)
10.15*	Fifth Amendment to 2000 Directors Stock Option Plan of State Auto Financial Corporation	Form 10-Q Quarterly Report for the period ended June 30, 2005 (see Exhibit 10.66 therein)
10.16	Investment Management Agreement between Stateco Financial Services, Inc. and State Automobile Mutual Insurance Company, effective April 1, 1993	Form 10-K Annual Report for the year ended December 31, 1992 (see Exhibit 10 (N) therein)
10.17	Investment Management Agreement between Stateco Financial Services, Inc. and Meridian Security Insurance Company, effective June 1, 2001	Form 10-K Annual Report for the year ended December 31, 2005 (see Exhibit 10.17 therein)
10.18	Investment Management Agreement between Stateco Financial Services, Inc. and State Auto Florida Insurance Company effective April 1, 2002	Form 10-K Annual Report for the year ended December 31, 2005 (see Exhibit 10.18 therein)
10.19	Investment Management Agreement between Stateco Financial Services, Inc. and Midwest Security Insurance Company effective January 1, 1997	Form 10-K Annual Report for the year ended December 31, 2005 (see Exhibit 10.19 therein)
10.20	Investment Management Agreement between Stateco Financial Services, Inc. and Meridian Citizens Mutual Insurance Company effective June 1, 2001	Form 10-K Annual Report for the year ended December 31, 2005 (see Exhibit 10.20 therein)
10.21	Investment Management Agreement dated March 29, 2007, between Stateco Financial Services, Inc. and Beacon National Insurance Company, First Preferred Insurance Company, Petrolia Insurance Company and Beacon Lloyds Insurance Company	Form 10-Q Quarterly Report for the period ended March 31, 2007 (see Exhibit 10.63 therein)
10.22	Amended and Restated Investment Management Agreement dated as of December 31, 2007, among Stateco Financial Services, Inc. and Patrons Mutual Insurance Company of Connecticut, Patrons Fire Insurance Company of Rhode Island, and Provision State Insurance Company	Included herein
10.23	Amended and Restated Investment Management Agreement dated as of December 31, 2007, between Stateco Financial Services, Inc. and Litchfield Mutual Fire Insurance Company	Included herein

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Exhibit No.	Description of Exhibit	If incorporated by reference document with which Exhibit was previously filed with SEC
10.24	Cost Sharing Agreement among State Auto Property and Casualty Insurance Company, State Automobile Mutual Insurance Company, and State Auto Florida Insurance Company effective January 1, 2003	Form 10-K Annual Report for year ended 12-31-02 (see Exhibit 10(OO) therein)
10.25	Midwest Security Insurance Company Management Agreement amended and restated as of January 1, 2000 by and among State Automobile Mutual Insurance Company, an Ohio corporation, State Auto Property and Casualty Insurance Company, a South Carolina corporation and Midwest Security Insurance (nka State Auto Insurance Company of Wisconsin), a Wisconsin corporation	Form 10-K Annual Report for the year ended December 31, 2005 (see Exhibit 10.45 therein)
10.26	Management and Operations Agreement, Amended and Restated as of January 1, 2005 by and among State Automobile Mutual Insurance Company, State Auto Financial Corporation, State Auto Property and Casualty Insurance Company, State Auto National Insurance Company, Milbank Insurance Company, State Auto Insurance Company of Ohio, Meridian Security Insurance Company, Meridian Citizens Mutual Insurance Company, Meridian Insurance Group, Inc., Farmers Casualty Insurance Company, Stateco Financial Services, Inc., Strategic Insurance Software, Inc., and 518 Property Management and Leasing, LLC	Form 10-Q Quarterly Report for the period ended March 31, 2005 (see Exhibit 10.56 therein)
10.27	First Amendment to Management and Operations Agreement Amended and Restated as of January 1, 2005, by and among State Automobile Mutual Insurance Company, State Auto Financial Corporation, State Auto Property and Casualty Insurance Company, State Auto National Insurance Company, Milbank Insurance Company, State Auto Insurance Company of Ohio, Meridian Security Insurance Company, Meridian Citizens Mutual Insurance Company, Meridian Insurance Group, Inc., Farmers Casualty Insurance Company, Stateco Financial Services, Inc., Strategic Insurance Software, Inc., 518 Property Management and Leasing, LLC, State Auto Florida Insurance Company, Beacon National Insurance Company, Beacon Lloyds, Inc., Beacon Lloyds Insurance Company, First Preferred Insurance Company, and Petrolia Insurance Company, made as of April 1, 2007	Form 10-Q Quarterly Report for the period ended June 30, 2007 (see Exhibit 66.67 therein)

