

State Auto Financial CORP
Form DEF 14A
March 30, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the

Securities Exchange Act of 1934

(Amendment No. __)

Filed by the Registrant Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement

Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

Definitive Proxy Statement

Definitive Additional Materials

Soliciting Material Pursuant to §240.14a-12

STATE AUTO FINANCIAL CORPORATION

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

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(2) Form, Schedule or Registration Statement No.:

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(4) Date Filed:

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STATE AUTO FINANCIAL CORPORATION
NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

To the Shareholders of

STATE AUTO FINANCIAL CORPORATION:

Notice is hereby given that the Annual Meeting of Shareholders of State Auto Financial Corporation (the Company) will be held at the Company's principal executive offices located at 518 East Broad Street, Columbus, Ohio, on May 4, 2007, at 10:00 a.m., local time, for the following purposes:

1. To elect three Class I directors, each to hold office for a three-year term and until a successor is elected and qualified;
2. To consider and vote upon a proposal to amend the Company's 1991 Employee Stock Purchase and Dividend Reinvestment Plan and Trust to increase the number of shares available to be purchased under the Plan;
3. To consider and vote upon a proposal to approve the material terms of the Company's Leadership Bonus Plan;
4. To consider and vote upon a proposal to approve the material terms of the Company's Long-Term Incentive Plan;
5. To ratify the selection of Ernst & Young LLP as the Company's independent registered public accounting firm for 2007; and
6. To transact such other business as may properly come before the meeting or any adjournment thereof.

The close of business on March 9, 2007, has been fixed as the record date for the determination of shareholders entitled to notice of and to vote at the meeting and any adjournment thereof.

In order that your shares may be represented at this meeting and to assure a quorum, please indicate your voting instructions by telephone, via the Internet or by signing and returning the enclosed proxy promptly. Instructions for indicating your voting instructions by telephone or via the Internet are included on the enclosed proxy. A return addressed envelope, which requires no postage, is enclosed if you choose to submit your voting instructions by mail. In the event you are able to attend and wish to vote in person, at your request we will cancel your proxy.

By Order of the Board of Directors

ROBERT P. RESTREPO, JR.

Chairman, President and CEO

Dated: March 30, 2007

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STATE AUTO FINANCIAL CORPORATION

PROXY STATEMENT

GENERAL

This Proxy Statement is furnished in connection with the solicitation of proxies by the Board of Directors of State Auto Financial Corporation (the Company) to be used at its Annual Meeting of Shareholders to be held May 4, 2007 (the Annual Meeting). Shares represented by properly executed proxies will be voted at the Annual Meeting in accordance with the choices indicated on the proxy. A proxy may be revoked at any time, insofar as it has not been exercised, by delivery to the Company of a subsequently dated proxy or by giving notice of revocation to the Company in writing or in open meeting. A shareholder's presence at the Annual Meeting does not by itself revoke the proxy.

The mailing address of the principal executive offices of the Company is 518 East Broad Street, Columbus, Ohio 43215. The approximate date on which this Proxy Statement and the form of proxy are first being sent or given to shareholders is March 30, 2007.

PROXIES AND VOTING

The close of business on March 9, 2007, has been fixed as the record date for the determination of shareholders entitled to notice of and to vote at the Annual Meeting and any adjournment thereof. On the record date there were outstanding and entitled to vote 41,079,773 of the Company's common shares, without par value (the Common Shares). Each Common Share is entitled to one vote.

For Proposal One (election of directors), the nominees receiving the highest number of votes will be elected as the Class I directors. Shareholders do not have the right to cumulate their votes in the election of directors.

For Proposal Two (proposal to amend the Company's 1991 Employee Stock Purchase and Dividend Reinvestment Plan and Trust (the Employee Stock Purchase Plan)) to increase the number of shares available to be purchased under that Plan, the vote required to approve the amendment is the favorable vote of a majority of the outstanding Common Shares.

For Proposal Three (proposal to approve the material terms of the Company's Leadership Bonus Plan (the Leadership Bonus Plan or LBP)), Proposal Four (proposal to approve the material terms of the Company's Long-Term Incentive Plan (the Long-Term Incentive Plan or LTIP)) and Proposal Five (ratification of the selection of Ernst & Young LLP as the Company's independent registered public accounting firm), the vote required to approve such Proposals is the favorable vote of a majority of the outstanding Common Shares that are voted on each such Proposal.

All Common Shares represented by properly executed proxies will be voted at the Annual Meeting in accordance with the choices indicated on the proxy. If no choices are indicated on a proxy, the Common Shares represented by that proxy will be voted as follows: (1) for the election of the nominees listed in this Proxy Statement as Class I directors; (2) for the approval of the amendment to the Employee Stock Purchase Plan; (3) for the approval of the material terms of the Leadership Bonus Plan; (4) for the approval of the material terms of the Long-Term Incentive Plan; and (5) for the ratification of the selection of Ernst & Young LLP as the

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Company's independent registered public accounting firm for 2007. Any proxy may be revoked at any time prior to its exercise by delivering to the Company a subsequently dated proxy or by giving notice of revocation to the Company in writing or in open meeting. A shareholder's presence at the Annual Meeting does not by itself revoke the proxy.

Abstentions will be considered as Common Shares present and entitled to vote at the Annual Meeting and will be counted for purposes of determining whether a quorum is present. Abstentions will not be counted in determining the votes cast for the election of directors and will not have a positive or negative effect on the outcome of the election. Abstentions will be counted as votes cast regarding Proposals Two through Five and will have the same effect as a vote against those Proposals.

If your Common Shares are held in street name, you will need to instruct your broker regarding how to vote your Common Shares. If you do not provide voting instructions to your broker, and if your broker does not have discretion to vote your Common Shares without your instructions, a broker non-vote will occur. Broker non-votes will not be counted in determining the votes cast for the election of directors or with respect to Proposals Three through Five and will not have a positive or negative effect on the outcome of these Proposals. With respect to Proposal Two, because passage of this Proposal requires the favorable vote of a majority of the outstanding Common Shares, broker non-votes will have the same effect as a vote against Proposal Two. State Automobile Mutual Insurance Company (State Auto Mutual), which owns approximately 65% of the outstanding Common Shares, has expressed an intention to vote in favor of each of the Proposals to come before the meeting.

PROPOSAL ONE: ELECTION OF DIRECTORS

Nominees for Class I Directors

The number of directors currently is fixed at nine. Our Board of Directors is divided into three classes, Class I, Class II and Class III, with three directors in each Class. The term of office of directors in one Class expires annually at each annual meeting of shareholders at such time as their successors are elected and qualified. Directors in each Class are elected for three-year terms. The term of office of the Class I directors expires concurrently with the holding of the Annual Meeting, and the current Class I directors are Alexander B. Trevor and Paul W. Huesman. Mr. Huesman will retire from our Board concurrently with the expiration of his term of office at the Annual Meeting. There is currently one vacancy in Class I due to the resignation of John R. Lowther from our Board in November 2006. Mr. Lowther resigned from our Board in connection with the announcement of his pending retirement from the Company in 2007. In March 2007, the Nominating and Governance Committee of our Board recommended that Mr. Trevor, along with Thomas E. Markert and Robert E. Baker, be nominated for election as Class I directors at the Annual Meeting.

At the Annual Meeting, it is the intention of the persons named in the accompanying form of proxy, unless a contrary position is indicated on such proxy, to vote the proxy for the election of the three nominees named in the following table as Class I directors, each to hold office until the 2010 annual meeting of shareholders and until a successor is elected and qualified. Each of the nominees has consented to being named in this Proxy Statement and to serve if elected. In the event that any nominee named in the table as a Class I director is unable to serve (which is not anticipated), the persons named in the proxy may vote it for another nominee of their choice.

Proxies cannot be voted at the Annual Meeting for a greater number of persons than the three nominees named in this Proxy Statement.

Majority Voting Policy for Incumbent Directors

Our Board of Directors has adopted a majority voting policy for incumbent directors (the Majority Voting Policy) which is reflected in our Corporate Governance Guidelines. The Majority Voting Policy provides that if a nominee for director who is an incumbent director does not receive the vote of at least the majority of the votes

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cast at any meeting for the election of directors at which a quorum is present, and no successor has been elected at such meeting, then that incumbent director will promptly tender his or her resignation to the Board of Directors. For purposes of the Majority Voting Policy, a majority of votes cast means that the number of Common Shares voted for a director's election exceeds 50% of the number of votes cast with respect to that director's election or, in the case where the number of nominees exceeds the number of directors to be elected, cast with respect to election of directors generally. Votes cast (i) include votes to withhold authority in each case, and (ii) exclude abstentions with respect to that director's election or, in the case where the number of nominees exceeds the number of directors to be elected, abstentions with respect to election of directors generally.

The Nominating and Governance Committee will make a recommendation to our Board of Directors as to whether to accept or reject the tendered resignation, or whether other action should be taken. Our Board of Directors will act on the tendered resignation, taking into account the Nominating and Governance Committee's recommendation, and publicly disclose (by a press release, a filing with the Securities and Exchange Commission or other broadly disseminated means of communication) its decision regarding the tendered resignation and the rationale behind the decision within 90 days from the date of the certification of the election results. The Nominating and Governance Committee, in making its recommendation, and our Board of Directors, in making its decision, may each consider any factors or other information that the Committee or Board, as the case may be, considers appropriate and relevant. The director who tenders his or her resignation will not participate in the recommendation of the Nominating and Governance Committee or the decision of our Board of Directors with respect to his or her resignation. If such incumbent director's resignation is not accepted by our Board of Directors, such director will continue to serve until the next annual meeting and until his or her successor is duly elected, or his or her earlier resignation or removal. If a director's resignation is accepted by our Board of Directors, then our Board of Directors, in its sole discretion, may fill any resulting vacancy pursuant to the provisions of our Code of Regulations.

Table of Contents**Backgrounds and Beneficial Ownership Information for Nominees and Continuing Directors**

Set forth below is information about each of the Class I director nominees:

Class I Director Nominees

(Terms expiring in 2010)

Name of Director Nominee and Position(s) with Company	Age(1)	Principal Occupation(s) During the Past Five Years	A Director of the Company Since	Common Shares Owned Beneficially as of March 9, 2007(2)(3)(4)	% Of Class
Robert E. Baker Director Nominee	60	President of Puroast Coffee Inc., a maker of specialty coffee products, 10/04 to present; Vice President of Corporate Marketing for ConAgra Foods, Inc., one of North America's largest packaged food companies, 4/99 to 10/04.	N/A	0	*
Thomas E. Markert Director Nominee	49	Global Chief Marketing and Client Service Officer, AC Nielsen, a leading global provider of marketing research and information services company, 1/04 to present; for more than five years prior thereto, Mr. Markert held various executive positions within AC Nielsen.	N/A	0	*
Alexander B. Trevor Director	62	President of Nuvocom Incorporated, a provider of patent litigation support services, 10/96 to present. Mr. Trevor is also a director of Applied Innovation, Inc., a network management solutions company.	2006	0	*

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Set forth below is information about the directors whose terms of office continue after the Annual Meeting:

Class II Directors**(Terms expiring in 2008)**

Name of Director and Position(s) with Company	Age(1)	Principal Occupation(s) During the Past Five Years	A Director of the Company Since	Common Shares Owned Beneficially as of March 9, 2007(2)(3)(4)	% Of Class
David J. D Antoni(5) Director	62	Retired from Ashland, Inc. since 9/04; Senior Vice President and Group Operating Officer, Ashland, Inc., 3/99 to 9/04; President of APAC, Inc., a subsidiary of Ashland, Inc., 7/03 to 1/04; Senior Vice President of Ashland, Inc. and President, Ashland Chemical, a division of Ashland, Inc., 7/88 to 3/99. Ashland, Inc. is a chemical, energy and transportation construction company. Mr. D Antoni is also a director of Omnova Solutions Inc., a producer of decorative and functional surfaces, coatings and specialty chemicals, and Compass Minerals International, Inc., a producer and distributor of inorganic minerals.	1995	56,400	*
David R. Meuse Director	62	Principal of Stonehenge Financial Holdings, Inc., a provider of financial and advisory resources, 8/99 to present. Mr. Meuse is also a director of Diamond Hill Investment Group, Inc., a provider of investment management services and manager of mutual funds and private investment funds.	2006	15,000	*
S. Elaine Roberts Director	54	President and Chief Executive Officer of the Columbus Regional Airport Authority, a public port authority which oversees the operations of Port Columbus, Rickenbacker and Bolton Field airports in Franklin County, Ohio, 01/03 to present; Executive Director of Columbus Airport Authority, 12/00 to 01/03; Executive Director of Rhode Island Airport Corporation, 12/94 to 12/00.	2002	8,400	*

Table of Contents**Class III Directors****(Terms expiring in 2009)**

Name of Director Nominee and Position(s) with Company	Age(1)	Principal Occupation(s) During the Past Five Years	A Director of the Company Since	Common Shares Owned Beneficially as of March 9, 2007(2)(3)(4)	% Of Class
Robert P. Restrepo, Jr.(6) Chairman, President and Chief Executive Officer	56	Chairman of the Board and Chief Executive Officer of the Company, State Auto Property & Casualty Insurance Company (State Auto P&C), Milbank Insurance Company (Milbank), State Auto National Insurance Company (National) and Farmers Casualty Insurance Company (Farmers Casualty), each a wholly owned subsidiary of the Company and of State Automobile Mutual Insurance Company (State Auto Mutual), 2/06 to present; President of the Company, State Auto P&C, Milbank, National, Farmers Casualty, and State Auto Mutual, 3/06 to present; Senior Vice President, Insurance Operations, Main Street American Group, a property and casualty insurance underwriting business, 4/05 to 2/06; President and Chief Executive Officer for two property and casualty insurance subsidiaries of Allmerica Financial Corporation (now known as Hanover Insurance Group), 1998 to 2003.	2006	20,500	*
Richard K. Smith(7) Director	62	Retired as Partner of KPMG, LLP, a public accounting firm, since 6/97; Partner of KPMG, LLP for more than five years prior to 6/97.	1999	18,400	*
Paul S. Williams Director	47	Managing Director with Major, Lindsey & Africa, LLC, an attorney search consulting firm, 4/05 to present; officer of Cardinal Health, Inc., a provider of products and services to healthcare providers and manufacturers, for more than five years prior to 4/05, last serving as that company s Executive Vice President, Chief Legal Officer and Secretary.	2003	4,525	*

* Less than one (1%) percent.

