

The Farmers Automobile Insurance Association

**Report on Audits of Financial Statements -
Statutory Basis**

For the Years Ended December 31, 2010 and 2009

The Farmers Automobile Insurance Association

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Independent Auditor's Report on the Financial Statements

Board of Directors
The Farmers Automobile Insurance Association
Pekin, Illinois

We have audited the accompanying statutory balance sheets of The Farmers Automobile Insurance Association (the "Association") as of December 31, 2010 and 2009, and the related statutory statements of income and changes in policyholders' surplus and cash flow for the years then ended. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audits 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 our audits provide a reasonable basis for our opinion.

As described in Note 1 to the financial statements, the Association prepared these financial statements using accounting practices prescribed or permitted by the Illinois Department of Insurance, which practices differ from U.S. generally accepted accounting principles. The effects on the statutory financial statements of the variances between the statutory basis of accounting and U.S. generally accepted accounting principles have not been determined, but are presumed to be material.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the statutory financial statements referred to above do not present fairly, in conformity with U.S. generally accepted accounting principles, the financial position of the Association as of December 31, 2010 and 2009, or the results of its operations or its cash flow for the years then ended.

In our opinion, the statutory financial statements referred to above present fairly, in all material respects, the financial position of the Association as of December 31, 2010 and 2009, and the results of its operations and its cash flow for the years then ended, on the statutory basis of accounting described in Note 1.

Strohm Ballweg, LLP

Madison, Wisconsin
May 11, 2011

The Farmers Automobile Insurance Association

Statutory Balance Sheets As of December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Admitted Assets:		
Bonds	\$ 575,495,363	\$ 560,368,044
Common stocks:		
Insurance company affiliates	173,263,665	164,067,658
Other than affiliates	25,768,101	22,614,724
Real estate (net of accumulated depreciation of \$8,710,759 and \$8,325,664)	6,356,597	6,702,156
Cash and short-term investments	16,430,672	11,630,948
Securities lending reinvested collateral assets	63,310,267	-
Notes receivable from affiliate	850,000	925,000
Other invested assets	107,607	148,310
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Cash and invested assets	861,582,272	766,456,840
Investment income due and accrued	7,255,312	7,259,602
Uncollected premiums	106,642,294	78,679,159
Net deferred tax asset	19,496,476	17,120,759
EDP equipment (net of accumulated depreciation of \$4,662,881 and \$4,281,504)	1,108,266	1,000,169
Receivable from affiliate and subsidiary	-	1,657,909
Recoverable from reinsurers	2,526,318	679,072
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Total admitted assets	<u>\$ 998,610,938</u>	<u>\$ 872,853,510</u>
Liabilities:		
Unpaid losses	\$ 237,940,808	\$ 229,186,510
Unpaid loss adjustment expenses	56,594,122	55,216,802
Unearned premiums	162,571,517	134,793,416
Commissions, expenses, fees, and taxes	25,574,093	20,434,130
Drafts outstanding	15,044,051	14,854,437
Current federal income taxes	1,783,579	4,579,134
Remittances and items not allocated	1,194,027	1,477,720
Advance premiums	5,821,085	5,753,471
Payable for securities lending	63,310,267	-
Other liabilities	11,006,919	8,322,624
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Total liabilities	<u>580,840,468</u>	<u>474,618,244</u>
Policyholders' surplus:		
Guaranty fund	872,500	872,500
Unassigned surplus	416,897,970	397,362,766
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Total policyholders' surplus	<u>417,770,470</u>	<u>398,235,266</u>
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Total liabilities and policyholders' surplus	<u>\$ 998,610,938</u>	<u>\$ 872,853,510</u>

The accompanying notes are an integral part of the statutory financial statements.

The Farmers Automobile Insurance Association

Statutory Statements of Income and Changes in Policyholders' Surplus For the Years Ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Underwriting income:		
Premiums written	\$ 361,846,887	\$ 327,048,509
Increase in unearned premiums	<u>(27,778,102)</u>	<u>(8,210,337)</u>
Premiums earned	<u>334,068,785</u>	<u>318,838,172</u>
Losses and expenses incurred:		
Losses	223,190,268	213,752,861
Loss adjustment expenses	30,331,510	23,962,999
Underwriting expenses	<u>100,559,594</u>	<u>91,545,633</u>
Total losses and expenses incurred	<u>354,081,372</u>	<u>329,261,493</u>
Underwriting loss	(20,012,587)	(10,423,321)
Net investment income earned	30,143,539	30,719,072
Realized capital gains (losses)	3,143,540	(1,629,842)
Other income	<u>2,199,893</u>	<u>2,066,939</u>
Net income before federal income tax	15,474,385	20,732,848
Federal income tax incurred	<u>6,122,806</u>	<u>7,725,380</u>
Net income	9,351,579	13,007,468
Other changes in policyholders' surplus:		
Change in net unrealized capital gains (losses):		
Insurance company affiliates	4,963,238	1,284,676
Other than affiliates	2,699,753	9,026,265
Change in non-admitted assets	98,525	(877,149)
Change in provision for reinsurance	46,392	(46,392)
Change in net deferred income taxes	<u>2,375,717</u>	<u>186,455</u>
Net change in policyholders' surplus	19,535,204	22,581,323
Policyholders' surplus, beginning of year	<u>398,235,266</u>	<u>375,653,943</u>
Policyholders' surplus, end of year	<u>\$ 417,770,470</u>	<u>\$ 398,235,266</u>

The accompanying notes are an integral part of the statutory financial statements.

The Farmers Automobile Insurance Association

Statutory Statements of Cash Flow For the Years Ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Cash from operations:		
Net premiums collected	\$ 335,314,674	\$ 322,790,151
Net investment income received	31,914,385	32,893,975
Other income received	2,199,894	2,066,939
Total cash received	<u>369,428,953</u>	<u>357,751,065</u>
Benefits and loss related payments	216,283,217	220,831,566
Commissions, expenses paid and other deductions	124,691,095	113,817,998
Federal income taxes paid (recovered)	8,918,361	(2,620,110)
Total cash disbursed	<u>349,892,673</u>	<u>332,029,454</u>
Net cash from operations	<u>19,536,280</u>	<u>25,721,611</u>
Cash from investments:		
Proceeds from investments sold, matured or repaid:		
Bonds	82,092,348	157,358,207
Stocks	17,574,831	23,103,234
Other invested assets	598,934	139,183
Miscellaneous	343,353	45,747
Total investment proceeds	<u>100,609,466</u>	<u>180,646,371</u>
Cost of investments acquired:		
Bonds	95,542,922	176,532,938
Stocks	22,135,518	27,801,293
Real estate	60,011	94,805
Other invested assets	390,000	215,736
Total investments acquired	<u>118,128,451</u>	<u>204,644,772</u>
Net cash from investments	<u>(17,518,985)</u>	<u>(23,998,401)</u>
Cash from financing and miscellaneous sources:		
Other cash provided (applied)	2,782,429	(6,437,849)
Net change in cash and short-term investments	4,799,724	(4,714,639)
Cash and short term-investments at beginning of year	11,630,948	16,345,587
Cash and short-term investments at end of year	<u>\$ 16,430,672</u>	<u>\$ 11,630,948</u>

The accompanying notes are an integral part of the statutory financial statements.

The Farmers Automobile Insurance Association

Notes to Financial Statements – Statutory Basis

1. Nature of Operations and Summary of Significant Accounting Practices

The Farmers Automobile Insurance Association (the “Association”) is a regional Midwest property and casualty insurance company domiciled in the State of Illinois. The Association sells insurance through independent agents. Insurance products primarily include private passenger and commercial automobile, homeowners, workers’ compensation, commercial multi-peril, general liability and business owners’ policies. Approximately 52% and 51% of the direct premium was written in the state of Illinois in 2010 and 2009.

The accompanying financial statements have been prepared principally for filing with regulatory agencies and, as such, are prepared in conformity with accounting practices prescribed or permitted by the Illinois Department of Insurance (statutory accounting practices).