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Exhibit No.	Description of Exhibit	If incorporated by reference document with which Exhibit was previously filed with SEC
10.28	Inter-Company Expense Agreement (dated as of June 18, 2001), including First Amendment (dated as of September 30, 2002) and Second Amendment (dated as of December 14, 2007), thereto, among Patrons Fire Insurance Company of Rhode Island, Patrons Mutual Insurance Company of Connecticut, State Automobile Mutual Insurance Company and State Auto Property & Casualty Insurance Company	Included herein
10.29	Inter-Company Expense Agreement (dated as of January 12, 2001), including First Amendment (dated as of September 30, 2002) and Second Amendment (dated as of December 14, 2007) thereto among Litchfield Mutual Fire Insurance Company, Patrons Mutual Insurance Company of Connecticut, State Automobile Mutual Insurance Company and State Auto Property & Casualty Insurance Company	Included herein
10.30	Inter-Company Expense Agreement (dated as of June 18, 2001), including First Amendment (dated as of December 14, 2007) thereto among Provision State Insurance Company, Patrons Mutual Insurance Company of Connecticut, State Automobile Mutual Insurance Company and State Auto Property and Casualty Insurance Company	Included herein
10.31	Management Services Agreement (dated as of August 30, 1996), including First Amendment (dated as of December 14, 2007) thereto among Patrons Fire Insurance Company of Rhode Island, Patrons Mutual Insurance Company of Connecticut, State Automobile Mutual Insurance Company and State Auto Property & Casualty Insurance Company	Included herein
10.32	Management Services Agreement (dated as of August 26, 1998), including First Amendment (dated as of December 14, 2007) thereto among Litchfield Mutual Fire Insurance Company, Patrons Mutual Insurance Company of Connecticut, State Automobile Mutual Insurance Company and State Auto Property & Casualty Insurance Company	Included herein

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Exhibit No.	Description of Exhibit	If incorporated by reference document with which Exhibit was previously filed with SEC
10.33	Property Catastrophe Overlying Excess of Loss Reinsurance Contract (effective July 1, 2006) among State Automobile Mutual Insurance Company, Milbank Insurance Company, State Auto National Insurance Company, State Auto Insurance Company of Wisconsin, Farmers Casualty Insurance Company, State Auto Insurance Company of Ohio, Meridian Security Insurance Company, Meridian Citizens Mutual Insurance Company, State Auto Florida Insurance Company and State Auto Property and Casualty Insurance Company	Form 10-Q Quarterly Report for the period ended September 30, 2006 (see Exhibit 10.69 therein)
10.34	Property Catastrophe Overlying Excess of Loss Reinsurance Contract (effective July 1, 2007) among State Automobile Mutual Insurance Company, Milbank Insurance Company, State Auto National Insurance Company, State Auto Insurance Company of Wisconsin, Farmers Casualty Insurance Company, State Auto Insurance Company of Ohio, Meridian Security Insurance Company, Meridian Citizens Mutual Insurance Company, State Auto Florida Insurance Company, Beacon National Insurance Company, First Preferred Insurance Company, Petrolia Insurance Company, Beacon Lloyds Insurance Company and State Auto Property and Casualty Insurance Company	Included herein
10.35	Endorsement No. 1 to the Property Catastrophe Overlying Excess of Loss Reinsurance Contract (effective July 1, 2007) among State Automobile Mutual Insurance Company, Milbank Insurance Company, State Auto National Insurance Company, State Auto Insurance Company of Wisconsin, Farmers Casualty Insurance Company, State Auto Insurance Company of Ohio, Meridian Security Insurance Company, Meridian Citizens Mutual Insurance Company, State Auto Florida Insurance Company, Beacon National Insurance Company, First Preferred Insurance Company, Petrolia Insurance Company, Beacon Lloyds Insurance Company, Patrons Mutual Insurance Company of Connecticut, Litchfield Mutual Fire Insurance Company, Patrons Fire Insurance Company of Rhode Island, Provision State Insurance Company and State Auto Property and Casualty Insurance Company	Included herein