(1) Ages shown are as of the date of the Annual Meeting.

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- (2) Except as indicated in the notes to this table, the persons named in the table have sole voting and investment power with respect to all Common Shares shown as beneficially owned by the named person. With respect to stock options, this table includes only stock options for Common Shares which are currently exercisable or exercisable within 60 days of March 9, 2007.
- (3) The amounts reported include Common Shares attributable to options granted under both the Company's Equity Incentive Compensation Plan for Mr. Restrepo (10,000) and Common Shares attributable to options granted under both the Company's 1991 Directors Stock Option Plan and 2000 Directors Stock Option Plan for Messrs. D. Antoni (15,400), Smith (10,400), Williams (4,200) and Ms. Roberts (7,400).
- (4) The amounts reported for Messrs. D. Antoni, Smith, Williams and Ms. Roberts do not include Restricted Share Units granted under the Outside Directors Restricted Share Unit Plan. See Board of Directors and Board Committees Compensation of Directors and Director Compensation Table for further information regarding this Plan and the number of Restricted Share Units held by these directors.
- (5) Includes 12,000 Common Shares owned by Mr. D. Antoni's spouse, as to which he disclaims beneficial ownership.
- (6) Includes 10,500 Common Shares received by Mr. Restrepo pursuant to the terms of a restricted share agreement entered into in connection with his employment by the Company. All 10,500 of these Common Shares are subject to a risk of forfeiture if Mr. Restrepo's employment is terminated for any reason prior to March 2, 2009 (or if he violates any provision of the restricted share agreement prior to that date). These Common Shares are also subject to restrictions on transfer until March 2, 2009. See Compensation of Executive Officers Contractual Arrangements with Named Executive Officers Robert P. Restrepo, Jr. and Grants of Plan-Based Awards in 2006 for additional information concerning these restricted Common Shares.
- (7) Includes 5,000 Common Shares owned by Mr. Smith's spouse, as to which he disclaims beneficial ownership.

Beneficial Ownership Information for Named Executive Officers and Executive Group

In addition to the Common Shares owned beneficially by Mr. Restrepo, as set forth above, Steven E. English, Mark A. Blackburn, Steven R. Hazelbaker, Richard L. Miley, Cynthia A. Powell and John R. Lowther, who are listed as Named Executive Officers in the Summary Compensation Table on page 40 of this Proxy Statement, beneficially owned the number of Common Shares set forth below as of March 9, 2007(1):

Named Executive Officer	Common Shares Beneficially Owned(2)	Stock Options(3)	Percent of	
			Total Beneficial Ownership of Common Shares	Class
Steven E. English	1,559	9,283	10,842	*
Mark A. Blackburn	7,425	61,698	69,123	*
Steven R. Hazelbaker	4,441	15,317	19,758	*
Richard L. Miley	104,269(4)	87,200(4)	191,469(4)	*
Cynthia A. Powell	7,681	34,600	42,281	*
John R. Lowther	21,693	69,899	91,592(5)	*

As of March 9, 2007, our directors and executive officers as a group (16 persons) beneficially owned 567,681 (1.4%) Common Shares, which included options for 310,498 Common Shares and 10,500 restricted Common Shares which have been issued to Mr. Restrepo subject to a risk of forfeiture. See Compensation of Executive Officers Contractual Arrangements Robert P. Restrepo, Jr. and Grants of Plan-Based Awards in 2006 for additional information concerning these restricted Common Shares.

* Less than one (1%) percent.

- (1) Does not include beneficial ownership information for Robert H. Moone or Steven J. Johnston, who are also listed as Named Executive Officers in the Summary Compensation Table. We no longer have current beneficial ownership information for these persons because their employment with the Company ended on May 31, 2006, in the case of Mr. Moone, and June 19, 2006, in the case of Mr. Johnston.

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- (2) These persons and/or their spouses have sole voting and investment power with respect to all Common Shares beneficially owned by them.
- (3) With respect to stock options, this table includes only stock options for Common Shares which are currently exercisable or exercisable within 60 days of March 9, 2007.
- (4) Includes 16,218 Common Shares and stock options exercisable for 43,600 Common Shares owned by Cathy B. Miley, an executive officer of the Company and Mr. Miley's spouse, as well as 71,600 Common Shares owned jointly with Ms. Miley.
- (5) Includes 2,000 stock options exercisable for Common Shares that Mr. Lowther assigned to trusts for the benefit of his children and 7,011 Common Shares owned by his spouse as to which he disclaims beneficial ownership.

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PROPOSAL TWO: APPROVAL OF AMENDMENT TO EMPLOYEE STOCK PURCHASE PLAN

Proposal

At the Annual Meeting, shareholders will be asked to consider and vote upon a proposal to approve an amendment to the State Auto Financial Corporation 1991 Employee Stock Purchase and Dividend Reinvestment Plan, or Employee Stock Purchase Plan, to increase the number of Common Shares available for purchase under the Employee Stock Purchase Plan from 2,400,000 to 3,400,000. The Board of Directors approved the amendment on March 2, 2007. At the Annual Meeting, unless otherwise indicated, proxies will be voted to approve the amendment to the Employee Stock Purchase Plan.

Reason for Amendment

A total of 2,400,000 Common Shares have been reserved for issuance under the Employee Stock Purchase Plan. As of March 9, 2007, 2,265,225 of these 2,400,000 Common Shares had been purchased under the Employee Stock Purchase Plan. If additional Common Shares are not added to the Employee Stock Purchase Plan, the Plan will cease to function in the near future. Management desires to continue to have this stock purchase plan available because it provides a convenient and low-cost mechanism for employees to acquire or increase a proprietary interest in the Company. For example, in the last two years, employees have purchased 161,468 Common Shares under the Employee Stock Purchase Plan.

Description of the Employee Stock Purchase Plan

The following discussion describes the important aspects of the Employee Stock Purchase Plan. This discussion is intended to be a summary of the material provisions of the Employee Stock Purchase Plan. Because it is a summary, some details that may be important to you are not included. For this reason, the entire Employee Stock Purchase Plan, including the proposed amendment, is attached as Exhibit A to this Proxy Statement. You are encouraged to read the Employee Stock Purchase Plan, including the proposed amendment, in its entirety.

Purpose

The purpose of the Employee Stock Purchase Plan is to provide each employee of the Company or its parent or subsidiaries with an opportunity to acquire or increase a proprietary interest in the Company by enabling such employees to purchase Common Shares through payroll deductions. Because the employee stock purchase feature of the Employee Stock Purchase Plan is intended to qualify as an employee stock purchase plan described in Section 423 of the Internal Revenue Code of 1986, as amended (the Code), eligible employees may purchase Common Shares at a discount to their fair market value, as described below.

Eligibility

All employees of the Company or its parent or subsidiary corporations are eligible to participate in the Employee Stock Purchase Plan. As of February 22, 2007, there were 1,015 employees participating in the Employee Stock Purchase Plan, which represents approximately 50% of the eligible participants.

Stock Purchases; Purchase Price; Reinvestment of Cash Dividends

Employees who desire to participate in the Employee Stock Purchase Plan may do so by making an election prior to either of two annual subscription periods. Participating employees may elect to contribute, by payroll deduction, from one percent to six percent of their base pay toward the purchase of Common Shares. Amounts accumulated in the plan account of each participating employee through the last pay period during a subscription period will be credited to the purchase of Common Shares from the Company. Unless withdrawn by the participant, Common Shares purchased under the plan will be held for the participant by an agent, currently National City Bank.

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The purchase price for Common Shares purchased under the plan is the lesser of 85% of the fair market value of the Common Shares on the last trading day before the subscription period or on the last trading day of the subscription period. The subscription periods are June 1 through November 30 and December 1 through May 31.

Cash dividends received with respect to Common Shares held by the agent for the benefit of participants will be applied by the agent to the purchase of Common Shares in the open market, and Common Shares so purchased are credited to the accounts of the respective participants.

Federal Income Tax Information

The employee stock purchase feature of the Employee Stock Purchase Plan is intended to qualify as an employee stock purchase plan described in Section 423 of the Code. As such, participants will recognize no income for federal income tax purposes upon the grant or exercise of the right to purchase Common Shares. The compensation deducted to purchase Common Shares under the Employee Stock Purchase Plan during a subscription period, however, will be includable in the participant's income.

If a participant disposes of Common Shares purchased under the employee stock purchase feature of the Employee Stock Purchase Plan within two years after the last trading day preceding the subscription period in which such Common Shares were purchased (the Grant Date), the participant must include in ordinary income, as compensation, an amount equal to the excess of the fair market value of the Common Shares on the purchase date over the purchase price paid for such Shares under the Employee Stock Purchase Plan. The employer company will be allowed a deduction in an amount equal to the amount included in the participant's income as compensation. If the participant does not dispose of the Common Shares purchased under the employee stock purchase feature of the Employee Stock Purchase Plan until after the expiration of the two-year holding period described above or if the participant dies while holding the Common Shares acquired under the employee stock purchase feature of the Employee Stock Purchase Plan, the participant must include in income, as compensation, in the taxable year in which disposition or death occurs, an amount equal to the lesser of (i) the excess of the fair market value of the Common Shares at the time of their disposition or death over the purchase price paid for the Common Shares under the plan, or (ii) the excess of the fair market value of the Common Shares on the Grant Date over the option price as of the Grant Date. The basis of the participant in the Common Shares purchased under the employee stock purchase feature of the Employee Stock Purchase Plan will equal the amount paid for the Common Shares plus the amount, if any, included in the participant's income as compensation. Any compensation resulting from the disposition of the Common Shares will be includable in the income of the participant in the participant's taxable year in which the disposition of the Common Shares occurs. The participant's holding period for the Common Shares purchased under the employee stock purchase feature of the plan will commence on the Grant Date. Any gain in excess of the basis will be treated as long-term capital gain if the participant's holding period for the Common Shares is more than one year.

Participants must include in ordinary income any dividends received on the Common Shares held by National City Bank under the Employee Stock Purchase Plan, even though such dividends are invested in Common Shares. The participant's basis in the Common Shares purchased with such dividends will equal the amount paid for such Common Shares and the participant's holding period will commence on the day such Common Shares are purchased.