Prescribed statutory accounting practices include the National Association of Insurance Commissioners (NAIC) “*Accounting Practices and Procedures Manual*”, as well as state laws, regulations and general administrative rules. Permitted statutory accounting practices encompass all accounting practices not so prescribed when such practices are approved by the insurance department of the insurer’s state of domicile. The Association does not use any permitted practices.

Accounting Estimates

The preparation of statutory financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Estimates that are particularly susceptible to significant change in the near-term relate to 1) the estimated unpaid losses and loss adjustment expenses, 2) the assumptions regarding the other than temporary impairment analysis of the investment portfolio, 3) the discount rate and other assumptions used to determine the benefit obligations for the defined benefit pension plan and post-retirement plan, and 4) the amount of deferred tax assets expected to be realized in the next fiscal year.

Subsequent Events

Subsequent events were evaluated through May 11, 2011, which is the date the financial statements were available to be issued.

Summary of Significant Differences between Statutory Accounting and GAAP

A description of the significant accounting practices used by the Association and significant variances from accounting principles generally accepted in the United States of America (GAAP) are as follows:

A. Investments

Bonds and stocks are valued in accordance with rules prescribed by the NAIC. Investment grade bonds (i.e., NAIC designation 1 or 2) not backed by other loans are stated at amortized cost using a scientific method. Below investment grade bonds (i.e., NAIC designation 3 or higher) not backed by other loans are stated at lesser of fair value or amortized cost with any change in the carrying value of the bond being treated as an unrealized gain/loss and credited/charged directly to surplus. Common stocks of non-affiliated companies are carried at market value and common stocks of insurance company affiliates are accounted for using the statutory equity method in which undistributed earnings are reported as unrealized gains and losses; under GAAP, the financial statements of wholly owned subsidiaries are consolidated with those of the parent.

The Farmers Automobile Insurance Association

Notes to Financial Statements – Statutory Basis

Loan-backed securities (mortgage-backed and asset-backed) securities are stated at amortized cost using a prospective basis. The prospective approach recognizes, through the recalculation of the effective yield to be applied to future periods, the effects of all cash flows whose amounts differ from those estimated earlier. Changes in amortization and amortized cost will occur in future periods. Assumptions for loan-backed securities are updated on a quarterly basis. Agency pass-through and collateralized mortgage obligations use the three month generic prepayment speed assumption. Non-agency collateralized mortgage obligations and asset-backed securities are updated using projected principal payment windows.

Investment income is recorded when earned. Realized gains and losses on sale or maturity of investments are determined on the basis of specific identification. Aggregate unrealized capital gains and losses are credited or charged directly to unassigned surplus without current income tax effect. Statutory accounting requires that unrealized capital losses on investments that are determined to be other than temporary declines in value must be recognized as realized capital losses. The Association reviews its investment portfolio on a periodic basis to determine other than temporary declines in value. In evaluating whether a decline in value is other than temporary, management considers several factors including, but not limited to, 1) the Association's ability and intent to retain the security for a sufficient amount of time for it to recover, 2) the extent and duration of the decline in value, 3) the probability of collecting all cash flows according to contractual terms in effect at acquisition or restructuring, 4) relevant industry conditions and trends, and 5) the financial condition and current and future business prospects of the issuer. The amount of declines deemed other than temporary was \$0 and \$3,444,888 for the years ended December 31, 2010 and 2009, respectively.

In 2010, the NAIC adopted revisions to *Statement of Statutory Accounting Principle No. 91R, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, which changed the way the Association records its securities lending program. Collateral received and reinvested on behalf of the Association under its securities lending contract is now required to be reported on the statutory balance sheet, and a corresponding liability is also established to record the obligation to return the collateral.

Under GAAP, equity securities that have readily determinable fair values and bonds would be classified into three categories: held-to-maturity, trading, and available-for-sale. Held-to-maturity securities would be reported at amortized cost. Trading securities would be reported at fair value, with unrealized gains and losses reported as a separate component of income. Available-for-sale securities would be reported at fair value, with unrealized gains and losses, net of applicable taxes, reported as a separate component of unassigned surplus.

B. Unpaid Losses and Loss Adjustment Expenses

The liabilities for unpaid losses and loss adjustment expenses are based upon management's estimates of reported and unreported losses determined on the basis of claim evaluation and past statistical experience. The Association does not anticipate salvage and subrogation in the estimate of the liabilities for direct unpaid loss and loss adjustment expenses, which is required under GAAP. Reinsurance recoverables related to unpaid losses and loss adjustment expenses are netted with the respective liabilities; under GAAP, these reinsurance recoverables would be shown on a separate gross basis.

The Farmers Automobile Insurance Association

Notes to Financial Statements – Statutory Basis

C. Policy Acquisition Costs

The costs of acquiring premium income are immediately charged against operations, whereas premium income is deferred over the periods covered by the policies. Under GAAP, costs which vary directly with the production of new and renewal business are capitalized and amortized as premium is earned.

D. Pension Plan

Under GAAP, net periodic pension expense would be based on the cost of incremental benefits for employee service during the period, interest on projected benefit obligation, actual return on plan assets and amortization of actuarial gains and losses. The statutory basis of accounting adopts a similar actuarial approach to estimate pension costs; however, costs related to non-vested participants are excluded.

E. Income Taxes

Current income taxes are determined based on taxable income at the statutory federal income tax rate. The Association records deferred income taxes on temporary differences between the financial reporting basis and the tax basis of assets and liabilities based upon enacted federal tax rates. However, limitations are placed on the admissibility of deferred tax assets and all changes in deferred tax assets and liabilities are reported as changes in surplus. Under GAAP, deferred income taxes would be provided for differences between the financial statement and the federal and state tax bases of assets and liabilities and any deferred tax assets would be reduced by a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. Changes in deferred tax assets and liabilities would be reported through operations and/or surplus depending on their characteristics.

F. Special Surplus Funds

The guaranty fund is an appropriation of unassigned surplus established to meet Wisconsin statutory requirements.

G. Non-Admitted Assets

Certain assets designated as non-admitted assets, aggregating \$7,673,974 and \$7,772,499 at December 31, 2010 and 2009, respectively, are not recognized by statutory accounting practices. These assets are excluded from the balance sheet, and the net change in such assets is charged or credited directly to unassigned surplus. Non-admitted deferred tax assets are not included in the amounts above. The change in the non-admitted deferred tax asset is charged or credited directly to unassigned surplus through the change in net deferred income taxes. Under GAAP, such assets would be recognized at the lower of cost or net realizable value.

The Farmers Automobile Insurance Association

Notes to Financial Statements – Statutory Basis

H. Premium Income Recognition

Premiums are earned over the terms of the related insurance policies and reinsurance contracts on a daily pro rata basis. Unearned premium reserves are established to cover the unexpired portion of premiums written and are computed on a pro rata basis. The Association determined that a premium deficiency reserve was not necessary for the years ended December 31, 2010 and 2009. The Association does not anticipate investment income as a factor in the calculation of a potential premium deficiency reserve.

I. Cash and Short-Term Investments

For purposes of reporting cash flows, the Association follows statutory accounting practices and considers cash in checking accounts, certain money market funds, and highly liquid debt instruments purchased with an original maturity of one year or less to be cash and short-term investments.

J. Other

Real estate consists of home office properties. Depreciation of real estate and other admitted and non-admitted assets is computed using the straight-line method over the estimated useful or class life.

Under statutory accounting practices, the Statements of Cash Flow reconcile cash and short-term investments with original maturities of one year or less. Under GAAP, the Statements of Cash Flow reconcile the corresponding captions of cash and cash equivalents with original maturity periods of three months or less.

Commissions on reinsurance ceded are credited to income at the time the premium is ceded; under GAAP, commissions on ceded premium would be deferred and recognized as income over the periods covered by the policies.

Statutory financial statements are presented in a form using language and groupings substantially the same as the annual statement of the Association filed with the NAIC and state regulatory authorities which differ from the presentation and disclosure of financial statements presented under GAAP.

Necessary reclassifications are made in prior period financial statements, whenever appropriate, to conform to the current presentation.