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Exhibit No.	Description of Exhibit	If incorporated by reference document with which Exhibit was previously filed with SEC
10.36	Reinsurance Pooling Agreement Amended and Restated as of January 1, 2005 by and among State Automobile Mutual Insurance Company, State Auto Property and Casualty Insurance Company, Milbank Insurance Company, State Auto Insurance Company of Wisconsin, Farmers Casualty Insurance Company, State Auto Insurance Company of Ohio, State Auto Florida Insurance Company, Meridian Security Insurance Company, and Meridian Citizens Mutual Insurance Company	Form 10-K Annual Report for the year ended December 31, 2004 (see Exhibit 10.55 therein)
10.37	First Amendment to the Reinsurance Pooling Agreement Amended and Restated as of January 1, 2005 by and among State Automobile Mutual Insurance Company, State Auto Property and Casualty Insurance Company, Milbank Insurance Company, State Auto Insurance Company of Wisconsin, Farmers Casualty Insurance Company, State Auto Insurance Company of Ohio, State Auto Florida Insurance Company, Meridian Security Insurance Company, and Meridian Citizens Mutual Insurance Company, made as of April 1, 2007	Form 10-Q Quarterly Report for the period ended June 30, 2007 (see Exhibit 10.66 therein)
10.38	Reinsurance Pooling Agreement Amended and Restated as of January 1, 2008 by and among State Automobile Mutual Insurance Company, State Auto Property and Casualty Insurance Company, Milbank Insurance Company, State Auto Insurance Company of Wisconsin, Farmers Casualty Insurance Company, State Auto Insurance Company of Ohio, State Auto Florida Insurance Company, Meridian Security Insurance Company, and Meridian Citizens Mutual Insurance Company, Patrons Mutual Insurance Company of Connecticut, Litchfield Mutual Fire Insurance Company and Beacon National Insurance Company	Included herein
10.39	Amended and Restated Declaration of Trust of STFC Capital Trust I, dated as of May 22, 2003	Form 10-Q Quarterly Report for the period ended June 30, 2003 (see 10(XX) therein)
10.40	Indenture dated as of May 22, 2003, for Floating Rate Junior Subordinated Debt Securities Due 2033	Form 10-Q Quarterly Report for the period ended June 30, 2003 (see 10(YY) therein)
10.41	Indenture dated as of November 13, 2003, among State Auto Financial Corporation, as Issuer, and Fifth Third Bank, as Trustee, regarding 6 1/4% Senior Note due 2013	Securities Act Registration Statement on Form S-4 (File No. 333-111507)(see Exhibit 4.01 therein)

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Exhibit No.	Description of Exhibit	If incorporated by reference document with which Exhibit was previously filed with SEC
10.42	Form of 6 1/4% Senior Note due 2013 (Exchange Note)	Securities Act Registration Statement on Form S-4 (File No. 333-111507)(see Exhibit 4.02 therein)
10.43	Credit Agreement dated as of July 12, 2007, among State Auto Financial Corporation, as borrower, a syndicate of financial institutions, as lenders, and KeyBank National Association, as Administrative Agent, Lead Arranger, Sole Book Runner and Swingline Lender	Form 8-K current Report filed on July 17, 2007 (see Exhibit 10.1 therein)
10.44*	Employment Agreement dated as of March 2, 2006, among State Auto Financial Corporation, State Auto Property and Casualty Insurance Company, State Automobile Mutual Insurance Company and Robert P. Restrepo, Jr.	Form 10-K Annual Report for the year ended December 31, 2005 (see Exhibit 10.26 therein)
10.45*	Amendment to Employment Agreement dated as of January 24, 2007, among State Auto Financial Corporation, State Auto Property and Casualty Insurance Company, State Automobile Mutual Insurance Company and Robert P. Restrepo, Jr.	Form 10-K Annual Report for the year ended December 31, 2006 (see Exhibit 10.24 therein)
10.46*	Executive Agreement dated as of March 2, 2006, among State Auto Financial Corporation, State Automobile Mutual Insurance Company and Robert P. Restrepo, Jr.	Form 10-K Annual Report for the year ended December 31, 2005 (see Exhibit 10.29 therein)
10.47*	Employment Agreement dated as of October 4, 2007, among State Auto Financial Corporation, State Auto Property and Casualty Insurance Company, State Automobile Mutual Insurance Company and Mark A. Blackburn	Form 10-Q Quarterly Report for the period ended September 30, 2007 (see Exhibit 10.69 therein)
10.48*	Amended and Restated Executive Agreement dated as of October 4, 2007, among State Auto Financial Corporation, State Automobile Mutual Insurance Company and Mark A. Blackburn	Form 10-Q Quarterly Report for the period ended September 30, 2007 (see Exhibit 10.70 therein)
10.49*	Employment Agreement made as of May 10, 2007, and effective as of January 1, 2007, among BroadStreet Capital Partners, Inc., State Auto Financial Corporation, State Auto Property and Casualty Insurance Company, State Automobile Mutual Insurance Company and Richard L. Miley	Form 10-Q Quarterly Report for the period ended June 30, 2007 (see Exhibit 10.68 therein)
10.50*	Retention Agreement dated as of February 9, 2004, between State Auto Property & Casualty Insurance Company and Steven E. English	Form 10-Q Quarterly Report for the period ended March 31, 2007 (see Exhibit 10.61 therein)
10.51*	Retention Agreement dated as of May 3, 2004, between State Auto Property & Casualty Insurance Company and Steven R. Hazelbaker	Form 10-Q Quarterly Report for the period ended March 31, 2007 (see Exhibit 10.62 therein)