Table of Contents**2006 Information Pertaining to Named Executive Officers and Other Groups**

The following table sets forth, with respect to each of the persons named in the Summary Compensation Table and certain groups of employees, certain information about Common Shares purchased under the Employee Stock Purchase Plan during 2006(1):

Name	Number of		Net Value of
	Common	Average	Common
	Shares	Per Share	Shares
	Purchased	Purchase	Realized(3)
		Price(2)	
Robert P. Restrepo, Jr.	0	0	0
Chairman, President and Chief Executive Officer			
Steven E. English	370	\$ 27.625	\$ 1,953
Vice President and Chief Financial Officer			
Mark A. Blackburn	606	\$ 27.625	\$ 3,217
Executive Vice President and Chief Operating Officer			
Steven R. Hazelbaker	421	\$ 27.625	\$ 2,231
Vice President			
Richard L. Miley	397	\$ 27.625	\$ 2,104
Vice President			
Cynthia A. Powell	408	\$ 27.625	\$ 2,154
Vice President, Treasurer and Chief Accounting Officer			
John R. Lowther	302	\$ 27.625	\$ 1,472
Acting General Counsel/Senior Advisor			
All executive officers as a group (9 persons)	2,808	\$ 27.625	\$ 14,873
All participants, other than executive officers, as a group (1,006 persons)	74,764	\$ 27.625	\$ 395,738

- (1) Does not include information for Robert H. Moone or Steven J. Johnston, who are also listed as Named Executive Officers in the Summary Compensation Table. We do not have the information included in this table for these persons because their employment with the Company ended on May 31, 2006, in the case of Mr. Moone, and June 19, 2006, in the case of Mr. Johnston.

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- (2) Represents 85% of the average fair market value of the Common Shares on the two Grant Dates in 2006.
- (3) Represents the net value of the Common Shares on the purchase date determined by subtracting the net purchase price from the fair market value of the Common Shares on the purchase date of each subscription period that ended in 2006 and multiplying that amount by the number of shares purchased for each subscription period.

Reasons for Shareholder Approval

The Company's shareholders are being asked to approve the amendment to the Employee Stock Purchase Plan so that the Employee Stock Purchase Plan can continue to meet the requirements of Section 423 of the Code, which will enable eligible employees to continue to purchase Common Shares at a discount from their fair market value. Shareholder approval is also required under the terms of the Employee Stock Purchase Plan.

The favorable vote of a majority of the outstanding Common Shares is required to approve the amendment to the Employee Stock Purchase Plan. The effect of an abstention or broker non-vote is the same as a vote against this proposal.

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE FOR APPROVAL OF THE AMENDMENT TO THE EMPLOYEE STOCK PURCHASE PLAN.

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PROPOSAL THREE: APPROVAL OF MATERIAL TERMS OF LEADERSHIP BONUS PLAN

Proposal

At the Annual Meeting, shareholders will be asked to consider and vote upon a proposal to approve the material terms of the State Auto Financial Corporation Leadership Bonus Plan, or Leadership Bonus Plan or LBP. The Board of Directors approved the terms of the Leadership Bonus Plan on March 2, 2007. At the Annual Meeting, unless otherwise indicated, proxies will be voted to approve the material terms of the Leadership Bonus Plan.

Reason for Leadership Bonus Plan

The Leadership Bonus Plan provides for an annual cash incentive bonus opportunity for the Company's executive officers and other key management employees based upon the achievement of corporate and individual performance goals in relation to the Company's achievement of its annual plan goals. The Board of Directors implemented the Leadership Bonus Plan to advance the interests of the Company and its shareholders by providing employees in leadership positions with an incentive bonus for achieving the strategic objectives of the Company. The Leadership Bonus Plan is also intended to provide for performance-based compensation which will not be subject to the deduction limitations under Section 162(m) of the Code as applicable to covered employees of the Company.

The Leadership Bonus Plan has been designed to take into account certain limits on the ability of a public corporation to claim tax deductions for compensation paid to certain highly compensated executives. Section 162(m) of the Code generally denies a corporate tax deduction for annual compensation exceeding \$1.0 million paid to any person who is considered a covered employee under Section 162(m) of the Code. However, qualified performance-based compensation paid to covered employees is exempt from this limitation. Covered employees are executive officers and other persons listed in a public corporation's summary compensation table. These executive officers and other persons are also known as named executive officers, or NEOs. For the Company, its covered employees, or NEOs, are those persons listed in the Summary Compensation Table found on page 40 of this Proxy Statement. Qualified performance-based compensation is compensation paid based solely upon the achievement of objective performance goals, the material terms of which are approved by the shareholders of the paying corporation.

Description of Leadership Bonus Plan

The following discussion describes the important aspects of the Leadership Bonus Plan. This discussion is intended to be a summary of the material provisions of the Leadership Bonus Plan. Because it is a summary, some details that may be important to you are not included. For this reason, the entire Leadership Bonus Plan is attached as Exhibit B to this Proxy Statement. You are encouraged to read the Leadership Bonus Plan in its entirety.

Purpose

The purposes of the Leadership Bonus Plan are to advance the interests of the Company and its shareholders by providing employees in leadership positions with an incentive bonus for achieving the strategic objectives of the Company, to focus management on key measures that drive superior financial and business performance and that build shareholder value over the long term, to provide compensation opportunities that are externally competitive and internally consistent with the Company's strategic objectives and total reward strategies and to provide bonus opportunities that reward executives, managers and key professionals who are in a position to make significant contributions to the overall success of the Company.

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Administration

The Compensation Committee of the Company's Board of Directors will administer the Leadership Bonus Plan. Among other things, the Compensation Committee will have the authority to select participants in the Leadership Bonus Plan from among the Company's employees who hold executive, management or selected professional positions and who are responsible for or contribute to the management, growth and/or profitability of the business of the Company, one of its subsidiaries or affiliates, or business segments in a material way. The Compensation Committee will also approve the performance goals, bonus amounts and other terms and conditions of awards under the Leadership Bonus Plan (subject to the terms of the Leadership Bonus Plan). The Compensation Committee will also have the authority to establish and amend rules and administrative processes relating to the Leadership Bonus Plan and to make all other determinations necessary and advisable for the administration of the Leadership Bonus Plan. All decisions made by the Compensation Committee pursuant to the Leadership Bonus Plan will be made in the Compensation Committee's sole discretion and will be final and binding.

Eligibility

Employees who hold an executive, management or selected professional position in the Company and who are designated by the Compensation Committee are eligible to be granted awards under the Leadership Bonus Plan. An employee who becomes eligible after the beginning of a performance period may participate on a pro-rated basis for that performance period, as determined by the Compensation Committee in its sole discretion. Participation is based primarily on the leadership position of an employee. As of March 20, 2007, 198 employees were eligible to participate in the Leadership Bonus Plan.

Term of Awards

Awards under the Leadership Bonus Plan will consist of cash amounts payable upon the achievement of specified objective performance goals during a specified performance period. It is anticipated that most performance periods will begin on the first day of the Company's fiscal year and end on the last day of that year. At the beginning of a performance period for a given award, the Compensation Committee will approve the performance goal(s) and the amount of the award, each as recommended by executive management, which will be earned if the performance goal(s) are achieved in full, together with any lesser amount that will be earned if the performance goal(s) are only partially achieved. After the end of the performance period, the Compensation Committee will certify the extent to which the performance goals are achieved and determine the amount of the award that is payable; provided, however, that the Compensation Committee will have the discretion to determine that the actual amount paid with respect to an award will be less than (but not greater than) the amount earned with respect to covered employees.

Performance Goals; Maximum Award

The performance goals for awards will be based upon the achievement of one or more of the following performance measures of the State Auto Group over the performance period: (i) earnings; (ii) return on capital; (iii) revenue; (iv) premiums; (v) net income; (vi) earnings per share; (vii) combined ratio; (viii) loss ratio; (ix) expense ratio; (x) assets; (xi) equity; (xii) cash flow; (xiii) stock price; (xiv) total shareholders' return; (xv) premium growth; and (xvi) corporate surplus growth. Corporate surplus growth is defined in the Leadership Bonus Plan as growth in State Auto Mutual's surplus less the impact of the value of its holdings of the Company. The State Auto Group consists of the Company and its related entities, subsidiaries and affiliates, including State Auto Mutual.

For eligible employees who are not covered employees (i.e., non-NEOs), the performance goals for awards may include one or more individual performance measures over the performance period. Performance measures applicable to covered employees will not include individual performance related to the achievement of

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personal goals unless a separate award is issued specific to such goals. However, any compensation paid to a covered employee with respect to the achievement of personal goals will not be considered performance-based compensation for purposes of Section 162(m) of the Code.

The maximum award that may be paid to any participant for any performance period is \$2.5 million.

Termination of Employment

A participant whose employment terminates during the performance period because of death, disability or upon the attainment of early or normal retirement age (as defined in the Company's defined benefit retirement plan) will receive a bonus equal to 100% of the participant's target bonus, pro-rated based upon the length of time that the participant was employed by the Company during the performance period, unless the Compensation Committee determines otherwise. In addition, a participant whose employment is terminated by the Company (other than for cause) during the fourth quarter of the performance period, will receive a pro rata portion of the award, based upon the length of participation prior to termination, unless the Compensation Committee determines otherwise. A participant whose employment terminates for any other reason before the end of the performance period for an award will not be entitled to any payment with respect to that award.

Amendment and Termination

The Leadership Bonus Plan may be amended, modified, suspended or terminated by the Compensation Committee at any time, but no such amendment, modification, suspension or termination will affect the payment of any award for a performance period that has already ended or increase the amount of any award. No new awards may be granted during any period of suspension of the Leadership Bonus Plan or after its termination.

Reasons for Shareholder Approval

The Company's shareholders are being asked to approve the material terms of the Leadership Bonus Plan so that compensation paid by the Company under the Leadership Bonus Plan to certain of its highly compensated executive officers qualifies as performance-based compensation under Section 162(m) of the Code, which will then permit the Company to claim tax deductions for the payment of this compensation without the limitations imposed by Section 162(m) of the Code.

The favorable vote of a majority of the outstanding Common Shares present in person or by proxy at the Annual Meeting is required to approve the material terms of the Leadership Bonus Plan. The effect of an abstention is the same as a vote against this proposal. Broker non-votes will not have a positive or negative effect on the outcome of this proposal.

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE FOR APPROVAL OF THE MATERIAL TERMS OF THE LEADERSHIP BONUS PLAN.

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PROPOSAL FOUR: APPROVAL OF MATERIAL TERMS OF LONG-TERM INCENTIVE PLAN

Proposal

At the Annual Meeting, shareholders will be asked to consider and vote upon a proposal to approve the material terms of the State Auto Financial Corporation Long-Term Incentive Plan, or LTIP. The Board of Directors approved the terms of the LTIP on March 2, 2007. At the Annual Meeting, unless otherwise indicated, proxies will be voted to approve the material terms of the LTIP.

Reason for the LTIP

The LTIP provides for a long-term cash incentive bonus opportunity for the Company's executive officers and other key management employees, managers and professionals based upon the achievement of corporate performance goals in relation to the Company's performance compared with the Company's peer group of regional property and casualty companies. The Board of Directors implemented the LTIP to advance the interests of the Company and its shareholders by providing employees in leadership positions with an incentive bonus for achieving the long-term operating performance objectives of the Company. The LTIP is also intended to provide for performance-based compensation which will not be subject to the deduction limitations under Section 162(m) of the Code as applicable to covered employees of the Company.

The LTIP has been designed to take into account certain limits on the ability of a public corporation to claim tax deductions for compensation paid to certain highly compensated executives. Section 162(m) of the Code generally denies a corporate tax deduction for annual compensation exceeding \$1.0 million paid to any person who is considered a covered employee under Section 162(m) of the Code. However, qualified performance-based compensation paid to covered employees is exempt from this limitation. Covered employees are executive officers and other persons listed in a public corporation's summary compensation table. These executive officers and other persons are also known as named executive officers, or NEOs. For the Company, its covered employees, or NEOs, are those persons listed in the Summary Compensation Table found on page 40 of this Proxy Statement. Qualified performance-based compensation is compensation paid based solely upon the achievement of objective performance goals, the material terms of which are approved by the shareholders of the paying corporation.

Description of the LTIP

The following discussion describes the important aspects of the LTIP. This discussion is intended to be a summary of the material provisions of the LTIP. Because it is a summary, some details that may be important to you are not included. For this reason, the entire LTIP is attached as Exhibit C to this Proxy Statement. You are encouraged to read the LTIP in its entirety.

Purpose

The purposes of the LTIP are to advance the interests of the Company and its shareholders by providing employees in leadership positions with an incentive bonus that aligns performance and results with the expectations of shareholders and the Company's goals, recognizes and rewards long-term operating performance compared with the Company's peer group of regional property and casualty companies, provides compensation opportunities that are externally competitive and internally consistent with the Company's growth objectives and total compensation strategies and provides award opportunities that reward executives who achieve financial and operating results for the Company that impact the achievement of the Company's goals.

Administration

The Compensation Committee of the Company's Board of Directors will administer the LTIP. Among other things, the Compensation Committee will have the authority to select participants in the LTIP from among the

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Company's employees who hold executive, management or selected professional positions and who are responsible for or contribute to the management, growth and/or profitability of the business of the Company, one of its subsidiaries or affiliates, or business segments in a material way. The Compensation Committee will also approve the performance goals, bonus amounts and other terms and conditions of awards under the LTIP (subject to the terms of the LTIP). The Compensation Committee will also have the authority to establish and amend rules and administrative processes relating to the LTIP and to make all other determinations necessary and advisable for the administration of the LTIP. All decisions made by the Compensation Committee pursuant to the LTIP will be made in the Compensation Committee's sole discretion and will be final and binding.