The Farmers Automobile Insurance Association

Notes to Financial Statements – Statutory Basis

2. Affiliated Entity Transactions

The Association and its wholly-owned subsidiary, Pekin Insurance Company, owned 74.38% and 71.81% of Pekin Life Insurance Company (PLIC) at December 31, 2010 and 2009, respectively. Specifically, the Association owned 66.80% and 64.23% of PLIC as of these dates.

The Association and Pekin Insurance Company occupy the same building, and, along with PLIC, utilize many common facilities, management, administrative and office personnel, and services. Since 1966, the Association and Pekin Insurance Company have had a reinsurance pooling agreement under which underwriting income and expense and other administrative expenses are prorated to the Association (80%) and to Pekin Insurance Company (20%). The proration does not include provisions for federal income taxes or results of investment transactions. In addition, the Association and PLIC allocate related expenses to one another. Intercompany balances are paid periodically throughout the year based on estimates and settled within 45 days after year-end based on actual allocated expenses. Such net expenses allocated to PLIC, and therefore not included in the accompanying statements of income, were \$5,601,717 in 2010 and \$5,454,412 in 2009.

In connection with structured settlements, the Association purchased twenty-one annuities from PLIC in 2010 and twenty annuities in 2009, of which the Association's claimant is the payee, but for which the Association is contingently liable. The single premium for these annuities totaled \$1,132,612 and \$661,440 in 2010 and 2009, respectively. The reserve carried by PLIC at December 31, 2010 and 2009, is \$3,580,356 and \$2,698,374, respectively.

3. Bonds and Common Stocks

The admitted value, unrealized gain and loss, and market value of investments in bonds as of December 31, 2010, are as follows:

Obligation	2010			
	Admitted Value	Unrealized Gain	Unrealized Loss	Market Value
U. S. Government	\$ 2,071,116	\$ 79,744	\$ -	\$ 2,150,860
Other Government	4,510,615	127,485	86,818	4,551,282
U.S. States, Territories and Possessions	17,906,661	1,314,966	-	19,221,627
U.S. Political Subdivisions of States and Territories	52,174,456	2,550,541	633,869	54,091,128
U.S. Special Revenue and Special Assessment	117,741,956	5,848,563	302,831	123,287,688
Industrial and Miscellaneous	261,301,276	16,660,964	1,067,496	276,894,744
Loan-Backed Securities	119,789,283	6,487,269	61,137	126,215,415
Total	<u>\$ 575,495,363</u>	<u>\$ 33,069,532</u>	<u>\$ 2,152,151</u>	<u>\$ 606,412,744</u>

The Farmers Automobile Insurance Association

Notes to Financial Statements – Statutory Basis

The admitted value, unrealized gain and loss, and market value of investments in bonds as of December 31, 2009 are as follows:

Obligation	2009			
	Admitted Value	Unrealized Gain	Unrealized Loss	Market Value
U. S. Government	\$ 3,198,239	\$ 186,053	\$ 15,622	\$ 3,368,670
Other Government	2,191,180	44,303	8,966	2,226,517
U.S. States, Territories and Possessions	19,109,381	1,368,087	-	20,477,468
U.S. Political Subdivisions of States and Territories	56,707,708	3,021,487	466,833	59,262,362
U.S. Special Revenue and Special Assessment	129,854,010	5,951,307	300,609	135,504,708
Industrial and Miscellaneous	222,840,449	9,209,814	1,105,299	230,944,964
Loan-Backed Securities	126,467,077	4,983,626	278,045	131,172,658
Total	<u>\$ 560,368,044</u>	<u>\$ 24,764,677</u>	<u>\$ 2,175,374</u>	<u>\$ 582,957,347</u>

The admitted value and market value of bonds at December 31, 2010, by contractual maturity, are shown below.

	Admitted Value	Market Value
Due in one year or less	\$ 6,001,881	\$ 6,165,210
Due after one year through five years	105,706,837	110,916,379
Due after five years through ten years	272,302,391	288,448,524
Due after ten years	71,694,971	74,667,216
Total	455,706,080	480,197,329
Loan-backed securities	119,789,283 *	126,215,415
Total	<u>\$ 575,495,363</u>	<u>\$ 606,412,744</u>

* The admitted value of loan-backed securities includes \$3,150,277 and \$3,929,283 of U.S. Government guaranteed securities for 2010 and 2009, respectively.

The Association does not engage in direct subprime residential mortgage lending. The Association's minimal exposure to subprime lending is limited to investments within the fixed maturity investment portfolio which contain securities collateralized by mortgages that have characteristics of subprime lending such as adjustable rate mortgages and alternative documentation mortgages. These investments are in the form of asset-backed securities collateralized by subprime mortgages and collateralized mortgage obligations backed by alternative documentation mortgages. The total carrying value of these investments is \$298,131 and \$314,384 as of December 31, 2010 and 2009, respectively, comprising 0.05% and 0.06% of the Association's total bond portfolio.

The Farmers Automobile Insurance Association

Notes to Financial Statements – Statutory Basis

Securities with unrealized losses based on market values at December 31, 2010 are shown below:

<u>Description of Securities</u>	<u>Less Than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Market Value</u>	<u>Unrealized Losses</u>	<u>Market Value</u>	<u>Unrealized Losses</u>	<u>Market Value</u>	<u>Unrealized Losses</u>
Other Government	\$ 1,897,520	\$ 86,818	\$ -	\$ -	\$ 1,897,520	\$ 86,818
U.S. Political Subdivisions of States and Territories	2,457,505	50,479	3,020,428	583,390	5,477,933	633,869
U.S. Special Revenue and Special Assessment	4,861,230	81,836	15,858,435	220,995	20,719,665	302,831
Industrial and Miscellaneous	32,852,575	925,042	7,480,326	142,454	40,332,901	1,067,496
Loan-Backed Securities	5,547,276	56,032	293,026	5,105	5,840,302	61,137
Subtotal Debt Securities	47,616,106	1,200,207	26,652,215	951,944	74,268,321	2,152,151
Common Stock - Unaffiliated	2,162,579	139,161	1,794,925	312,264	3,957,504	451,425
Total Securities With Unrealized Losses	<u>\$ 49,778,685</u>	<u>\$ 1,339,368</u>	<u>\$ 28,447,140</u>	<u>\$ 1,264,208</u>	<u>\$ 78,225,825</u>	<u>\$ 2,603,576</u>

Securities with unrealized losses based on market values at December 31, 2009 are shown below:

<u>Description of Securities</u>	<u>Less Than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Market Value</u>	<u>Unrealized Losses</u>	<u>Market Value</u>	<u>Unrealized Losses</u>	<u>Market Value</u>	<u>Unrealized Losses</u>
U. S. Government	\$ 538,595	\$ 15,622	\$ -	\$ -	\$ 538,595	\$ 15,622
Other Government	736,972	8,966	-	-	736,972	8,966
U.S. Political Subdivisions of States and Territories	-	-	4,146,536	466,833	4,146,536	466,833
U.S. Special Revenue and Special Assessment	441,067	81	22,860,155	300,528	23,301,222	300,609
Industrial and Miscellaneous	55,328,618	930,689	6,831,250	174,610	62,159,868	1,105,299
Loan-Backed Securities	20,262,623	202,587	3,199,245	75,458	23,461,868	278,045
Subtotal Debt Securities	77,307,875	1,157,945	37,037,186	1,017,429	114,345,061	2,175,374
Common Stock - Unaffiliated	4,937,887	453,146	1,084,991	107,508	6,022,878	560,654
Total Securities With Unrealized Losses	<u>\$ 82,245,762</u>	<u>\$ 1,611,091</u>	<u>\$ 38,122,177</u>	<u>\$ 1,124,937</u>	<u>\$ 120,367,939</u>	<u>\$ 2,736,028</u>

The Farmers Automobile Insurance Association

Notes to Financial Statements – Statutory Basis

Proceeds from sales of bonds, excluding calls and maturities, during 2010 and 2009 were \$35,904,236 and \$122,513,620, respectively. Gross gains of \$2,041,299 and \$5,251,580 and gross losses of \$55,811 and \$1,274,741 were realized on those sales, respectively.