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Exhibit No.	Description of Exhibit	If incorporated by reference document with which Exhibit was previously filed with SEC
10.52*	Amended and Restated Equity Incentive Compensation Plan of State Auto Financial Corporation	Form 10-Q Quarterly Report for the period ended June 30, 2005 (see Exhibit 10.60 therein)
10.53*	Restricted Share Award Agreement under the Amended and Restated Equity Incentive Compensation Plan dated as of March 2, 2006 between State Auto Financial Corporation and Robert P. Restrepo, Jr.	Form 10-K Annual Report for the year ended December 31, 2005 (see Exhibit 10.49 therein)
10.54*	Restricted Stock Agreement under the Amended and Restated Equity Incentive Compensation Plan dated as of October 4, 2007, between State Auto Financial Corporation and Mark A. Blackburn	Form 10-Q Quarterly Report for the period ended September 30, 2007 (see Exhibit 10.71 therein)
10.55*	Form of Non-Qualified Stock Option Agreement under the Amended and Restated Equity Incentive Compensation Plan of State Auto Financial Corporation	Form 10-Q Quarterly Report for the period ended June 30, 2005 (see Exhibit 10.62 therein)
10.56*	Non-Qualified Stock Option Agreement under the Amended and Restated Equity Incentive Compensation Plan of State Auto Financial Corporation dated March 2, 2006 between State Auto Financial Corporation and Robert P. Restrepo, Jr.	Form 10-K Annual Report for the year ended December 31, 2005 (see Exhibit 10.51 therein)
10.57*	Form of Incentive Stock Option Agreement under the Amended and Restated Equity Incentive Compensation Plan of State Auto Financial Corporation	Form 10-Q Quarterly Report for the period ended June 30, 2005 (see Exhibit 10.63 therein)
10.58*	Outside Directors Restricted Share Unit Plan of State Auto Financial Corporation	Form 10-Q Quarterly Report for the period ended June 30, 2005 (see Exhibit 10.61 therein)
10.59*	First Amendment to the Outside Directors Restricted Share Unit Plan of State Auto Financial Corporation	Form 10-K Annual Report for the year ended December 31, 2005 (see Exhibit 10.54 therein)
10.60*	Form of Restricted Share Unit Agreement for the Outside Directors Restricted Share Unit Plan of State Auto Financial Corporation	Form 10-Q Quarterly Report for the period ended June 30, 2005 (see Exhibit 10.64 therein)
10.61*	Form of Designation of Beneficiary for the Outside Directors Restricted Share Unit Plan of State Auto Financial Corporation	Form 10-Q Quarterly Report for the period ended June 30, 2005 (see Exhibit 10.65 therein)
10.62*	Amended and Restated SERP of State Auto Mutual effective as of January 1, 1994	Form 10-K Annual Report for the year ended December 31, 1997 (see Exhibit 10(HH) therein)
10.63*	State Auto Financial Corporation Supplemental Executive Retirement Plan, effective January 1, 2007	Form 10-Q Quarterly Report for the period ended September 30, 2007 (see Exhibit 10.72 therein)