Eligibility

Employees who hold an executive, management or selected professional position in the Company and who are designated by the Compensation Committee are eligible to be granted awards under the LTIP. An employee who becomes eligible after the beginning of a performance period may participate on a pro-rated basis for that performance period, as determined by the Compensation Committee in its sole discretion. Participation is based primarily on the leadership position of an employee. As of March 20, 2007, 198 employees are eligible to participate in the LTIP.

Term of Awards

Awards under the LTIP will consist of performance award units which represent the right of the participant to receive an amount in cash equal to the value related to the performance award units issued and payable upon the achievement of specified objective performance goals during a specified performance period. It is anticipated that most performance periods will be a three-year rolling period beginning on the date an award is granted and ending on the last day of the third calendar year following the grant. At the beginning of a performance period for a given award, the Compensation Committee will establish the performance goal(s) and the amount of the award, which will be earned if the performance goal(s) are achieved in full, together with any lesser amount that will be earned if the performance goal(s) are only partially achieved. After the end of the performance period, the Compensation Committee will certify the extent to which the performance goals are achieved and determine the amount of the award that is payable; provided, however, that the Compensation Committee will have the discretion to determine that the actual amount paid with respect to an award will be less than (but not greater than) the amount earned.

Performance Goals; Maximum Award

The performance goals for awards will be based upon the achievement of one or more of the following performance measures of the State Auto Group over the performance period: (i) earnings; (ii) return on capital; (iii) revenue; (iv) premiums; (v) net income; (vi) earnings per share; (vii) combined ratio; (viii) loss ratio; (ix) expense ratio; (x) assets; (xi) equity; (xii) cash flow; (xiii) stock price; (xiv) total shareholders' return; and (xv) Company performance as respects the State Auto Group's statutory combined ratio and total revenue growth and the Company's book value per share relative to the same performance measures for a group of peer companies. The State Auto Group consists of the Company and its related entities, subsidiaries and affiliates, including State Auto Mutual.

The maximum award that may be paid to any participant for any performance period is \$2.5 million.

Termination of Employment

A participant whose employment terminates during the performance period because of death or disability will receive a bonus equal to 100% of the participant's target bonus, pro-rated based upon the length of time that the participant was employed by the Company during the performance period, unless the Compensation Committee determines otherwise. A participant whose employment terminates during the performance period

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upon the attainment of early or normal retirement age (as defined in the Company's defined benefit retirement plan) will receive a bonus based on the actual performance results at the end of the performance period, pro-rated based upon the length of time that the participant was employed by the Company during the performance period, unless the Compensation Committee determines otherwise. In addition, a participant whose employment is terminated by the Company (other than for cause) during the performance period, will receive a pro rata portion of the award, based upon the length of participation prior to termination, unless the Compensation Committee determines otherwise. A participant whose employment terminates for any other reason before the end of the performance period for an award will not be entitled to any payment with respect to that award.

Change in Control

In the event of a change in control or potential change in control of the Company (generally defined by reference to the acquisition of a specified percentage of voting power, or a change in the composition of the Board of Directors, or an acquisition of the Company that requires shareholder approval, or a transaction involving the Company or its affiliates that requires shareholder approval and has the effect of causing the Company to cease to be a public company), all participants will become vested in and entitled to their awards calculated based on their individual awards times a fraction, the numerator of which is the number of days from the beginning of the performance period to the date of the change in control or potential change in control and the denominator of which is the total number of days in the performance period. The amount so calculated will be the minimum amount payable as a final award for the performance period in which the change in control or potential change in control occurs.

Amendment and Termination

The LTIP may be amended, modified, suspended or terminated by the Compensation Committee at any time, but no such amendment, modification, suspension or termination will affect the payment of any award for a performance period that has already ended or increase the amount of any award. No new awards may be granted during any period of suspension of the LTIP or after its termination.

Reasons for Shareholder Approval

The Company's shareholders are being asked to approve the material terms of the LTIP so that compensation paid by the Company under the LTIP to certain of its highly compensated executive officers qualifies as performance-based compensation under Section 162(m) of the Code, which will then permit the Company to claim tax deductions for the payment of this compensation without the limitations imposed by Section 162(m) of the Code.

The favorable vote of a majority of the outstanding Common Shares present in person or by proxy at the Annual Meeting is required to approve the material terms of the LTIP. The effect of an abstention is the same as a vote against this proposal. Broker non-votes will not have a positive or negative effect on the outcome of this proposal.

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE FOR APPROVAL OF THE MATERIAL TERMS OF THE LONG-TERM INCENTIVE PLAN.

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PROPOSAL FIVE: RATIFICATION OF SELECTION OF INDEPENDENT PUBLIC ACCOUNTANTS

The Audit Committee of the Company's Board of Directors has selected Ernst & Young LLP as the Company's independent registered public accounting firm for 2007. Although not required, the Board of Directors is submitting the selection of Ernst & Young LLP to the Company's shareholders for ratification. Ernst & Young LLP has served as the Company's independent registered public accounting firm since 1994. The Audit Committee and the Board of Directors believe that the appointment of Ernst & Young LLP for 2007 is appropriate because of the firm's reputation, qualifications and experience.

The favorable vote of a majority of the outstanding Common Shares that are voted on this proposal at the Annual Meeting is required to approve the ratification of the selection of Ernst & Young LLP. The effect of an abstention is the same as a vote against this proposal. Broker non-votes will not have a positive or negative effect on the outcome of this proposal.

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE FOR RATIFICATION OF THE SELECTION OF ERNST & YOUNG LLP AS THE COMPANY'S INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR 2007.

The Audit Committee will reconsider the appointment of Ernst & Young LLP if its selection is not ratified by the Company's shareholders. Even if the selection of Ernst & Young LLP is ratified by shareholders, the Audit Committee, in its discretion, could decide to terminate the engagement of Ernst & Young LLP and to engage another independent registered public accounting firm if the Audit Committee determines such action to be necessary or desirable.

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BOARD OF DIRECTORS AND BOARD COMMITTEES

Board Meetings

Our Board of Directors held 12 meetings during the fiscal year ended December 31, 2006. Each incumbent director attended at least 75% of the meetings of both the Board and the meetings of all committees on which he or she served, with the exception of David J. D. Antoni, who did not attend three of eight Audit Committee meetings, and Alexander B. Trevor, who did not attend one of two Independent Committee meetings. A majority of our directors are independent as defined by the Nasdaq Marketplace Rules. See Corporate Governance Director Independence.

Board Committees and Committee Meetings

Our Board has established an Audit Committee, a Compensation Committee, a Nominating and Governance Committee, an Investment Committee and a standing Independent Committee. All of the members of the Audit, Compensation, Nominating and Governance and Independent Committees are independent as defined by the Nasdaq Marketplace Rules. In addition, all of the members of the Audit Committee are independent as defined by the applicable rules of the Securities and Exchange Commission (the SEC). Our Board has adopted charters for each of the foregoing Committees. The current charters for each of these Committees, along with our Corporate Governance Guidelines, Director Ethical Principles, Employee Code of Business Conduct and Code of Ethics for Senior Financial Officers, are available on our website at www.stfc.com under Corporate Governance (<http://www.stfc.com/corp.gov/index.htm>).

The Audit Committee is charged with several responsibilities, including: (1) appointment, compensation, retention and oversight of the work performed by our independent auditors; (2) reviewing our accounting functions, operations and management; (3) considering the adequacy and effectiveness of our internal controls and internal auditing methods and procedures; (4) meeting and consulting with our independent auditors and with our financial and accounting personnel concerning the foregoing matters; (5) reviewing with our independent auditors the scope of their audit and the results of their examination of our financial statements; (6) participating in the process of administering our Employee Code of Business Conduct and our Director Ethical Principles set forth in our Corporate Governance Guidelines; (7) establishing procedures for receipt, retention and treatment of compliance regarding accounting, internal accounting controls or auditing matters, including procedures for the confidential, anonymous submission by employees of concerns regarding accounting or auditing matters; and (8) approving in advance any other work performed by our independent auditors that they are permitted by law to perform for us. Present members of the Audit Committee are Chairperson Richard K. Smith, David J. D. Antoni, David R. Meuse and Paul S. Williams. Based on a recommendation of the Audit Committee, our Board has designated Richard K. Smith as the Audit Committee Financial Expert. The Audit Committee held eight meetings during 2006.

The Compensation Committee is charged with several responsibilities, including: (1) administering our Amended and Restated Equity Incentive Compensation Plan (the Equity Incentive Compensation Plan), our 1991 Stock Option Plan and our Outside Directors Restricted Share Unit Plan; (2) evaluating and approving the compensation, fringe benefits and perquisites provided to our executive officers and adopting compensation policies applicable to our officers; and (3) evaluating the compensation provided to the members of the Board and its committees. The Compensation Committee will also be charged with administering the Leadership Bonus Plan and LTIP, assuming the material terms of these Plans are approved by shareholders. See Proposal Three: Approval of Material Terms of Leadership Bonus Plan and Proposal Four: Approval of Material Terms of Long-Term Incentive Plan contained elsewhere in this Proxy Statement. Present members of the Compensation Committee are Chairperson Paul S. Williams, David J. D. Antoni, Richard K. Smith and Alexander B. Trevor. The Compensation Committee held nine meetings during 2006.

The Nominating and Governance Committee is charged with several responsibilities, including: (1) selecting nominees for election as directors; (2) reviewing the performance of our Board and individual directors; and (3) annually reviewing and recommending to our Board changes to our Corporate Governance

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Guidelines and Director Ethical Principles. The members of the Nominating and Governance Committee are Chairperson David J. D. Antoni, David R. Meuse, S. Elaine Roberts and Paul S. Williams. The Nominating and Governance Committee met seven times in 2006. See also Corporate Governance Nomination of Directors contained elsewhere in this Proxy Statement.

The Investment Committee oversees our investment functions and those of our insurance subsidiaries. The members of the Investment Committee are Chairperson Paul W. Huesman, S. Elaine Roberts, Richard K. Smith, David R. Meuse and Alexander B. Trevor. The Investment Committee met four times in 2006.

The standing Independent Committee principally serves to review inter-company transactions between or among us and our subsidiaries, on the one hand, and State Auto Mutual and its subsidiaries, on the other. The Independent Committee also helps determine which entity, our Company or State Auto Mutual, is best suited to take advantage of transactional opportunities presented by a third party. The members of the standing Independent Committee are Chairperson S. Elaine Roberts, Richard K. Smith, Alexander B. Trevor and Paul S. Williams. The Independent Committee, which only meets as needed, met two times in 2006.

Compensation of Directors and Director Compensation Table

Name	Fees Earned or	Stock Awards	Total
	Paid in Cash		
	(\$)	\$(1)	(\$)
David J. D. Antoni	67,000	49,670	116,670
Paul W. Huesman	46,000	49,670	95,670
David R. Meuse	35,750	48,983	84,733
S. Elaine Roberts	54,000	49,670	103,670
Richard K. Smith	73,000	49,670	122,670
Alexander B. Trevor	34,750	48,983	83,733
Paul S. Williams	67,000	49,670	116,670

(1) We account for our Outside Director Restricted Share Unit Plan as a liability plan and do not apply Statement of Financial Accounting Standards No. 123(R), Share-Based Payment (SFAS 123R), to the Restricted Share Units awarded under the Outside Directors Restricted Share Unit Plan. Each Restricted Share Unit is worth the equivalent of one Common Share. Each Restricted Share Unit is payable in cash or stock at the election of the outside director. In addition to the 1,400 Restricted Share Units granted as of the Annual Shareholders Meeting in 2006, the Outside Directors Restricted Share Unit Plan also contemplates that each director receives additional units that are the equivalent of dividend reinvestment on Common Shares. The total dollar amount shown in the stock award column represents the cash value of the total number of Restricted Share Units awarded in 2006, including from the dividend reinvestment feature, valued at \$34.68 per Restricted Share Unit (\$34.68 was the closing price of Common Shares as of the last business day of 2006).