Bonds carried at \$2,071,116 and \$2,088,566 at December 31, 2010 and 2009, respectively, were on deposit with the Illinois Department of Insurance as required by law. Bonds in the amount of \$100,000 were on deposit with the Arizona Department of Insurance at December 31, 2010 as required by law.

The adjusted cost, unrealized gain and loss, and statement value of investments in common stock as of December 31, 2010 are as follows:

Common Stocks	2010			
	Adjusted Cost	Unrealized Gain	Unrealized Loss	Statement Value
Other Than Affiliates	\$ 21,274,765	\$ 4,944,761	\$ 451,425	\$ 25,768,101
Insurance Company Affiliates	56,814,314	116,449,351	-	173,263,665
Total	<u>\$ 78,089,079</u>	<u>\$ 121,394,112</u>	<u>\$ 451,425</u>	<u>\$ 199,031,766</u>

The adjusted cost, unrealized gain and loss, and statement value of investments in common stock as of December 31, 2009 are as follows:

Common Stocks	2009			
	Adjusted Cost	Unrealized Gain	Unrealized Loss	Statement Value
Other Than Affiliates	\$ 20,686,494	\$ 2,488,884	\$ 560,654	\$ 22,614,724
Insurance Company Affiliates	52,581,545	111,486,113	-	164,067,658
Total	<u>\$ 73,268,039</u>	<u>\$ 113,974,997</u>	<u>\$ 560,654</u>	<u>\$ 186,682,382</u>

The Association lends securities to agreed upon borrowers through an agreement with its custodian. The Association's policy is to require initial collateral from the borrower in an amount not less than 102 percent and 105 percent of the fair value of the domestic and foreign securities loaned at the outset of the contract as collateral. All collateral so received is held either in the physical custody of the custodian or for the account of the custodian by their agent or a central bank. The offsetting collateral liability is included in Payable for Securities Lending. At December 31, 2010 and 2009, the amount of securities loaned was \$61,991,508 and \$42,315,657, respectively, and the related collateral was \$63,310,267 and \$43,501,952. At December 31, 2010, collateral assets valued at \$9,110,347 had maturity dates beyond one year. The aggregate amount of cash collateral received as of December 31, 2010 is shown below by maturity date.

Maturity Date	Fair Value
Open	\$ 14,991,871
30 Days or less	10,522,166
31 to 60 Days	11,003,324
61 to 90 Days	5,659,938
Greater than 90 days	<u>21,132,968</u>
Total Collateral Received	<u>\$ 63,310,267</u>

The Farmers Automobile Insurance Association

Notes to Financial Statements – Statutory Basis

The aggregate amount of cash collateral reinvested as of December 31, 2010 is shown below by maturity date.

	<u>Amortized Cost</u>	<u>Fair Value</u>
30 Days or less	\$ 24,138,237	\$ 24,138,135
31 to 60 Days	9,050,757	9,051,123
61 to 90 Days	3,301,537	3,301,487
91 to 120 Days	1,448,826	1,448,785
121 to 180 Days	1,648,238	1,648,186
181 to 365 Days	9,385,305	9,384,425
1 to 2 Years	6,964,624	6,964,638
2 to 3 Years	2,027,419	2,025,636
Greater than 3 years	<u>5,498,515</u>	<u>5,451,435</u>
Total Collateral Reinvested	<u>\$ 63,463,458</u>	<u>\$ 63,413,850</u>

4. Fair Value Measurement

Statutory Accounting Practices establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets (level one measurements) and the lowest priority to unobservable inputs (level three measurements). The three levels of the fair value hierarchy under Statutory accounting are described below:

Level 1 – Inputs to the valuation methodology are unadjusted quoted prices for identical assets in active markets that the Association has the ability to access.

Level 2 – Inputs to the valuation methodology include quoted prices for similar assets in active markets; quoted prices for identical or similar assets in inactive markets; inputs other than quoted prices that are observable; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.

The fair values of the Level 2 securities are obtained from independent pricing services or from the Association's investment manager and are determined using quoted market prices from an orderly market at the reporting date for those or similar investments.

Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The following table sets forth by level, within the fair value hierarchy, the Association's assets at fair value as of December 31, 2010.

<u>Description</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Common Stock	\$ 23,723,454	\$ 1,727,987	\$ 316,660	\$ 25,768,101

The Association did not have any liabilities measured at fair value at December 31, 2010.

The Farmers Automobile Insurance Association

Notes to Financial Statements – Statutory Basis

The fair value measurements in Level 3 of the fair value hierarchy are shown below as of December 31, 2010.

	<u>Balance at 1/1/2010</u>	<u>Total gains/ (losses) included in Surplus</u>	<u>Balance at 12/31/2010</u>
Common Stock	\$ 432,427	\$ (115,767)	\$ 316,660

5. Liability for Loss and Loss Adjustment Expense Reserves

Activity in the liability for loss and loss adjustment expense reserves is summarized as follows:

	<u>2010</u>	<u>2009</u>
Balance at January 1	\$ 295,553,840	\$ 306,191,834
Less reinsurance recoverable	<u>(11,150,528)</u>	<u>(10,776,806)</u>
Net balance at January 1	<u>284,403,312</u>	<u>295,415,028</u>
Incurred related to:		
Current year	288,223,641	273,481,485
Prior years	<u>(34,701,863)</u>	<u>(35,765,625)</u>
Total incurred	<u>253,521,778</u>	<u>237,715,860</u>
Paid related to:		
Current year	153,899,188	152,130,285
Prior years	<u>89,490,972</u>	<u>96,597,291</u>
Total paid	<u>243,390,160</u>	<u>248,727,576</u>
Net balance at December 31	<u>294,534,930</u>	<u>284,403,312</u>
Plus reinsurance recoverable	<u>14,235,567</u>	<u>11,150,528</u>
Balance at December 31	<u>\$ 308,770,497</u>	<u>\$ 295,553,840</u>

As a result of actual claim payments varying from previous estimates of insured events and subsequent reserve changes, the provision for loss and loss adjustment expenses decreased by \$34,701,863 and \$35,765,625 in 2010 and 2009, respectively. The decrease in incurred loss and loss adjustment expenses in 2010 and 2009 is primarily attributable to favorable development of automobile liability, general liability, and homeowners estimated loss and loss adjustment expense reserves.

The Farmers Automobile Insurance Association

Notes to Financial Statements – Statutory Basis

6. Reinsurance

The Association has reinsurance treaties in place for its property and casualty insurance business to reduce exposure to large losses. Although reinsurance does not relieve the Association of its legal liability to its policyholders, it provides a measure of protection against catastrophic losses and provides a means of risk reduction on individual losses. In order to maintain an appropriate balance between the cost of reinsurance and surplus growth, the Association periodically evaluates its retention levels correlated to specific types of property and casualty insurance policies.

The Association is also a party to an intercompany pooling agreement with Pekin Insurance Company. All direct business written by the Company is subject to the intercompany pool. An immaterial portion of business is ceded to third parties. Under this agreement, underwriting income and expenses and other administrative expenses are prorated to the Association (80%) and to Pekin Insurance Company (20%).