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Exhibit No.	Description of Exhibit	If incorporated by reference document with which Exhibit was previously filed with SEC
10.64*	Form of Designation of Distribution Election for the State Auto Financial Corporation Supplemental Executive Retirement Plan	Form 10-Q Quarterly Report for the period ended September 30, 2007 (see Exhibit 10.73 therein)
10.65*	State Auto Insurance Companies Amended and Restated Directors Deferred Compensation Plan (amended and restated as of March 1, 2001)	Form 10-K Annual Report for the year ended December 31, 2005 (see Exhibit 10.58 therein)
10.66*	First Amendment to the state Auto Insurance Companies Amended and restated Directors Deferred Compensation Plan (amendment effective as of December 1, 2005)	Form 10-K Annual Report for the year ended December 31, 2005 (see Exhibit 10.59 therein)
10.67*	Agreement of Assignment and Assumption dated as of March 1, 2001, among State Auto Financial Corporation, State Automobile Mutual Insurance Company, State Auto Property and Casualty Insurance Company, and Midwest Security Insurance Company (nka State Auto Insurance Company of Wisconsin) regarding the State Auto Insurance Companies Amended and Restated Directors Deferred Compensation Plan	Form 10-K Annual Report for the year ended December 31, 2005 (see Exhibit 10.60 therein)
10.68*	Form of State Auto Insurance Companies Directors Deferred Compensation Agreement	Form 10-K Annual Report for the year ended December 31, 2005 (see Exhibit 10.61 therein)
10.69*	State Auto Property & Casualty Insurance Company s Amended and Restated Incentive Deferred Compensation Plan (amended and restated as of March 1, 2001)	Form 10-K Annual Report for the year ended December 31, 2005 (see Exhibit 10.62 therein)
10.70*	First Amendment to the State Auto Property & Casualty Insurance Company s Amended and Restated Incentive Deferred Compensation Plan (amendment effective as of November 22, 2002)	Form 10-K Annual Report for the year ended December 31, 2005 (see Exhibit 10.63 therein)
10.71*	Agreement of Assignment and Assumption dated as of March 1, 2001, among State Auto Financial Corporation, State Automobile Mutual Insurance Company, and State Auto Property and Casualty Insurance Company regarding the State Auto Property & Casualty Insurance Company s Amended and Restated Incentive Deferred Compensation Plan	Form 10-K Annual Report for the year ended December 31, 2005 (see Exhibit 10.64 therein)
10.72*	Form of State Auto Property & Casualty Insurance Company s Incentive Deferred Compensation Agreement	Form 10-K Annual Report for the year ended December 31, 2005 (see Exhibit 10.65 therein)
10.73*	State Auto Financial Corporation Leadership Bonus Plan	Form 10-Q Quarterly Report for the period ended June 30, 2007 (see Exhibit 10.64 therein)

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Exhibit No.	Description of Exhibit	If incorporated by reference document with which Exhibit was previously filed with SEC
10.74*	State Auto Financial Corporation Long-Term Incentive Plan	Form 10-Q Quarterly Report for the period ended June 30, 2007 (see Exhibit 10.65 therein)
21.01	List of Subsidiaries of State Auto Financial Corporation	Included herein
23.01	Consent of Independent Registered Public Accounting Firm	Included herein
24.01	Powers of Attorney Robert P Restrepo, Jr., David J D Antoni, David R. Meuse, S. Elaine Roberts, Richard K. Smith, Alexander B. Trevor and Paul S. Williams	Form 10-K Annual Report for the year ended December 31, 2007 (see Exhibit 24.01 therein)
24.02	Powers of Attorney Robert E. Baker and Thomas E. Markert	Included herein
31.01	CEO certification required by Section 302 of Sarbanes-Oxley Act of 2002	Included herein
31.02	CFO certification required by Section 302 of Sarbanes-Oxley Act of 2002	Included herein
32.01	CEO certification required by Section 906 of Sarbanes-Oxley Act of 2002	Included herein
32.02	CFO certification required by Section 906 of Sarbanes-Oxley Act of 2002	Included herein

* Constitutes either a management contract or a compensatory plan or arrangement required to be filed as an Exhibit.