In 2006, our outside directors received an annual cash retainer of \$25,000. This annual cash retainer was increased at the beginning of 2007 to \$32,000 as authorized by the Compensation Committee in November 2006. In addition, outside directors receive a fee of \$1,000 for each board meeting (regular or special) and committee meeting attended in person or telephonically. Outside directors are also reimbursed for travel expenses incurred in attending board and committee meetings. Each committee chairperson also receives an additional \$5,000 annual retainer (up to a maximum of \$5,000 for all committees chaired), other than the Audit Committee chairperson, who receives an additional retainer of \$10,000. The Lead Director is also paid a supplemental retainer equal to \$10,000 annually. Mr. D. Antoni waived his 2006 retainer for serving as chairperson of the

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Nominating and Governance Committee. Outside directors may defer all or a portion of the cash fees under our deferred compensation plan for directors. For 2006, only one director elected to defer payment of his or her meeting fees and retainers. These amounts of cash compensation totaled to the figures shown in the first column in the 2006 Director Compensation Table.

Outside directors also received Restricted Share Units pursuant to the Outside Directors Restricted Share Unit Plan. A Restricted Share Unit is a unit representing one Common Share. The value of each Restricted Share Unit, on any particular day, is equal to the last reported sale price of a Common Share on the Nasdaq National Market System on the most recent previous trading day. Under the Outside Directors Restricted Share Unit Plan, promptly following each annual meeting of our shareholders, each outside director is granted 1,400 Restricted Share Units. In addition, whenever a dividend is made with respect to the Common Shares, participants receive, with respect to each Restricted Share Unit held in the account of the participant on the dividend record date, additional Restricted Share Units in an amount equal to the value of the dividend. The administrative committee of the Outside Directors Restricted Share Unit Plan has the authority to decrease or increase the annual award of Restricted Share Units to outside directors to a minimum of 500 and a maximum of 5,000 without further shareholder approval. Under the Outside Directors Restricted Share Unit Plan, outside directors must, in general, hold their Restricted Share Units until they conclude their board service, after which time these Restricted Share Units are settled in cash or Common Shares, as elected by the outside director, with payments made in a single lump sum or annual installments over a five-or ten-year period, as selected by the outside director.

The following table sets forth the number of Restricted Share Units owned by each of our current outside directors as of March 9, 2007:

Name	Number of Restricted Share Units
David J. D. Antoni	2,838.302
Paul W. Huesman	2,838.302
David R. Meuse	1,412.430
S. Elaine Roberts	2,838.302
Richard K. Smith	2,838.302
Alexander B. Trevor	1,412.430
Paul S. Williams	2,838.302

Outside Directors receive no other forms of compensation other than as described in this section Compensation of Directors.

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CORPORATE GOVERNANCE

Director Independence

The Nominating and Governance Committee has affirmatively determined that six of our eight directors, namely David J. D'Antoni, David R. Meuse, S. Elaine Roberts, Richard K. Smith, Alexander B. Trevor and Paul S. Williams, are independent as defined by the Nasdaq Marketplace Rules. The Nominating and Governance Committee made this determination based upon information included in director questionnaires provided by each of the incumbent directors and reviewed by the Nominating and Governance Committee. In the course of its review, the Nominating and Governance Committee concluded that Mr. Meuse's service on the board of directors of Central Benefits Insurance Company did not represent a conflict of interest because Central Benefits does not engage in the lines of business underwritten by our insurance subsidiaries and affiliates, based on representations from Mr. Meuse and information available to the Nominating and Governance Committee about the nature of Central Benefits' business. No other outside director presented any issues reflecting a potential conflict of interest with respect to the performance of their fiduciary duties as directors of our Company.

Our Corporate Governance Guidelines, which are posted at <http://www.stfc.com/corp.gov/index>, expressly provide that four of the five standing committees are to be comprised solely of independent directors. Our Board's Audit, Compensation, Standing Independent and Nominating and Governance Committee meet this standard. The only non-management director who serves on any committee is Paul W. Huesman, who is chairperson of the Investment Committee. Our Board of Directors has concluded that the Investment Committee does not need to be comprised solely of independent directors as members. As noted above, Mr. Huesman is retiring from our Board in conjunction with the Annual Meeting.

Robert P. Restrepo, Jr., who is our employee, and Mr. Huesman, who has a family member who is an executive officer of an insurance agency which does a substantial amount of business with us, are not independent directors under the standards set forth in the Nasdaq Marketplace Rules.

Based on information developed from each candidate, the Nominating and Governance Committee believes that Robert E. Baker and Thomas W. Markert, the two non-incumbent director nominees for election as Class I directors at the Annual Meeting, will qualify as independent directors under the standards set forth in the Nasdaq Marketplace Rules. Assuming their election, at that point, eight of our nine directors will be independent.

Communications with the Board

As further described in our Corporate Governance Guidelines, we provide a process by which security holders may send communications to our Board. Any security holder who desires to communicate with one or more of our directors may send such communication to any or all directors through our Corporate Secretary, by e-mail to corporatesecretary@stateauto.com or in writing to Corporate Secretary at our principal executive offices, 518 East Broad Street, Columbus, Ohio 43215. Security holders should designate whether such communication should be sent to a specific director or to all directors. The Corporate Secretary is responsible for forwarding such communication to the director or directors so designated by the security holder.

Director Attendance at Annual Meeting of Shareholders

Our Corporate Governance Guidelines provide that directors are expected to attend our annual meetings of shareholders. All of our directors who were directors last year attended last year's annual meeting of shareholders.

Executive Sessions of Non-Management Directors; Lead Director

Since 2002, our Board has met in executive session, without management present, prior to or following each regular quarterly Board meeting. Consistent with our Corporate Governance Guidelines and the Nasdaq

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Marketplace Rules, during 2006, there were four executive sessions with only independent directors present, each of which was followed or preceded by an executive session with only non-management directors present. Our Corporate Governance Guidelines provide that the Lead Director acts as the presiding director at these executive sessions.

In March 2006, Mr. D. Antoni was elected by our Board as the Lead Director. The Lead Director's responsibilities include, among other things, leading the executive session of our independent and non-management directors, being a principal point of contact with our Chairman and CEO, working with the Chairman to develop a regular board meeting schedule and an annual agenda for such meetings, securing input from other directors on agenda items, ensuring the adequate flow of information from management to our Board and delivering the CEO's performance evaluation on behalf of the Compensation Committee of our Board.

Nomination of Directors

The Nominating and Governance Committee sets the minimum qualifications for persons it will consider to recommend for nomination for election or re-election (election and re-election are hereafter collectively referred to as "election") as a director of the Company. These minimum qualifications are described in the Nominating and Governance Committee's charter, which is posted on our website as set forth in this section. The following matters will be considered in the Nominating and Governance Committee's determination of persons to recommend for nomination as directors of the Company: (i) status as independent based on the then-current Nasdaq rules; (ii) business or professional skill and experience; (iii) temperament; (iv) integrity; (v) educational background; and (vi) judgment. The objective of the Nominating and Governance Committee in this regard is to nominate for election as directors persons who share our values and possess the following minimum qualifications: high personal and professional integrity; the ability to exercise sound business judgment; an inquiring mind; professional demeanor; and the time available to devote to Board activities and the willingness to do so. The Nominating and Governance Committee will consider these criteria in the context of an assessment of the perceived needs of our Board as a whole and will seek to achieve diversity of occupational and personal backgrounds. Ultimately, the Nominating and Governance Committee's intention is to select nominees for election to our Board who the Nominating and Governance Committee believes will be effective, in conjunction with the other members of our Board, in collectively serving the long-term interests of the shareholders. In the context of recommending an incumbent director to be nominated for election to our Board, the Nominating and Governance Committee will focus its assessment on the contributions of such person during his or her Board tenure and such person's independence at that time.

In addition to incumbent directors who will be evaluated for re-nomination as described above, the Nominating and Governance Committee may maintain a list of other potential candidates whom the Nominating and Governance Committee may evaluate pursuant to the criteria set forth above for consideration as Board members. By following the procedures set forth below, shareholders may recommend potential candidates to be included on this list. As a matter of policy, the Nominating and Governance Committee will consider and evaluate such candidates recommended by shareholders in the same manner as all other candidates for nomination to our Board who are not incumbent directors.

The Charter of the Nominating and Governance Committee details the process by which our Board of Directors fills vacancies on the Board. The Nominating and Governance Committee's Charter provides that, in the absence of extraordinary circumstances, when a director vacancy arises for any reason, the Nominating and Governance Committee will first look to the list of names of potential nominees, as described above, and make a preliminary evaluation of such person(s) based on the criteria set forth above. If there are no names on the list or if all of the names on this list are eliminated following such evaluation process, the Nominating and Governance Committee may solicit other potential nominees names from our other directors, directors of our parent, the Chairman or other persons who the Nominating and Governance Committee reasonably believes would have the opportunity to possess first hand knowledge of a suitable candidate based on the criteria described above. The Nominating and Governance Committee may also hire a director search firm, as contemplated below. This

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process was followed in identifying Robert E. Baker and Thomas W. Markert, the two non-incumbent director nominees for election as Class I directors at the Annual Meeting, to fill the vacancy created by the resignation of John R. Lowther in November 2006 and the vacancy to be created upon the retirement of Paul W. Huesman concurrent with the Annual Meeting.

Once the Nominating and Governance Committee has preliminarily concluded that a person(s) may meet the criteria described above, the Nominating and Governance Committee will, at a minimum, obtain from such person(s) a completed Prospective Director Questionnaire which shall solicit information regarding the person's business experience, educational background, personal information and information relating to the person's business, personal or family relationships with the Company and other directors, among other matters. Following a review of such completed Prospective Director Questionnaire by the Nominating and Governance Committee and the Chairman and counsel for the Company, the Nominating and Governance Committee will conduct at least one interview with a person(s) whose candidacy it desires to pursue. Based on all information secured from the prospective nominee, which will include a background check and a criminal record check, the Nominating and Governance Committee will meet and decide whether or not to recommend such person(s) for nomination for election as a director of the Company. Any decision by the Nominating and Governance Committee in this regard will reflect its judgment of the ability of the person(s) to fulfill the objectives outlined above.

With respect to the existing and pending vacancies noted above, the Nominating and Governance Committee discussed the needs of our Board in terms of business background and skill sets that might be offered by new directors. After making that assessment, the Nominating and Governance Committee reviewed the lists compiled from previous director searches and solicited input from our other directors and our parent, State Auto Mutual. Finally, the Nominating and Governance Committee retained a search firm to identify potential candidates. The two persons being nominated for election for the first time at the Annual Meeting were identified by this search firm retained by the Nominating and Governance Committee.

We have adopted procedures by which shareholders may recommend individuals for membership to our Board. As described in its charter, it is the policy of the Nominating and Governance Committee to consider and evaluate candidates recommended by shareholders for membership on our Board in the same manner as all other candidates for nomination to our Board who are not incumbent directors. If a shareholder desires to recommend an individual for Board membership, then that shareholder must provide a written notice to the Secretary of the Company at 518 East Broad Street, Columbus, Ohio 43215 (the Recommendation Notice). For a recommendation to be considered by the Nominating and Governance Committee, the Recommendation Notice must contain, at a minimum, the following: (i) the name and address, as they appear on our books, and telephone number of the shareholder making the recommendation, including information on the number of shares owned; (ii) if such person is not a shareholder of record or if such shares are owned by an entity, reasonable evidence of such person's ownership of such shares or such person's authority to act on behalf of such entity; (iii) the full legal name, address and telephone number of the individual being recommended, together with a reasonably detailed description of the background, experience and qualifications of that individual; (iv) a written acknowledgement by the individual being recommended that he or she has consented to that recommendation and consents to our undertaking of an investigation into that individual's background, experience and qualifications in the event that the Nominating and Governance Committee desires to do so; (v) the disclosure of any relationship of the individual being recommended with our Company or any of our subsidiaries or affiliates, whether direct or indirect; and (vi) if known to the shareholder, any material interest of such shareholder or individual being recommended in any proposals or other business to be presented at our next annual meeting of shareholders (or a statement to the effect that no material interest is known to such shareholder).

As of March 20, 2007, we had not received any such recommendations from shareholders for nominees for our Board.

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Other Governance Issues of Interest

Our Corporate Governance Guidelines as currently in effect illustrate the evolving nature of our corporate governance policies. Several changes made to our Corporate Governance Guidelines reflect our Board of Directors sensitivity to governance issues. For example, Guideline #5 expresses our Board's policy with respect to changes in the size of our Board, stating:

An increase or decrease in the size of the Board would be largely dependent upon a material increase in the complexity of the Company's business or material changes in the workload for independent directors.

Our Corporate Governance Guidelines also address the issue of service on other boards. Guideline #22 provides, in part, that a director should not serve on the audit committee of more than three public company boards, and a rebuttable presumption is created that a director of our Company serving on more than a total of four public company boards is not in the interest of our shareholders.