	<u>Assumed Reinsurance</u>		<u>Ceded Reinsurance</u>		<u>Net</u>	
	<u>Premium Reserve</u>	<u>Commission Equity</u>	<u>Premium Reserve</u>	<u>Commission Equity</u>	<u>Premium Reserve</u>	<u>Commission Equity</u>
At December 31, 2010						
Intercompany pooling agreement	\$105,313,364	\$ 17,232,576	\$ 40,642,879	\$ 5,884,147	\$ 64,670,485	\$ 11,348,429
All other	365,846	-	4,418,821	237,194	(4,052,975)	(237,194)
	<u>\$105,679,210</u>	<u>\$ 17,232,576</u>	<u>\$ 45,061,700</u>	<u>\$ 6,121,341</u>	<u>\$ 60,617,510</u>	<u>\$ 11,111,235</u>
At December 31, 2009						
Intercompany pooling agreement	\$ 94,587,625	\$ 15,444,943	\$ 33,698,354	\$ 4,898,260	\$ 60,889,271	\$ 10,546,683
All other	445,100	-	3,887,988	206,909	(3,442,888)	(206,909)
	<u>\$ 95,032,725</u>	<u>\$ 15,444,943</u>	<u>\$ 37,586,342</u>	<u>\$ 5,105,169</u>	<u>\$ 57,446,383</u>	<u>\$ 10,339,774</u>

The direct unearned premium reserve was \$101,954,007 and \$77,347,033 at December 31, 2010 and 2009, respectively. Commission equity is computed as the maximum amount of return commission which would be due to the reinsurer if all reinsurance contracts were cancelled at year-end.

7. Pension Plan, Post-Retirement Benefits, and Deferred Compensation

Retirement Benefits

The Association and its affiliates participate in a trustee non-contributory defined benefit pension plan. This plan covers full-time employees who have completed one year of service and have reached the age of 21. The Association's funding policy is to contribute annually an amount that represents the current cost of the benefits expected to be earned in the current year offset by the expected asset return higher than the discount rate, but no more than the maximum amount that can be deducted for federal income tax purposes. Each affiliate is charged for its applicable share of such contributions based on a percentage of the projected benefit obligation.

The Farmers Automobile Insurance Association

Notes to Financial Statements – Statutory Basis

401(k) Savings Plan

The Association and its affiliates participate in a voluntary 401(k) savings plan for eligible participants. The participation requirements are the same as the defined benefit plan mentioned above. The Association may elect, at its sole discretion, to contribute a matching contribution to the savings plan. The Association elected to match 25 percent of each employee's contribution up to a maximum match of \$400 in 2010 and 2009. Employer contributions of \$115,643 and \$110,748 respectively, were made to this plan in 2010 and 2009. At December 31, 2010 and 2009, the fair value of plan assets was \$22,497,930 and \$18,439,510, respectively.

Post-Retirement Benefits

In addition to providing pension benefits, the Association and its affiliates provide certain health care and life insurance benefits (post-retirement benefits) for retired employees. Substantially all employees may become eligible for these benefits if they reach retirement age while working for the Association.

Net post-retirement benefit cost includes the expected cost of such benefits for newly-eligible or vested employees, interest cost, gains and losses arising from differences between actuarial assumptions and actual experience, and amortization of the transition obligation.

The unfunded post-retirement benefit obligation for retirees and other fully eligible or vested plan participants included in loss adjustment expense reserves and accrued expenses was \$2,475,018 and \$3,767,747 respectively, at December 31, 2010 and \$1,882,110 and \$2,718,290, respectively, at December 31, 2009.

Deferred Compensation

The Association maintains a deferred compensation plan for the Directors. This plan allows for voluntary deferral of all or any part of compensation to which a Director might otherwise be entitled to as Directors' fees, in accordance with the plan provisions. During 2010 and 2009, respectively, \$37,000 of Directors' fees were deferred. The liability for Directors' deferred compensation was \$373,607 and \$336,918 at December 31, 2010 and 2009, respectively.

Medicare Act

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) was signed into law. The Act introduced a prescription drug benefit under Medicare in 2006, as well as a federal subsidy to qualifying sponsors of retiree healthcare benefit plans. The assumption for the December 31, 2010 post-retirement valuation is that no Medicare reimbursement is expected. Subsequently, the net post-retirement benefit cost included in these financial statements reflects an expected Medicare reimbursement of \$0 and \$325,815, respectively, in 2010 and 2009. Additionally, the Association's accumulated post-retirement benefit obligation at December 31, 2010 has not been affected by the Act and was reduced in 2009 by \$1,575,678 as a result of the impact of changes in the federal subsidy.

The Farmers Automobile Insurance Association

Notes to Financial Statements – Statutory Basis

Expected Cash Flows

The Association expects to contribute \$3,728,000 to the Pension Plan and \$1,258,000 to the Other Post-Retirement Benefit Plan in 2011.

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

<u>Year</u>	<u>Pension Benefit</u>	<u>Post-Retirement Benefit</u>
2011	\$ 477,141	\$ 1,235,254
2012	740,092	1,387,382
2013	1,097,997	1,444,378
2014	1,440,708	1,663,561
2015	1,864,092	1,739,951
2016 to 2020	16,653,031	9,155,741

Assets, Obligations, and Assumptions

A summary of assets, obligations, and assumptions of the Pension and Other Post-Retirement Benefit Plans of the Association is as follows at December 31:

	<u>Pension Benefits</u>		<u>Post-Retirement Benefits</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
Change in projected benefit obligation:				
Projected benefit obligation at beginning of year	\$ 46,360,169	\$ 39,596,433	\$ 23,187,332	\$ 21,396,477
Net benefits accrued	2,998,834	2,657,091	2,714,783	1,920,264
Interest on prior liability	2,896,265	2,445,798	1,573,469	1,218,379
Amendments	597,130	-	-	-
Actuarial loss (gain)	7,115,878	2,905,347	(1,227,193)	(536,020)
Benefits paid	<u>(2,146,498)</u>	<u>(1,244,500)</u>	<u>(1,085,476)</u>	<u>(811,768)</u>
Projected benefit obligation at end of year	<u>\$ 57,821,778</u>	<u>\$ 46,360,169</u>	<u>\$ 25,162,915</u>	<u>\$ 23,187,332</u>
Change in plan assets:				
Fair value of plan assets at beginning of year	\$ 31,750,543	\$ 27,567,943	\$ 9,891,164	\$ 9,306,354
Actual return on plan assets	4,075,188	2,756,377	1,014,374	522,307
Employer contribution	3,528,450	2,670,723	1,183,350	874,271
Benefits paid	<u>(2,146,498)</u>	<u>(1,244,500)</u>	<u>(732,851)</u>	<u>(811,768)</u>
Fair value of plan assets at end of year	<u>\$ 37,207,683</u>	<u>\$ 31,750,543</u>	<u>\$ 11,356,037</u>	<u>\$ 9,891,164</u>

A measurement date of September 30, 2010 was used to determine the plan assets and benefit obligations for the pension and other post-retirement plan.

The vested projected benefit obligation of the Association in relation to the total obligation of the Association and its affiliates (excluding inactive participants) is the basis for allocating the plan assets. The net periodic benefit cost of the Pension Plan is allocated to the Association based on the same method as the plan assets. The net periodic benefit cost of the Other Post-Retirement Benefit Plan is measured on a seriatim basis that projects future benefit costs participant by participant based on demographic characteristics. The projected costs are discounted to a present value.

The Farmers Automobile Insurance Association

Notes to Financial Statements – Statutory Basis

A summary of the funded status and net periodic benefit cost of the Pension and Other Post-Retirement Benefit Plans for the Association is as follows for the years ended December 31:

	Pension Benefits		Post-Retirement Benefits	
	2010	2009	2010	2009
Funded status:				
Unamortized prior service cost	\$ 43,941	\$ 56,555	\$ -	\$ -
Unrecognized net loss	13,650,503	8,915,778	4,661,655	5,940,179
Remaining net obligation at initial date of application	592,309	658,494	-	-
Accrued liabilities	2,095,686	1,573,427	6,383,847	4,713,525
Accumulated benefit obligation for vested employees	41,157,300	26,441,284	25,162,915	18,549,866
Benefit obligation for non-vested employees:				
Projected pension obligation	383,884	539,620	-	-
Accumulated benefit obligation	-	-	24,427,322	20,443,882
Components of net periodic benefit cost:				
Service cost	2,222,035	2,034,353	2,171,826	1,536,211
Interest cost	2,146,035	1,970,999	1,258,774	974,703
Actual return on plan assets	(382,016)	(1,447,431)	(811,499)	(470,820)
Amortization of unrecognized transition obligation	66,185	67,191	-	-
Amortization of unrecognized prior service cost	13,005	13,203	-	-
Amortization of net loss from earlier period	382,159	418,324	280,000	283,802
Net asset (loss) deferred for later recognition	(1,352,163)	-	-	-
Total net periodic benefit cost	\$ 3,095,240	\$ 3,056,639	\$ 2,899,101	\$ 2,323,896