(b) EXHIBITS

The exhibits included with this Form 10-K, as indicated in Item 15(a) (3), have been separately filed.

(c) FINANCIAL STATEMENT SCHEDULES

Our financial statement schedules included with this Form 10-K, as indicated in Item 15(a) (2), follow the signatures to this Form 10-K.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

STATE AUTO FINANCIAL CORPORATION

Dated: March 14, 2008

/s/ ROBERT P. RESTREPO, JR.
Robert P. Restrepo, Jr.
Chairman, President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Name	Title	Date
/s/ ROBERT P. RESTREPO, JR. **Robert P. Restrepo, Jr.**	Chairman, President and Chief Executive Officer (principal executive officer)	March 14, 2008
/s/ STEVEN E. ENGLISH **Steven E. English**	Vice President and Chief Financial Officer (principal financial officer)	March 14, 2008
/s/ CYNTHIA A. POWELL **Cynthia A. Powell**	Vice President and Treasurer (principal accounting officer)	March 14, 2008
DAVID J. D ANTONI* **David J. D Antoni**	Director	March 14, 2008
ROBERT E. BAKER* **Robert E. Baker**	Director	March 14, 2008
THOMAS E. MARKERT* **Thomas E. Markert**	Director	March 14, 2008
DAVID R. MEUSE* **David R. Meuse**	Director	March 14, 2008
S. ELAINE ROBERTS* **S. Elaine Roberts**	Director	March 14 2008
RICHARD K. SMITH* **Richard K. Smith**	Director	March 14, 2008

ALEXANDER B. TREVOR*	Director	March 14, 2008
Alexander B. Trevor		
PAUL S. WILLIAMS*	Director	March 14, 2008
Paul S. Williams		

* Steven E. English by signing his name hereto, does sign this document on behalf of the person indicated above pursuant to a Power of Attorney duly executed by such person.

/s/ STEVEN E. ENGLISH	Attorney in Fact	March 14, 2008
Steven E. English		

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

SCHEDULE I - SUMMARY OF INVESTMENTS - OTHER THAN

INVESTMENTS IN RELATED PARTIES

DECEMBER 31, 2007

($ millions)

Type of Investments	Cost [1]	Value	Amount at which shown in the balance sheet
Available-for-Sale			
Fixed maturities:			
Bonds:			
U.S. Treasury securities & obligations	$ 90.9	$ 93.0	$ 93.0
States & political subdivisions	1,432.7	1,452.0	1,452.0
Corporate securities	10.7	11.0	11.0
Mortgage-backed securities of U.S. government agencies	188.6	189.4	189.4
Total fixed maturities	1,722.9	1,745.4	1,745.4
Equity securities:			
Common stocks:			
Consumer	65.2	81.6	81.6
Technologies	24.7	29.9	29.9
Pharmaceuticals	8.5	8.8	8.8
Financial services	35.6	42.8	42.8
Manufacturing & other	76.2	91.1	91.1
Total equity securities	210.2	254.2	254.2
Other Invested Assets	20.1	20.3	20.3
Total Available for Sale	1,953.2	2,019.9	2,019.9
Other invested assets	0.6	1.3	21.6
Total investments	$ 1,953.8	$ 2,021.2	$ 2,021.2

[1] Original cost of equity securities and, as to fixed maturities, original cost reduced by repayments and adjusted for amortization of premiums or accrual of discounts.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