On the issue of supermajority voting requirements, our Code of Regulations and Articles of Incorporation do not require supermajority voting to approve mergers or business combinations. Furthermore, except under limited circumstances, only the shareholders can approve amendments to the Code of Regulations. This governance rule reflects Ohio law and is documented in Guideline #34 of our Corporate Governance Guidelines.

Another change resulting from the evolution of our Corporate Governance Guidelines is a process of annual performance evaluations of individual directors. This is documented at Guideline #7 of our Corporate Governance Guidelines. The Nominating and Governance Committee engaged in this process for the first time in the fall of 2006.

Another area of development is director continuing education. We sponsored an ISS-certified continuing education program for our directors in May 2006. All but two of our incumbent outside directors attended that program. We plan to host another director continuing education program this year for our directors and those of other local companies who might wish to attend.

Our Corporate Governance Guidelines also include a majority voting policy. See [Proposal One: Election of Directors Majority Voting Policy for Incumbent Directors](#) for a discussion of this policy.

Availability of Corporate Governance Documents

The following documents are available on our website at www.stfc.com under [Corporate Governance](#) :

The charters for our Audit Committee, Compensation Committee, Nominating and Governance Committee, Investment Committee and standing Independent Committee;

Our Corporate Governance Guidelines, including Director Ethical Principles;

Our Employee Code of Business Conduct; and

Our Code of Ethics for Senior Financial Officers.

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COMPENSATION OF EXECUTIVE OFFICERS

Pursuant to our 2005 Management Agreement, our executive officers, as well as every other person providing services to our Company and our subsidiaries, are employees of State Auto P&C, with State Auto Mutual acting as the common paymaster and common agent for these employees. The costs and expenses associated with the employees of State Auto P&C are reimbursed to State Auto Mutual, as paymaster, in accordance with the terms of this management agreement. See [Related Person Transactions Transactions Involving State Auto Mutual](#) on page 68 for a discussion of our 2005 Management Agreement.

Compensation Discussion and Analysis

The purpose of this Compensation Discussion and Analysis section (this [CD&A](#)) is to discuss the what, why and how of the various elements of our compensation system for our executive officers, including those persons identified as Named Executive Officers in the Summary Compensation Table (the [NEOs](#)). Before addressing those matters, we would like to outline the framework of this discussion.

In May 2005, Robert H. Moone, who was then our Chief Executive Officer, announced his intention to retire the following year. At that point, the Boards of Directors of our Company and State Auto Mutual appointed a special joint committee of independent directors which consisted of our Company's Compensation Committee and the State Auto Mutual Nominating and Governance Committee (the [Joint Selection Committee](#)) to lead the evaluation and selection process for our new CEO. At the outset of this process, the Joint Selection Committee decided to conduct a national search for external candidates, in addition to considering internal candidates. After the completion of a thorough search process, at a special joint meeting of the Boards of Directors of our Company and State Auto Mutual held on February 10, 2006, the Joint Selection Committee recommended the appointment of Robert P. Restrepo, Jr. as Chairman and Chief Executive Officer of all State Auto companies. The Boards of Directors of our Company and State Auto Mutual accepted this recommendation, and Mr. Restrepo was elected as Chairman and Chief Executive Officer at this meeting. The Joint Selection Committee also negotiated an employment agreement with Mr. Restrepo. See [Contractual Arrangements with Named Executive Officers Robert P. Restrepo, Jr.](#) for a summary of the material terms of Mr. Restrepo's employment and related agreements.

We are also required to include in the Summary Compensation Table any individual who served as our principal executive officer or principal financial officer during the last completed fiscal year. As indicated above, Mr. Moone served as our CEO until Mr. Restrepo's appointment. For this reason, Mr. Moone is included in the Summary Compensation Table. On June 5, 2006, Steven J. Johnston, who at that time was our Chief Financial Officer, gave notice that he was leaving State Auto, and on June 19, 2006, we entered into an agreement with Mr. Johnston regarding his separation from employment which included, among other things, Mr. Johnston's resignation as our CFO. On December 13, 2006, the Boards of Directors of our Company and State Auto Mutual appointed Steven E. English as our new CFO. At the time of his appointment, Mr. English was a Vice President of State Auto. Between the time of Mr. Johnston's resignation and Mr. English's appointment, Cynthia A. Powell, our Treasurer and Chief Accounting Officer, also served as our principal financial officer. For these reasons, Mr. Johnston, Mr. English and Ms. Powell are included in the Summary Compensation Table. See [Contractual Arrangements with Named Executive Officers Steve J. Johnston](#) for a summary of the material terms of Mr. Johnston's separation agreement.

Finally, we are required to include in the Summary Compensation Table any individual who would have been an NEO but for the fact that such individual was not serving as an executive officer at the end of our fiscal year. In accordance with this requirement, we have included compensation matters for John R. Lowther, who resigned on November 3, 2006, as our Senior Vice President, Secretary and General Counsel in connection with the announcement of his pending retirement in 2007. In connection with the announcement of his pending retirement, we entered into a retirement agreement with Mr. Lowther. See [Contractual Arrangements with Named Executive Officers John R. Lowther](#) for a summary of the material terms of Mr. Lowther's retirement agreement.

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Our compensation program for our NEOs and other executive officers includes traditional elements such as salary, short-term incentive plans, long-term incentive plans, a defined benefit pension plan, a supplemental executive retirement plan, a defined contribution plan and a non-qualified defined contribution plan, as well as other life insurance and health insurance benefits generally made available to our employees. Perquisites include (i) a corporate club membership (non-golfing) used by one of our NEOs; (ii) company-paid premiums on whole life insurance policies with policy limits not to exceed \$50,000 per policy; (iii) reimbursement for up to \$500 of financial planning assistance which is made available to all persons who receive stock options; and (iv) the opportunity to have the NEO's spouse accompany him or her on insurance agent incentive trips as hosts.

Because of new leadership, 2006 was a year of transition for us. As noted above, Mr. Moone's retirement was planned well in advance. Because of the pending leadership change, the Compensation Committee was reluctant to make significant changes in any of the compensation plans or programs for 2006 because it wanted to receive the input of Mr. Moone's successor on those matters. Several changes in our compensation program are being implemented for 2007 as a result of Mr. Restrepo's input and decisions, some of which will be noted in the course of this CD&A.

The objective of our executive compensation program is to provide competitive compensation that will attract and retain executive talent. Our executive compensation program is designed to reward individuals appropriately for their individual performance and its impact on our performance; offer incentives that encourage a focus on underwriting profit while achieving sales goals; foster the attainment of company-wide goals over the long term; and drive behaviors that are reasonably expected to build shareholder value over the long term. The fundamental objective is to compensate our executive officers at or close to median compensation levels relative to a set of peer companies. The set of peer companies is selected by the Compensation Committee with input from its compensation consultant. The Compensation Committee believes that superior performance warrants executive compensation in excess of market medians, with total compensation in the range of the 75th percentile of the set of peer companies being considered acceptable compensation.

The Compensation Committee has its compensation consultant perform a review of the insurance company officer compensation marketplace every other year, with the last full review completed in the fall of 2004. At that time, the compensation consultant used a set of 27 peer companies in assessing the relative position of compensation paid to senior officers, including our NEOs, which included the following: W.R. Berkley Corporation, White Mountains Insurance Group, American Financial Group, Inc., Allmerica Financial Corporation, Old Republic International Corporation, Cincinnati Financial Corporation, Unitrin, Inc., Kingsway Financial Services, Inc., Arch Capital Group Ltd., Mercury General Corporation, The Commerce Group, Inc., Ohio Casualty Corporation, Selective Insurance Group, Inc., 21st Century Insurance Group, Erie Indemnity Company, HCC Insurance Holdings, Inc., Infinity Property and Casualty Corporation, PMA Capital Corporation, Philadelphia Consolidated Holding Corp., Harleysville Group, Inc., Horace Mann Educators Corporation, Argonaut Group, Inc., Alfa Corporation, The Midland Company, Vesta Insurance Group, Inc., Safety Insurance Group, Inc., and United Fire & Casualty Company. Peer companies were selected based on their size and business overlap with the State Auto Group(1). In terms of the latter, the compensation consultant, with the concurrence of the Compensation Committee, selected companies with a significant portion of their business in personal and commercial automobile, homeowners and property and casualty insurance. In terms of the former, the compensation consultant sought to focus on companies that were similar to the State Auto Group in terms of premium volume, total assets, market capitalization and number of employees. While some of these companies are substantially larger than the State Auto Group, and others are smaller, the size of the median peer company is comparable to the State Auto Group:

(1) See page 70 of this Proxy Statement for the list of companies included in the State Auto Group.

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	Median Peer Company	State Auto Group
Revenue	\$ 1.301 billion	\$ 1.298 billion
Total Assets	\$ 3.438 billion	\$ 3.055 billion
Market Capitalization	\$ 1.197 billion	\$ 1.050 billion
Employees	2,452	2,060

This broad based peer information is buttressed by available compensation survey information on insurance company executive compensation compiled by other compensation consulting firms.

Ultimately, the Compensation Committee is responsible for setting compensation policies applicable to our CEO and the other NEOs. The Compensation Committee determines our CEO's base salary and incentive compensation and works with the Nominating and Governance Committee of State Auto Mutual to evaluate the CEO's performance. It also approves salary and bonus arrangements for other NEOs and other executive officers. It approves management's recommendations regarding other aspects of the compensation and benefit programs we have in place for other officers and employees. However, in making its compensation decisions relating to both form of compensation and amount, the Compensation Committee has consistently relied upon competitive information obtained from its compensation consultant. The Compensation Committee has directly engaged the services of Towers Perrin as its compensation consultant for the last five years.

The competitive landscape, as gleaned from the work done by its compensation consultant, is a constant consideration in its decision making process. However, the duties of the Compensation Committee should not overshadow the importance of our executive management's input into our compensation system. This is illustrated by the process that resulted in the changes to the compensation program in and for 2007, as described below. Management developed the elements of the program and presented them to the Compensation Committee for its consideration, review and ultimate approval prior to implementing the new program.

Base Salary

Each NEO's annual base salary is the amount of regular cash compensation paid to such NEOs on a bi-weekly basis. It is the basic consideration in the employment relationship. The purpose of the annual base salary is to compensate the NEO based on that person's skills, competencies, experience and job performance. It also reflects the compensation marketplace for executive talent based on a competitive analysis performed by the Compensation Committee's compensation consultant. Our practice has been to adjust salaries annually, except in the case of a new hire, who typically receives a salary adjustment after six months on the job and then again after one year. Annual merit salary increases reflect a subjective assessment of the respective NEO's performance as well as the nature and extent of the person's responsibilities, including any changes in the same during the previous year. It also reflects the consequences of such person's decisions on our successes or failures as a whole. In the case of the CEO's merit increase, this subjective assessment is conducted by the Compensation Committee and the Nominating and Governance Committee of State Auto Mutual. As a result, merit increases focus on individual results as well as a discretionary evaluation of that individual's performance over the course of the year. The other NEOs had their performance evaluated by the CEO or the CFO, since two of our NEOs reported to the CFO at the time 2006 merit increases were determined.

The base salary of our NEOs is intended to reflect an amount substantially equivalent to the median base compensation paid to executive officers performing similar responsibilities at comparable insurance companies, both public and private. The objective is for base salary to approximate the market median or 50th percentile among these companies, based upon competitive information developed by the Compensation Committee's compensation consultant.

Aside from Mr. Restrepo, each of our NEOs listed in the Summary Compensation Table received salary increases in or for 2006. Our standard practice has been to have annual merit raises determined in late December

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of each year to be effective for the start of the next year. Subject to the approval of the Compensation Committee, Mr. Moone was responsible for determining the amount of 2006 annual merit raises for our NEOs who reported directly to him at that time (December 2005), a group which included Mr. Blackburn, Mr. Johnston, Mr. Lowther, Mr. Hazelbaker and Mr. Miley. Each of these individuals received from Mr. Moone a merit raise based on an assessment of their individual performance and market median base salary data as developed by the compensation consultant for the Compensation Committee. Some executives also received promotional increases to reflect new or additional job responsibilities. The following table summarizes these decisions:

Named Executive Officer	Base Annual Salary as of December 31, 2005	Base Annual Salary as of December 31, 2006	Rationale Behind Increase
Current Executives			
Mr. Restrepo(1)	\$ 600,000	\$ 600,000	New hire
Mr. Blackburn(2)	\$ 270,000	\$ 425,000	Normal merit and promotion to Executive Vice President and COO
Mr. English(2)	\$ 162,000	\$ 250,000	Increase in duties and subsequent promotion to CFO
Ms. Powell(2)	\$ 173,000	\$ 200,000	Normal merit and promotion to Treasurer and Chief Accounting Officer
Mr. Hazelbaker	\$ 190,000	\$ 194,000	Normal merit and internal pay equity
Mr. Miley	\$ 178,000	\$ 183,000	Normal merit
Former Executives			
Mr. Moone	\$ 565,000	\$ 620,000(3)	Excellent company performance Progress in succession Progress in diversity Contributions over his career Assistance in transition
Mr. Johnston	\$ 303,000	\$ 314,000(3)	Normal merit
Mr. Lowther	\$ 268,000	\$ 278,000	Normal merit

(1) Mr. Restrepo's employment did not commence until February 10, 2006.