The Farmers Automobile Insurance Association

Notes to Financial Statements – Statutory Basis

Weighted average assumptions used to determine the projected benefit obligation at December 31:

	Pension Benefits		Post-Retirement Benefits	
	2010	2009	2010	2009
Discount rate	5.66%	5.95%	5.66%	5.95%
Rate of compensation increase	6.01%	6.01%	N/A	N/A

Weighted average assumptions used to determine net periodic benefit cost for the years ended December 31:

	Pension Benefits		Post-Retirement Benefits	
	2010	2009	2010	2009
Discount rate	5.95%	6.15%	5.95%	6.15%
Rate of compensation increase	6.01%	6.01%	N/A	N/A
Expected long-term rate of return on plan assets	6.50%	6.50%	6.50%	6.50%

The healthcare portion of the post-retirement benefit plan is contributory, with participants' contributions adjusted annually as determined by the Association; the life insurance portion of the post-retirement benefit plan is non-contributory. The healthcare cost trend rate in 2010 was assumed to be 7.0 percent for three years, graded to 6.0 percent for three years, then graded to 5.0 percent thereafter. In 2009 the healthcare cost trend rate was 7.7 percent, graded to 5.6 percent over six years.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed healthcare trend rates would have the following effects:

	One Percentage Point Increase	One Percentage Point Decrease
Effect on total of service and interest cost components	\$ 336,421	\$ (276,897)
Effect on post-retirement benefit obligation	\$ 2,543,139	\$ (2,139,835)

The retirement plan assets are held in a deposit administration contract and equity securities. The Trustees of the Farmers Automobile Insurance Association Retirement Plan maintain a deposit administration contract with Pekin Life Insurance Company for pension benefits. The fund is a group annuity contract consisting of employer contributions with guaranteed interest, less annuities purchased to provide benefit payments to retirees and lump sum benefits paid directly to participants. The fair value of the account included in plan assets of the Association and its affiliates was \$26,481,222 and \$24,875,803 as of December 31, 2010 and 2009, respectively, or 53 and 58 percent of total plan assets. Equity securities comprise the remaining plan assets. At December 31, 2010 and 2009, equity securities amounted to \$23,138,935 and \$18,313,837, respectively, or 47 and 42 percent of total plan assets.

The Farmers Automobile Insurance Association

Notes to Financial Statements – Statutory Basis

The expected long-term rate of return on plan assets was selected based upon current market conditions, Association experience, and future Association expectations.

The specific goal of the investment portfolio is to maintain a fully funded plan over time to ensure the benefit for the plan participants. New contributions are invested in equity securities until the amount in equities exceeds 45 percent of the plan's total assets. Additional amounts will be paid into the deposit administration fund, unless the equity portfolio falls under 45 percent. If the equity portfolio exceeds 60 percent of the plan's assets, part of the equity portfolio will be liquidated and proceeds moved into the deposit administration fund within a reasonable time frame. There are three return objectives. The primary benchmark is the projected annual rate of return used by the plan's actuary. The average annualized investment performance of the invested assets, net of investment related expenses, should be equal to or in excess of this benchmark. The secondary (equity) benchmark is the percent total rate of return of a balanced portfolio comprised of a 70 percent weighting of the Standard & Poor's 500 Index and a 30 percent weighting of the Barclay's Government Corporate Index. The secondary (fixed income) benchmark is the weighted average rate of return of the Association's mortgage-backed securities portfolio less .75 percent for expenses (.25 percent) and spread (.50 percent). All plan assets in excess of those funds targeted for short-term cash flow needs should be invested in a manner consistent with the basic principles of prudent long-term portfolio management. Derivatives, private placement securities, and commodity contracts are prohibited investment vehicles. The Trustees of the plan recognize the long-term nature of the majority of the plan's assets.

The Association's retirement plan maintains a contract to partially fund health benefits provided to certain retirees and their eligible dependents through a deposit administration contract with Pekin Life Insurance Company. The permissible contract funding was determined in accordance with generally recognized and accepted actuarial principles and practices which are consistent with the Actuarial Standards of Practice. At December 31, 2010 and 2009, the fair value of the account was \$14,027,524 and \$12,778,222 respectively. Contributions of \$1,500,000 and \$1,132,622 were made in 2010 and 2009, respectively, into this deposit administration fund. The Association's share of the contribution was \$946,680 and \$699,417, in 2010 and 2009, respectively.

8. Income Taxes

The components of the net deferred tax asset at December 31 are as follows:

	<u>2010</u>	<u>2009</u>
Deferred tax assets (gross)	\$ 33,294,470	\$ 28,191,448
Deferred tax liabilities	(2,719,283)	(1,785,628)
Deferred tax assets non-admitted	<u>(11,078,711)</u>	<u>(9,285,061)</u>
Net deferred tax asset	<u>\$ 19,496,476</u>	<u>\$ 17,120,759</u>
Increase (decrease) in deferred tax assets non-admitted	<u>\$ 1,793,650</u>	<u>\$ (3,850,709)</u>

The Farmers Automobile Insurance Association

Notes to Financial Statements – Statutory Basis

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities are as follows:

	<u>December 31,</u> <u>2010</u>	<u>December 31,</u> <u>2009</u>	<u>Change</u>
Deferred tax assets:			
Unpaid losses and loss adjustment expenses	\$ 7,410,058	\$ 7,307,643	\$ 102,415
Unearned premium	11,054,863	9,165,952	1,888,911
Accrued salvage and subrogation	4,842,404	4,542,116	300,288
Capital loss carry forward	4,957,756	-	4,957,756
Nonadmitted assets	2,609,151	2,641,539	(32,388)
Other items	<u>2,420,238</u>	<u>4,534,198</u>	<u>(2,113,960)</u>
Gross deferred tax assets	33,294,470	28,191,448	5,103,022
Nonadmitted deferred tax assets	<u>(11,078,711)</u>	<u>(9,285,061)</u>	<u>(1,793,650)</u>
Admitted deferred tax assets	<u>22,215,759</u>	<u>18,906,387</u>	<u>3,309,372</u>
Deferred tax liabilities:			
Unrealized capital gain - Pekin Life Insurance Company	1,328,682	1,552,094	(223,412)
Unrealized capital gains - Common stocks	1,212,354	55,287	1,157,067
Other items	<u>178,247</u>	<u>178,247</u>	<u>-</u>
Total deferred tax liabilities	<u>2,719,283</u>	<u>1,785,628</u>	<u>933,655</u>
Net admitted deferred tax asset	<u>\$ 19,496,476</u>	<u>\$ 17,120,759</u>	<u>\$ 2,375,717</u>

The Association did not elect to admit additional deferred tax assets under the provisions of Paragraph 10.e. of NAIC *Statement of Statutory Accounting Principles No. 10R* in either 2010 or 2009.

The Farmers Automobile Insurance Association

Notes to Financial Statements – Statutory Basis

Current law governing the taxation of property and casualty insurance companies requires substantial adjustments to statutory net income in arriving at taxable income. The effective tax rate differs from the federal income tax rate of 34.6 percent in 2010 and 35 percent in 2009 due to the following differences between statutory and tax valuations of assets and liabilities:

	<u>2010</u>	<u>2009</u>
Federal income tax	\$ 5,354,038	\$ 7,256,497
Tax exempt interest	(2,277,578)	(3,043,902)
Capital gains	(1,087,645)	570,445
Dividends received deduction	(707,320)	(827,927)
Conditional reserve	529,479	563,555
Adjustment for prior year under accrual	1,642,751	2,481,565
Unearned premium	1,922,209	574,724
Loss reserve discounting	206,212	(398,720)
Salvage and subrogation	332,154	336,000
Bonus depreciation	(343,815)	8,155
Pension benefits	180,698	392,713
Alternative minimum tax credit carryforward utilized	-	(606,323)
All others	371,623	418,598
Federal income tax expense	<u>\$ 6,122,806</u>	<u>\$ 7,725,380</u>

Federal income tax incurred of \$6,122,806 includes tax of \$0 on realized capital gains. Federal income taxes which would be available for recoupment in the event of future tax losses are \$3,950,550 and \$4,948,999 for 2010 and 2009, respectively. At December 31, 2010, the Association had net taxable income of \$11,417,988. There are capital losses of \$14,534,380 to be carried forward to offset future capital gains.