SCHEDULE II CONDENSED FINANCIAL INFORMATION OF REGISTRANT

Condensed Balance Sheets

($ millions)	December 31	
	2007	2006
ASSETS		
Fixed maturities, available for sale, at fair value	**$ -**	1.0
Equity securities, available for sale, at fair value	**0.9**	10.0
Investments in common stock of subsidiaries (equity method)	**1,009.3**	920.9
Other invested assets,	**1.7**	1.5
Cash and cash equivalents	**36.3**	12.3
Other assets	**2.1**	1.9
Current federal income tax	**3.4**	6.3
Net deferred federal income tax	**4.1**	2.0
Total assets	**$ 1,057.8**	955.9
LIABILITIES AND STOCKHOLDERS EQUITY		
Notes payable (affiliates $15.5 and $15.5, respectively)	**118.0**	118.4
Due to affiliates	**1.3**	0.7
Accrued expenses	**3.0**	2.6
Total liabilities	**122.3**	121.7
STOCKHOLDERS EQUITY		
Class A Preferred stock (nonvoting), without par value. Authorized 2.5 shares; none issued	**-**	-
Class B Preferred stock, without par value. Authorized 2.5 shares; none issued	**-**	-
Common stock, without par value. Authorized 100.0 shares; 46.0 and 45.7 issued, respectively, at stated value of $2.50 per share	**115.0**	114.3
Less Treasury Stock, 5.5 and 4.7 shares, respectively, at cost	**(81.0)**	(58.1)
Additional paid-in capital	**98.2**	87.3
Accumulated other comprehensive loss	**(3.3)**	(17.3)
Retained earnings	**806.6**	708.0
Total stockholders equity	**935.5**	834.2
Total liabilities and stockholders equity	**1,057.8**	955.9

See accompanying note to condensed financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

SCHEDULE II CONDENSED FINANCIAL INFORMATION OF REGISTRANT

CONTINUED

Condensed Statements of Income

	Year ended December 31		
($ millions)	**2007**	2006	2005
Net Investment income	**$ 1.4**	1.4	1.1
Net realized gain on investments	**1.5**	0.1	-
Total revenue	**2.9**	1.5	1.1
Interest expense (affiliate $1.5, $1.5, and $2.8, respectively)	**7.6**	7.4	8.8
Other operating expenses	**3.7**	3.2	3.2
Total expenses	**11.3**	10.6	12.0
Loss before federal income taxes	**(8.4)**	(9.1)	(10.9)
Federal income tax benefit	**(4.4)**	(4.8)	(3.3)
Net loss before equity in net income of subsidiaries	**(4.0)**	(4.3)	(7.6)
Equity in net income of subsidiaries	**123.1**	124.7	133.5
Net income	**$ 119.1**	120.4	125.9

See accompanying note to condensed financial statements.

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STATE AUTO FINANCIAL CORPORATION

SCHEDULE II - CONDENSED FINANCIAL INFORMATION OF REGISTRANT

CONTINUED

Condensed Statements of Cash Flows

($ millions)	Year Ended December 31		
	2007	2006	2005
Cash flows from operating activities:			
Net income	**$ 119.1**	120.4	125.9
Adjustments to reconcile net income to net cash used in operating activities:			
Depreciation and amortization, net	**0.2**	(0.2)	0.1
Share-based compensation	**0.3**	0.4	0.6
Net realized gain on investments	**1.3**	(0.1)	-
Equity in net income from consolidated subsidiaries	**(123.1)**	(124.7)	(133.5)
Changes in operating assets and liabilities:			
Accrued expenses and due to affiliates	**0.8**	-	1.0
Other assets	**(0.8)**	0.1	(0.3)
Excess tax benefits on share-based awards	**0.4**	(0.1)	-
Federal income taxes	**(7.3)**	(6.2)	1.9
Net cash used in operating activities	**(9.1)**	(10.4)	(4.3)
Cash flows from investing activities:			
Capitalization of subsidiary	**3.7**	4.4	(1.5)
Dividends received from consolidated subsidiaries	**57.5**	7.1	47.6
Purchase fixed maturities	**(2.0)**	(2.0)	(9.0)
Purchase equity securities	**(0.6)**	(3.9)	(1.9)
Purchase other invested assets	**(0.4)**	(0.1)	-
Maturities of fixed maturities	**3.0**	14.0	2.6
Sale of fixed maturities	**-**	-	3.9
Sale of equity securities	**9.9**	3.2	1.7
Disposal of fixed assets	**-**	-	0.3
Net cash provided by investing activities	**71.1**	22.7	43.7
Cash flows from financing activities:			
Net proceeds from sale of common stock	**4.3**	7.4	4.1
Payments to acquire treasury shares	**(22.1)**	-	-
Repayment of debt	**-**	-	(45.5)
Payment of dividends	**(20.5)**	(15.4)	(8.6)
Excess tax benefits on share-based awards	**0.3**	0.1	-
Net cash used in financing activities	**(38.0)**	(7.9)	(50.0)
Net increase (decrease) in cash and invested cash	**24.0**	4.4	(10.6)
Cash and cash equivalents at beginning of year	**12.3**	7.9	18.5
Cash and cash equivalents at end of year	**$ 36.3**	12.3	7.9