(2) The salary as of December 31, 2006 reflects two salary increases.

(3) Employment terminated prior to December 31, 2006.

When salaries for the calendar year 2006 were originally set in December 2005, neither the Compensation Committee nor the then-CEO considered other elements of compensation that were available to NEOs, such as annual bonus earned, option gains, and equity ownership. Our executive base salaries stand on their own. However, it is also true that as executives become more highly compensated in our compensation structure, an increasing percentage of total compensation is performance-based, be it through stock options or short-term incentive bonuses. Salary increases impact short-term incentive bonus opportunities, though, because the amounts of bonuses are based on percentages of base salary. Salary increases also affect the amount of the executives retirement benefit, since a key component of the defined benefit plan retirement formula is career average salary.

Short-Term Incentive Plans

We currently have two forms of short-term incentive plans available to our NEOs. One plan provides for a quarterly bonus if our combined ratio is lower than the current target set forth in the plan. We call this plan the Quality Performance Bonus Plan, or QPB Plan, which has been in place since 1991. All employees are eligible to participate in the QPB Plan upon satisfaction of a minimum service requirement. The other plan is an annual cash incentive bonus that we refer to as the Executive Bonus Plan, or EBP.

Compensation surveys indicate that annual performance bonuses for executives are and have been common place in our industry, as in most businesses. Accordingly, in order to maintain competitiveness of the total cash compensation payable to our executives, including our NEOs, the

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Compensation Committee created the EBP. The Compensation Committee's objective is for each NEO's total cash compensation to be in the range of the 50th percentile or median total cash compensation for performance that meets expectations, while total cash

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compensation in the range of the 75th percentile is acceptable for performance that exceeds expectations. Human capital is among the most important assets an insurer can possess, and the quality of its executive team is critical to the success of any company. The property casualty insurance business is changing more rapidly than ever before due to the impact of information technology. A company's ability to compete successfully in a crowded insurance marketplace depends on thoughtful strategies and effective execution of those strategies. The opportunity to earn a competitive annual bonus creates a significant incentive to achieve high levels of performance. The point of any incentive program is to drive performance, and our management and the Compensation Committee believe that for an insurance underwriting company like State Auto, the QPB Plan and EBP reinforce those behaviors that are likely to have the greatest impact on our ability to build value for our owners. The Compensation Committee further believes that the relative performance measures used in the EBP for 2006 ensure that bonuses are earned strictly based on our performance relative to that of the selected peer group. By outperforming our peers, we believe investors will more likely invest in our Company as compared to other stocks in our sector.

Quality Performance Bonus Plan

Historically, under the QPB Plan, quarterly performance bonuses have been paid to all employees if the direct statutory combined ratio for all of our affiliated insurers combined exceeds a trigger point which is set annually. The amount of the QPB bonus received by employees is directly related to State Auto's direct loss ratio, once the combined ratio trigger is met. The QPB Plan was created to motivate employees to focus on the bottom line, i.e., underwriting profit, a key performance measure associated with our operating success. Moreover, the program helps build teamwork across all functions and all levels of State Auto because all employees are eligible and held to the same standard. Our management believes we have succeeded in that regard - our employees have earned a QPB bonus in 20 of the 28 quarters during the period from January 2000 to December 2006. The original intent of the QPB Plan was to share with our employees approximately 20% of the underwriting profit we achieve in excess of the annual trigger point, and to provide it quarterly to ensure prompt feedback on our performance in selecting and pricing insurance risks.

The other advantage of the QPB Plan is that the formula is incremental. The bonus is relatively smaller if the combined ratio target is exceeded by a small amount while it becomes more substantial if the target is exceeded by a substantial amount. In essence, the bonus formula is self-correcting in that the amounts paid as a bonus directly reflect the quality of the performance. Being strictly performance-based and purely formula-driven, we believe it plays a material role in the underwriting, pricing discipline, and expense management that we consider critical in profitably underwriting a book of business. We believe that we have been able to stand out from the crowd based on our underwriting success, fostered to a significant degree by the QPB Plan.

Under the QPB Plan for 2006, quarterly bonuses were paid to employees who had completed two full calendar quarters of service if the direct statutory combined ratio for the quarter was 98% or less for all combined affiliated insurers. Our line operations are conducted through regional or branch offices and when the program was established, it was decided that each branch's results should weigh more heavily in the bonus earned by the employees of that branch. Accordingly, in calculating the bonus for branch employees, 70% of the QPB bonus was based on the branch's underwriting profit while 30% was based on our overall underwriting profit, which strengthened the performance orientation of the plan by focusing on underwriting results that participants can control and influence. The QPB Plan is purely formulaic; no discretionary performance considerations affect whether the QPB bonus is paid or the amount each employee receives. All NEOs participate in the QPB Plan, and their QPB bonus was based solely on our overall results. The NEOs' QPB bonuses earned in 2006, which amounts are set out in the Summary Compensation Table, reflected the application of the formula set forth in the QPB Plan without variation. The only exception made from the provisions of the rules in the QPB Plan is that Mr. Restrepo received a dollar amount of bonus equivalent to the QPB bonus in the first and second quarter which was a negotiated term of his employment contract. The QPB Plan had a two-quarter service requirement as a condition of eligibility which the Compensation Committee did not apply to Mr. Restrepo by virtue of this alternative bonus to the QPB bonus. This exception allowed the Compensation Committee to approximate the

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bonus opportunity Mr. Restrepo had with his former employer, while at the same time preserving an element of consistency with our compensation structure. This also helped to ensure that Mr. Restrepo, a new leader from outside our Company, was invested in this employee benefit that has become a part of our culture.

Periodically, the QPB Plan has been modified in an effort to more properly incentivize the employees' performance or reflect changes in the property casualty insurance marketplace. Beginning in the second quarter of 2004, quarterly bonuses were reduced by 10% if we did not achieve targeted sales goals for the calendar quarter in which the bonus was earned. The combined ratio trigger was changed from 100% to 98% effective as of the beginning of the second quarter of 2005, consistent with our commitment to achieve an annual underwriting profit and reinforce the need for continuous improvement. In 2006, an annual maximum payout was imposed so that no employee's QPB bonus on an annual basis would exceed 35% of such employee's annual salary. This change was implemented in order to more appropriately align our cash compensation levels with the market for other employees. No NEO was affected by this maximum payout in 2006, nor was there an expectation that any corporate employee would be affected by the 35% maximum payout, because the corporate bonus percentages were historically simply not large enough to make the maximum payout applicable. For example, the QPB bonus percentages applicable to corporate employees for each quarter in 2006 were as follows: 33.4%, 0%, 15.9% and 37.8%, respectively. Annualized, these QPB bonuses paid for 2006 reflect 20.1% of the average of our NEO's base salary paid in 2006. When these QPB bonuses were paid, the bonus percentages reflected the application of the 10% reduction for not meeting our sales goal for the quarter.

In 2007, the QPB Plan is being modified to reduce the combined ratio trigger to an average of 96%. This more closely reflects our long-standing underwriting performance goal. In 2007, the trigger will be adjusted on a quarterly basis to reflect the seasonality of our results; the performance targets for the first through the fourth quarter are respectively 94%, 98%, 98%, and 94%. The other major change to the program is the elimination of the branch employee/corporate employee distinctions for bonus award calculation purposes. Every employee, regardless of whether the employee has line or staff responsibilities, will be paid the same percentage of quarterly salary, in the quarters in which a bonus is earned. This change reinforces the importance of the team effort required across our Company for us to achieve our strategic goals. Certain smaller branches results were much more volatile than others because of the disparity in the amount of business generated by each branch. It also eliminates a branch employee being over-rewarded based more on circumstances that are not within the control of that branch's employees. The percentage of profits intended to be shared in the QPB Plan was decreased to 15% from 20% based on competitive market analysis and an assessment of historical payouts under the QPB Plan. We simply did not need to fund as large a bonus pool as we had done in the past to offer our employees a competitive level of incentive compensation. Also, this facilitates our ability to restructure our total rewards program which is briefly discussed below.

Furthermore, to the extent our NEOs or other employees participate in the new Leadership Bonus Plan, discussed below, the amount of any QPB bonus earned during the year will be an offset against any bonus earned by that employee under the LBP. In other words, any QPB bonuses earned by these employees will serve as installment payments against their LBP bonus. If the QPB bonuses earned during the year exceed the bonus amounts earned under the LBP, the employee will not receive an LBP award. Nor would such employee be required to reimburse us for the overage. Finally, the 35% maximum payout and the 10% reduction for not achieving sales goals have been removed. The annual maximum payout became moot with the elimination of branch-based underwriting performance award calculations and the reduced amount of profits being shared. The 10% reduction for not achieving sales goals had been in place for at least two years and did not appear to affect employees' behaviors, so that was also eliminated from the QPB Plan.

The changes to the QPB Plan put in place in 2007 reflect changes in the property casualty insurance market place as well as our desire to restructure the overall incentive reward system. The QPB Plan as previously operated carried with it an unsustainable expense burden which precluded other important, useful changes in our compensation and performance reward system. These changes are being implemented in 2007 to make the compensation of more of our employees more performance-based and more at-risk. We want to incentivize

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those whose responsibilities directly drive our performance, rewarding them for strong performance while moderating compensation when performance is not as strong. We also want to change the performance measures to reflect elements over which we have more direct control as will be noted in more detail below.

Executive Bonus Plan

The annual Executive Bonus Plan, or EBP, is an individual annual cash incentive bonus arrangement with certain features that are universal among all NEOs. Historically, the EBP has rewarded these officers based on our performance relative to a set of publicly traded property casualty insurance companies, and this set has remained constant over the last five years. While the QPB Plan rewards our employees for results tied to internally established goals, the EBP rewards for how well our results compare to certain of our key competitors in our industry. Moreover, it supports our pay philosophy of providing relatively high payouts for relatively high levels of performance.

Opportunities under the plan range from 0% of salary to:

50% of salary for vice presidents

60% of salary for senior vice presidents

75% of salary for the CEO

In addition to the above, the CEO is eligible to receive an additional 25% of salary based on the Compensation Committee's discretionary evaluation of his performance for the year. No other participant in the EBP had a portion of their award expressly based on a discretionary evaluation of their individual performance. The Compensation Committee did not delegate this authority to the CEO and it was not in a position to fairly assess the annual contributions of all other participants. However, the Compensation Committee retains the discretion to act on its own initiative or at the suggestion of the CEO to increase a bonus award for a particular NEO beyond the amount determined by the formula.

Awards under the EBP were based on the following performance measures: (i) our statutory combined ratio for the calendar year; (ii) net written premium growth for the calendar year; and (iii) total shareholder return over the previous three years. These performance measures were selected because they are objectively measurable, universally reported by insurance companies (combined ratio and net written premium growth) or calculable for public company insurers. They also tend to be reliable indicators of successful performance. One NEO's EBP was different from the others because it included a measurement relating to the performance of the business unit he operates.

These performance measures are compared to the same results for the following nine publicly held insurers: Alfa Corporation, Allstate Insurance Company, Chubb, Cincinnati Financial Corporation, Harleysville Group Inc., EMC Insurance Group, Inc., Ohio Casualty Corporation, Safeco Corporation and Selective Insurance Group, Inc. (the EBP Peer Group). Some of these companies are included in the peer group used for determining competitive pay levels. Those companies that are not included are much larger than us and would not be appropriate to include in pay comparisons with our executives. Nonetheless, their business mix closely resembles that of State Auto's. As a result, they are appropriate for performance comparisons with our Company as they represent the types of companies that investment analysts and investors use to assess our performance. Overall, the Compensation Committee believes the EBP Peer Group is appropriate and reasonable for assessing our annual performance.

The EBP formula operated the same way in 2006 as it has in the last several years. The NEOs earned points based upon our rank for each of these criteria in comparison to the EBP Peer Group. Points ranged from 10 points for a 1st place finish in a category to 1 point for a 10th place finish. The object was to accumulate the

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greatest number of points out of a possible 30 points (three 1st place finishes in the three categories). The points system worked as follows:

Total Points Earned	% of EBP Bonus
30-27	100%
26-23	80%
22-19	60%
18-15	40%
14-11	20%
10 or less	0%

The only exception to the formula is set forth in the CEO's EBP which has an express discretionary element to it, as discussed above.