Federal income tax returns of the Association have been examined by the Internal Revenue Service for all years through 2008. In the opinion of management, the liability for federal income taxes is sufficient to cover computed taxes for the current and prior years that are currently payable. As of December 31, 2010, the Association accrued \$3,569,479 for potential tax contingencies as an income tax liability on the statutory balance sheet and \$125,924 is recognized as income taxes incurred on the statutory statement of income. State income tax expense of \$1,882,823 and \$1,961,886 in 2010 and 2009, respectively, is included in underwriting expenses.

9. Structured Settlements

The Association has purchased annuities of which the claimant is payee, but for which the Association is contingently liable. The aggregate amount of annuities from all life insurers was \$5,799,668 and \$4,941,880 at December 31, 2010 and 2009, respectively.

SUPPLEMENTAL FINANCIAL INFORMATION



Independent Auditor's Report on the Supplementary Information

To the Board of Directors
The Farmers Automobile Insurance Association
Pekin, Illinois

Our audits were made for the purpose of forming an opinion on the statutory financial statements taken as a whole. The supplementary information is presented for purposes of additional analysis and is not a required part of the statutory financial statements. This information is presented in a format consistent with the Annual Statement filed by the Association with the regulatory authorities. Such information has been subjected to the auditing procedures applied in the audits of the statutory financial statements and, in our opinion, is fairly stated in all material respects in relation to the statutory financial statements taken as a whole.

Strohm Ballweg, LLP

May 11, 2011

The Farmers Automobile Insurance Association

Summary Investment Schedule December 31, 2010

	Gross Investment Holdings		Admitted Assets as Reported in the Annual Statement	
	Amount	Percentage	Amount	Percentage
1. Bonds:				
1.1 U.S. treasury securities	\$ 2,071,116	0.2	\$ 2,071,116	0.2
1.2 U.S. government agency obligations (excluding mortgage-backed securities):				
1.21 Issued by U.S. government agencies				
1.22 Issued by U.S. government sponsored agencies				
1.3 Foreign government (including Canada, excluding mortgage-backed securities)	4,510,615	0.5	4,510,615	0.5
1.4 Securities issued by states, territories, and possessions and political subdivisions in the U.S.:				
1.41 States, territories and possessions general obligations	17,906,660	2.1	17,906,660	2.1
1.42 Political subdivisions of states, territories and possessions and political subdivisions general obligations	52,174,457	6.0	52,174,457	6.0
1.43 Revenue and assessment obligations	117,741,956	13.7	117,741,956	13.7
1.44 Industrial development and similar obligations				
1.5 Mortgage-backed securities (includes residential and commercial MBS):				
1.51 Pass-through securities:				
1.511 Issued or guaranteed by GNMA	3,150,274	0.4	3,150,274	0.4
1.512 Issued or guaranteed by FNMA and FHLMC	79,900,668	9.3	79,900,668	9.3
1.513 All Other				
1.52 CMO's and REMIC's				
1.521 Issued or guaranteed by GNMA FNMA FHLMC or VA	5,647,875	0.7	5,647,875	0.7
1.522 Issued by non-U.S. Government issuers and collateralized by mortgage-backed securities issued or guaranteed by agencies shown in Line 1.521				
1.523 All Other	31,090,463	3.6	31,090,463	3.6
2. Other debt and other fixed income securities (excluding short-term):				
2.1 Unaffiliated domestic securities (includes credit tenant loans rated by the SVO)	203,531,010	23.6	203,531,010	23.6
2.2 Unaffiliated foreign securities	57,770,268	6.7	57,770,268	6.7
2.3 Affiliated securities				
3. Equity interests:				
3.1 Investments in mutual funds				
3.2 Preferred stocks				
3.3 Publicly traded equity securities (excluding preferred stocks):				
3.31 Affiliated				
3.32 Unaffiliated	23,736,909	2.7	23,736,909	2.7
3.4 Other equity securities:				
3.41 Affiliated	173,263,665	20.1	173,263,665	20.1
3.42 Unaffiliated	2,031,192	0.2	2,031,192	0.2
3.5 Other equity interests including tangible personal property under lease				
4. Mortgage loans: None				
5. Real estate investments:				
5.1 Property occupied by company	4,909,054	0.6	4,909,054	0.6
5.2 Property held for production of income (including \$ _____ of property acquired in satisfaction of debt)	1,447,543	0.2	1,447,543	0.2
6. Contract loans: None				
7. Receivables for securities: None				
8. Cash, cash equivalents and short-term investments	16,430,672	1.9	16,430,672	1.9
9. Securities lending reinvested collateral assets	63,310,267	7.3	63,310,267	7.3
10. Other invested assets	1,124,274	0.2	957,608	0.2
11. Total invested assets	<u>\$ 861,748,938</u>	<u>100.0</u>	<u>\$ 861,582,272</u>	<u>100.0</u>

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1. Reporting entity's total admitted assets as reported on Page 2 of this annual statement. \$ 998,610,938

2. Ten largest exposures to a single issuer/borrower/investment:

1	2	3	4
<u>Issuer</u>	<u>Description of Exposure</u>	<u>Amount</u>	<u>Percentage of Total Admitted Assets</u>
2.01 Pekin Insurance Company	Affiliated Common Stock	\$ 97,819,637	9.8 %
2.02 Pekin Life Insurance Company	Affiliated Common Stock	75,443,028	7.6 %
2.03 Fannie Mae	Bond	56,698,166	5.7 %
2.04 Freddie Mac	Bond	28,850,378	2.9 %
2.05 JPMCC 2002-CIB5 A2	Bond	8,000,294	0.8 %
2.06 Detroit Mich City Sch Dist	Bond	5,667,035	0.6 %
2.07 MSDWC 2001-Top5 A4	Bond	5,327,955	0.5 %
2.08 LBUBS 2002-C7 A4	Bond	5,015,552	0.5 %
2.09 University N C Sys Pool Rev	Bond	4,505,505	0.5 %
2.10 Cleveland Ohio	Bond	4,396,327	0.4 %

3. Amounts and percentages of the reporting entity's total admitted assets held in bonds and preferred stocks by NAIC rating.

	<u>Bonds</u>	<u>1</u>	<u>2</u>	<u>Preferred Stocks</u>	<u>3</u>	<u>4</u>
3.01 NAIC-1	\$ 513,668,076	51.4 %	3.07 P/RP-1	\$	%	
3.02 NAIC-2	\$ 65,398,115	6.5 %	3.08 P/RP-2	\$	%	
3.03 NAIC-3	\$ -	0.0 %	3.09 P/RP-3	\$	%	
3.04 NAIC-4	\$ -	0 %	3.10 P/RP-4	\$	%	
3.05 NAIC-5	\$ -	0 %	3.11 P/RP-5	\$	%	
3.06 NAIC-6	\$ -	0 %	3.12 P/RP-6	\$	%	

4. Assets held in foreign investments:

4.01	Are assets held in foreign investments less than 2.5% of the reporting entity's total :	Yes []	No [X]
4.02	Total admitted assets held in foreign investments	\$ 59,924,381	6.0 %
4.03	Foreign-currency-denominated investments	\$	
4.04	Insurance liabilities denominated in that same foreign currency	\$	

If response to 4.01 above is yes, responses are not required for interrogatories 5 - 10.