Supplemental Disclosures:

Cash received for federal income taxes	$	**6.3**	5.3	5.1
Cash paid for interest	$	**7.8**	7.7	9.0

Note to condensed financial statements:

In our parent-company-only financial statements, our Company s investment in subsidiaries is stated at cost plus equity in net income from consolidated subsidiaries since the date of acquisition. Our Company s share of net income of its unconsolidated subsidiaries is included in consolidated income using the equity method. Our parent-company-only financial statements should be read in conjunction with our Company s consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

SCHEDULE III - SUPPLEMENTARY INSURANCE INFORMATION

Years Ended December 31, 2007, 2006, and 2005

($ millions)

Segment	Deferred policy acquisition cost(1)	Future benefits, claims and losses(2)	Unearned premiums(1)	Other claims and benefits payable	Premium revenue
Year ended December 31, 2007:					
Personal insurance segment		$ 249.6		-	$ 609.6
Business insurance segment		397.5		-	402.0
Investment operations segment		-			-
Total	$ 105.8	$ 647.1	$ 436.0		$ 1,011.6
Year ended December 31, 2006:					
Personal insurance segment		$ 258.1		-	$ 614.8
Business insurance segment		402.9		-	409.0
Investment operations segment		-			-
Total	$ 104.0	$ 661.0	$ 428.8	-	$ 1,023.8
Year ended December 31, 2005:					
Personal insurance segment		$ 285.5		-	$ 641.0
Business insurance segment		425.9		-	409.3
Investment operations segment		-			-
Total	$ 106.0	$ 711.4	$ 432.9	-	$ 1,050.3

Segment	Net investment income	Benefits, losses and settlement expenses(3)	Amort. of deferred policy acquisition costs(1)	Other operating expenses(1)	Premiums written
Year ended December 31, 2007:					
Personal insurance segment	$ -	$ 378.4			$ 615.1
Business insurance segment	-	207.2			404.7
Investment operations segment	84.7	-	-		-
Total	84.7	$ 585.6	$ 242.7	$ 105.2	$ 1,019.8
Year ended December 31, 2006:					
Personal insurance segment	$ -	$ 389.6			$ 612.8
Business insurance segment	-	192.4			406.7
Investment operations segment	83.1	-	-		-

Total	83.1	$ 582.0	$ 248.1	$ 99.9	$ 1,019.5
Year ended December 31, 2005:					
Personal insurance segment	$ -	$ 383.7			$ 650.9
Business insurance segment	-	230.2			418.6
Investment operations segment	78.7	-	-		-
Total	78.7	$ 613.9	$ 251.8	$ 81.1	$ 1,069.5

(1) Deferred policy acquisition costs, unearned premiums, amortization of deferred policy acquisition costs, and other operating expense are not allocated to a segment for internal reporting purposes.
(2) Segmented balances are net of reinsurance recoverable on losses and loss expenses payable.
(3) Benefits, losses and settlement expense are monitored on a statutory basis.

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STATE AUTO FINANCIAL CORPORATION

SCHEDULE IV - REINSURANCE

Years Ended December 31, 2007, 2006, and 2005

($ million, except percentages)

	Gross Amount	Ceded to Outside Companies	Ceded to Affiliated Companies[1]	Assumed from Outside Companies	Assumed from Affiliated Companies[1]	Net Amount	Percentage of amount assumed to net[2]
Year ended December 31, 2007:							
Property-casualty earned premiums	$ 751.0	$ 18.8	$ 695.7	$ 6.5	$ 968.6	$ 1,011.6	0.6%
Year ended December 31, 2006:							
Property-casualty earned premiums	743.1	17.6	687.8	7.1	979.0	1,023.8	0.7%
Year ended December 31, 2005:							
Property-casualty earned premiums	746.9	16.4	683.4	6.1	997.1	1,050.3	0.6%

(1) These columns include the effect of intercompany pooling.
(2) Calculated as earned premiums assumed from outside companies to net amount.