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5. Aggregate foreign investment exposure categorized by NAIC sovereign rating:		1	2
5.01	Countries rated NAIC-1	\$ 48,583,164	4.9 %
5.02	Countries rated NAIC-2	11,307,902	1.1 %
5.03	Countries rated NAIC-3 or below	33,315	0.0 %

6. Largest foreign investment exposures by country, categorized by the country's NAIC sovereign rating:		1	2
	Countries rated NAIC-1:		
6.01	Country 1: Australia	\$ 12,469,059	1.2 %
6.02	Country 2: United Kingdom	11,962,800	1.2 %
	Countries rated NAIC-2:		
6.03	Country 1: Mexico	7,059,300	0.7 %
6.04	Country 2: Ireland	2,141,117	0.2 %
	Countries rated NAIC-3 or below:		
6.05	Country 1: Argentina	33,315	0.0 %
6.06	Country 2:	-	0.0 %
		1	2

7. Aggregate unhedged foreign currency exposure: None. \$ %

8. Aggregate unhedged foreign currency exposure categorized by NAIC sovereign rating: None.

9. Largest unhedged foreign currency exposures by country, categorized by the country's NAIC sovereign rating: None.

10. Ten largest non-sovereign (i.e. non-governmental) foreign issues:

1	2	3	4
Issuer	NAIC Rating	Amount	Percentage of Total Admitted Assets
10.01	BP Capital Markets PLC	\$ 2,541,713	0.3 %
10.02	Abbey Natl Treasury Serv	2,499,547	0.3 %
10.03	Telefonos De Mexico SAB	2,494,153	0.2 %
10.04	Barrick PD AU Fin PTY LT	2,477,948	0.2 %
10.05	Macquarie Group Ltd	2,022,081	0.2 %
10.06	Statoil ASA	2,020,696	0.2 %
10.07	Santander US Debt SA Uni	2,016,069	0.2 %
10.08	Svenska Handelsbanken AB	1,998,578	0.2 %
10.09	Westpac Banking Corp	1,998,417	0.2 %
10.10	Deutsche Bank AG London	1,997,024	0.2 %

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11. Amounts and percentages of the reporting entity's total admitted assets held in Canadian investments and unhedged Canadian currency exposure:

11.01 Assets held in Canadian investments less than 2.5% of the reporting entity's total admitted assets, therefore detail not required for interrogatory 11. Yes No

12. Report aggregate amounts and percentages of the reporting entity's total admitted assets held in investments with contractual sales restrictions:

12.01 Assets held in investments with contractual sales restrictions less than 2.5% of the reporting entity's total admitted assets, therefore detail not required for interrogatory 12. Yes No

13. Amounts and percentages of admitted assets held in the ten largest equity interests:

13.01 Are assets held in equity interests less than 2.5% of the reporting entity's total admitted assets? Yes No

1	2	3
Name of Issuer	Amount	Percentage of Total Admitted Assets
13.02 Pekin Insurance Company	\$ 97,819,637	9.8 %
13.03 Pekin Life Insurance Company	75,443,028	7.6 %
13.04 Apple Inc	518,676	0.1 %
13.05 IVANS	315,624	0.0 %
13.06 Cognizant Tech Solutions-A	306,572	0.0 %
13.07 US Bancorp	261,609	0.0 %
13.08 Cit Group Inc	260,463	0.0 %
13.09 Hasbro Inc	254,253	0.0 %
13.10 Proctor & Gamble Co	242,395	0.0 %
13.11 Schlumberger Ltd	239,979	0.0 %

14. Amounts and percentages of the reporting entity's total admitted assets held in nonaffiliated, privately placed equities:

14.01 Assets held in nonaffiliated, privately placed equities less than 2.5% of the reporting entity's total admitted assets, therefore detail not required for interrogatory 14. Yes No

15. Amounts and percentages of the reporting entity's total admitted assets held in general partnership interests:

15.01 Assets held in general partnership interests less than 2.5% of the reporting entity's total admitted assets, therefore detail not required for interrogatory 15. Yes No

16. Amounts and percentages of the reporting entity's total admitted assets held in mortgage loans:

16.01 Mortgage loans reported in Schedule B less than 2.5% of the reporting entity's total admitted assets, therefore detail not required for interrogatories 16 and 17. Yes No

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Investment Risks Interrogatories December 31, 2010

17. Aggregate mortgage loans having the following loan-to-value ratios as determined from the most current appraisal as of the annual statement date: None.

18. Amounts and percentages of the reporting entity's total admitted assets held in each of the five largest investments in real estate:

18.01 Assets held in real estate reported less than 2.5% of the reporting entity's total admitted assets, therefore detail not required for interrogatory 18. Yes [X] No []

19. Report aggregate amounts and percentages of the reporting entity's total admitted assets held in investments held in mezzanine real estate loans:

19.01 Assets held in investments held in mezzanine real estate loans less than 2.5% of the reporting entity's total admitted assets, therefore detail not required for interrogatory 19. Yes [X] No []

20. Amounts and percentages of the reporting entity's total admitted assets subject to the following types of agreements:

	At Year-End		(Unaudited) 1st Qtr	At End of Each Quarter (Unaudited)		(Unaudited) 3rd Qtr
	1	2	3	4	5	
20.01 Securities lending agreements (do not include assets held as collateral for such transactions)	\$ 61,991,508	6.2 %	\$ 61,493,177	\$ 55,121,408	\$ 51,652,876	
20.02 Repurchase agreements	\$	%	\$	\$	\$	
20.03 Reverse repurchase agreements	\$	%	\$	\$	\$	
20.04 Dollar repurchase agreements	\$	%	\$	\$	\$	
20.05 Dollar reverse repurchase agreements	\$	%	\$	\$	\$	

21. Amounts and percentages of the reporting entity's total admitted assets for warrants not attached to other financial instruments, options, caps, and floors: None.

22. Amounts and percentages of the reporting entity's total admitted assets of potential exposure for collars, swaps, and forwards: None.

23. Amounts and percentages of the reporting entity's total admitted assets of potential exposure for futures contracts: None.

The Farmers Automobile Insurance Association

Reinsurance Interrogatories December 31, 2010

7.1 Has this reporting entity reinsured any risk with any other entity under a quota share reinsurance contract that includes a provision that would limit the reinsurer's losses below the stated quota share percentage (e.g., a deductible, a loss ratio corridor, a loss ratio cap, an aggregate limit or any similar provisions)? Yes [] No [X]

9.1 Has the reporting entity ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement: (i) it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contract(s) contain one or more of the following features or other features that would have similar results:

- a. A contract term longer than two years and the contract is noncancellable by the reporting entity during the contract term;
- b. A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;
- c. Aggregate stop loss reinsurance coverage;
- d. A unilateral right by either party (or both parties) to commute the reinsurance contract, whether conditional or not, except for such provisions which are only triggered by a decline in the credit status of the other party;
- e. A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or
- f. Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity. Yes [] No [X]

9.2 Has the reporting entity during the period covered by the statement ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates), for which, during the period covered by the statement, it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; excluding cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member where:

- a. The written premium ceded to the reinsurer by the reporting entity or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or
- b. Twenty-five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates in a separate reinsurance contract.

Yes [] No [X]

9.3 If yes to 9.1 or 9.2, please provide the following information in the Reinsurance Summary Supplemental Filing for General Interrogatory 9:

- a. The aggregate financial statement impact gross of all such ceded reinsurance contracts on the balance sheet and statement of income;
- b. A summary of the reinsurance contract terms and indicate whether it applies to the contracts meeting the criteria in 9.1 or 9.2; and
- c. A brief discussion of management's principle objectives in entering into the reinsurance contract including the economic purpose to be achieved.

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Reinsurance Interrogatories December 31, 2010

9.4 Except for transactions meeting the requirements of paragraph 31 of SSAP No. 62, Property and Casualty Reinsurance, has the reporting entity ceded any risk under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:

- a. Accounted for that contract as reinsurance (either prospective or retroactive) under statutory accounting principles ("SAP") and as a deposit under generally accepted accounting principles ("GAAP"); or
- b. Accounted for that contract as reinsurance under GAAP and as a deposit under SAP? Yes [] No [X]