One of the difficulties of the 2006 EBP plan's performance criteria is the delay in securing peer information on underwriting results and premium growth. We rely on figures from A.M. Best Company for those two components and those typically are not available until late May or early June, long after the annual shareholders meeting proxy statement has been printed and mailed. As a result, the Summary Compensation Table included herein does not contain any compensation resulting from the EBP in 2006, except for Mr. Restrepo and Mr. Miley. We will update the Summary Compensation Table with a Form 8-K filing when the information becomes available regarding our NEOs' bonuses under the 2006 EBP.

Mr. Miley, whose business unit's performance was strong, earned his maximum bonus opportunity under his EBP, an amount equal to 50% of his salary. Under his EBP, Mr. Miley could earn as a bonus 2% of his business unit's pre-tax profit up to a maximum award of 50% of his salary. This amount is shown in the Summary Compensation Table in the Non-Equity Incentive Plan Compensation column (the Cash Incentive Plan Column). Mr. Miley's business unit's results are not included in our financial results, since the entity that constitutes his business unit is owned by State Auto Mutual and it is not engaged in the insurance underwriting business. In the case of Mr. Restrepo, his employment agreement guaranteed him a minimum bonus equal to 25% of his salary for the calendar year 2006. This amount is shown in the Summary Compensation Table in the Bonus column.

The compensation consultant of the Compensation Committee has indicated that the design of the EBP was relatively unusual among annual bonus plans, in that other insurers' annual incentive bonus plans tend to be based on performance measures tied to internally developed goals or objectives and not on specific results relative to peers. The compensation consultant also indicated our target of total cash compensation available from salary and QPB and EBP bonuses was at the lower end of market practice and did not afford top quartile pay for top quartile performance. As a result, the reward system for NEOs is being changed for 2007.

The new LBP, an annual incentive bonus plan, will be available to a much larger group of employees than was the EBP. Management and the Compensation Committee believe it is important to restructure the rewards system to incentivize those performance measures which more directly affect shareholder value and to base the reward on how we performed relative to our financial goals for the performance year. The 2006 EBP with its relative performance measures makes bonus compensation dependent upon factors over which our executives have no control, i.e., how the EBP Peer Group performed from an underwriting and sales standpoint, and how the stock market reacted to those companies' performance as compared to ours. Changing the EBP to measure performance against our Company's goals and objectives strengthens the connection between compensation and strategy, which we consider to be important to our success.

The three objective performance metrics of the 2007 LBP are combined ratio, premium growth and surplus growth (less the market value of Common Shares owned by State Auto Mutual). For 2007, 75% of any bonus payable under the LBP to our NEOs will be based on these three metrics compared to our financial plan for 2007.

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It is intended that all of these bonus payments will qualify as performance-based compensation and will not be subject to the deduction limitations under Section 162(m) of the Code, which is applicable to compensation paid to our NEOs who are deemed to be covered employees under section 162(m) of the Code. The NEOs will also have a set of individual goals, the attainment of which could generate an additional 25% of bonus compensation, which is not performance based compensation under 162(m) of the Code. For other LBP participants, 75% of any bonus payable under the LBP will be based on these three metrics compared to our financial plan for 2007 and the remaining 25% of any bonus payable under the LBP will be based on the attainment of individual goals. A point system will be used for each of the three metrics to determine maximum, target, and threshold performance. The LBP bonus payout will be a percentage of each participant's salary minus what was earned under the QPB Plan.

Through 2006, cash compensation (base salary and bonuses) paid to NEOs had not exceeded the amount of compensation that was deductible under Section 162(m) of the Code. Accordingly, we were not required to address any issues relating to the impact of Section 162(m) of the Code. We intend to address the impact of Section 162(m) of the Code going forward by seeking shareholder approval of the material terms of the Leadership Bonus Plan and Long-Term Incentive Plan, including the performance standards set forth therein, as described elsewhere in this Proxy Statement. See Proposal Three: Approval of Material Terms of Leadership Bonus Plan and Proposal Four: Approval of Material Terms of Long-Term Incentive Plan.

These changes in our annual incentive bonus arrangements, as contained in the LBP for 2007, are intended and expected to help build a performance-oriented culture. Another objective with the LBP for 2007 is to align our strategic goals with our operational goals, both annual and long term. We also want to enhance accountability for achieving results by creating more risk based compensation while also increasing the total amount of the rewards available when our performance exceeds pre set plan targets.

Awards under the EBP plans in prior years or in other parts of our compensation/rewards program do not influence the opportunities or payments made available to executives under the LBP in 2007. We do not target a specific level for bonus as a percent of an executive's total direct compensation. We target market median opportunities and pay levels. Historically, that has meant executives higher in our Company have had a greater level of their pay tied to variable pay and most of that tied to long-term incentives. Annual bonus payments do not increase payments under other reward programs, except for benefits under change in control agreements.

Long-Term Incentive Program

In 2006, the only form of long-term incentive awarded by the Compensation Committee (with one exception to be noted below) was incentive stock options (ISO) and non-qualified stock options (NQSO) granted under our Equity Incentive Compensation Plan. On May 17, 2006, the day before the 2006 annual shareholders meeting, which timing was consistent with our past practices, the Compensation Committee met and awarded our NEOs the number of options indicated in the Grants of Plan Based Awards Table (the Plan Based Awards Table). For the past several years (since before the year 2000), the Compensation Committee or its predecessor has met and granted options in conjunction with its second regular meeting of the year, which is timed to coincide with the annual shareholders meeting and annual meeting of the board of directors. This timing is after first quarter earnings are released and basically in the middle of the second calendar quarter. We have not timed option grants to employees other than to recommend to the Compensation Committee that they be done in the second regular meeting of the year. This timing for option grants is documented in the Compensation Committee's charter.

Stock Options have historically been the only long term incentive plan we have offered. Stock options have been an attractive incentive for a number of reasons. They motivate the kinds of business behavior that is directed at stock price appreciation because options have no real value to the optionee unless the stock price increases from the date of grant. That aligns the interests of our NEOs and the rest of the optionees with those of shareholders. One of the reasons State Auto Mutual formed State Auto Financial Corporation and took it public was to motivate employees and make them act like owners. We believe our option program, as well as our

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employee stock purchase plan in which all employees are eligible to participate, have helped produce the kind of performance that has driven our stock price from our 1991 initial public offering price of \$2.25 per share (split-adjusted) to \$34.68 as of December 31, 2006. Under Section 162(m) of the Code, stock options also qualify as performance-based compensation, so we have been able to, and will continue to be able to, deduct all compensation associated with non-qualified stock option awards. Moreover, options help build executive ownership and meet our Company's stock ownership objectives, which are described in more detail on page 39 of this Proxy Statement. Finally, stock options are a significant part of the total direct compensation paid to executives at peer companies for which we compete for executive talent. The Compensation Committee intends that equity-based compensation awards will approximate market median levels and produce, together with the total cash compensation described above, total direct compensation at the 50th percentile of comparable publicly held insurers, based on information developed by its compensation consultant. While the CEO makes recommendations to the Compensation Committee regarding option grants to our employees, the Compensation Committee retains the discretion to set the terms of any options granted, including the number of options granted to any optionee.

The ISOs are tailored to comply with the Code requirements to receive favorable tax treatment. Each ISO and NQSO granted in 2006 has a ten-year exercise period and vests in accordance with a three-year graduated vesting schedule. The typical mix of option grants was an equal amount of ISOs and NQSOs. The purpose of offering this mix of option grants was to allow optionees to use the cash generated from exercising the NQSOs to exercise and hold the ISOs. We believed that this would facilitate option recipients retaining ownership of a material portion of the equity obtainable through option exercises. For those who were within a certain number of years of retirement, the Compensation Committee allowed an optionee to elect to receive all NQSOs, which continued to be exercisable to the end of their original ten-year term even when the optionee retired. While this served the interest of the optionee who was close to retirement, it also served our interest by creating a tax deduction that was otherwise lost if an ISO had been granted.

In 2006, Mr. Restrepo was granted options in accordance with his employment agreement. He did not receive stock options when the Compensation Committee granted options in May 2006. These are reflected in the Plan Based Award Table and are discussed in more detail in the context of his employment agreement. See Contractual Arrangements with Named Executive Officers Robert P. Restrepo, Jr. It should be noted that neither Mr. Moone nor Mr. Johnston was awarded stock options in 2006 as a result of the termination of their respective employment with us.

The objective of the Compensation Committee is to grant a number of stock options which have a value under the Black-Scholes pricing model equal to a percentage of base salary paid to the optionee. The percentage of salary varies depending on the level of the optionee within the management structure, recognizing that managers at a higher level in our Company should be more accountable for the results produced for shareholders.

In 2003, 2004, and 2005 the Compensation Committee awarded a consistent number of options each year to our NEOs, based on a decision made in 2003 to hold the number of options granted constant, despite fluctuations in the price of our stock. Prior to that time, annual changes in stock price produced results in terms of option grants based on their estimated value that sent contradictory messages to participants, the Compensation Committee and shareholders. Participants could receive more shares and a greater ownership potential for results that led to a decline in our stock price. Conversely, the formula used penalized participants by reducing the number of options granted for producing the results that arguably caused an increase in stock price. Since we were undergoing an extensive review of our reward program, management proposed and the Compensation Committee agreed to base grants for 2006 on the guidelines used for the prior three years but at a reduced level to recognize the change in our stock price from 2003. The changes in awards were applied uniformly across all option participants and resulted in the option grants to NEOs disclosed in the Plan Based Awards Table. That necessitated a reduction in the number of options granted to our NEOs with the exception of Mr. Blackburn and Mr. Lowther. Since our stock price was higher, the value of the stock options themselves (based on the Black-Scholes pricing model) were deemed to be more valuable. Thus, to retain the same relationship between the value

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of option grants and base salary, the number of options granted was reduced in 2006 for most NEOs. With respect to Mr. Blackburn and Mr. Lowther, each of these NEOs' option grants was increased due to a decision to have the value of options reflect a higher percentage of salary than had been the case in years past and maintain a competitive total compensation package for these two senior executives.

Another change in our rewards package will occur in 2007 with respect to long-term incentive compensation. We, like most companies, have recently evaluated our traditional approach to long-term incentives as a result of the accounting rule changes associated with SFAS 123(R). These changes resulted in an accounting expense for options when such awards previously had no charge to our income statement. Moreover, we wanted to strike a better balance in rewarding sustained, superior financial results and stock price appreciation, the latter of which has been the only focus of our historical approach to long-term incentives as delivered in the form of stock options. As noted, we have historically only used options as our form of long term incentive compensation.

Beginning in 2007, we will offer our NEOs, as well as a substantial number of other officers and managers, two forms of long-term incentive compensation: non-qualified stock options and performance award units. It is our intent to deliver 50% of our long-term incentive opportunities in the form of stock options and the remainder in the form of performance award units. In this manner, we intend to meet our objective of balancing long-term incentives between awards tied solely to stock price appreciation and those based on sustained long-term performance. The performance award units will be paid in cash based on our long term performance relative to the results of a peer group of regional property and casualty insurance companies. This approach is similar to the one used under the 2006 EBP and balances the objectives of the new LBP, which focuses on internally developed annual objectives. The number of performance award units awarded will vary within a range around target awards and be based on performance in the following areas: statutory combined ratio for the State Auto Group, our Company's book value per share growth, and total State Auto Group revenue growth. As a result, the measures associated with a performance unit focus on profitable long-term growth, consistent with our strategic direction. More details associated with these changes will be discussed in our 2008 proxy statement.

Defined Benefit Plan/Retirement Plan

We maintain a defined benefit plan, referred to as our Retirement Plan, which is intended to be a qualified plan under Section 401(a) of the Code. The Retirement Plan is subject to the minimum funding standards of Section 412 of the Code. All of our NEOs and other employees are eligible to participate in the Retirement Plan on the same terms. Benefits payable under the Retirement Plan are funded through employer contributions to a trust fund. The purpose of the Retirement Plan is to recognize career contributions and service of our employees, assist in the retention of employees and provide them income continuity into retirement. For service prior to 1989, each year of accrual is calculated using the January 1 salary of that year. For service after 1989, we use the average of the January 1 salaries for all years subsequent to 1989. So, for accruals after 1989, we take the salaries as of January 1 for each year worked, come up with an average, then multiply that average by the 1.75%. If the average salary is greater than the covered compensation as prescribed by the Internal Revenue Service for that individual (covered compensation rates are based on year of birth), then we take the excess and multiply that by .65%, and add the two results together. These are accumulated and multiplied by the number of years and months of credited service. The Retirement Plan does not take into consideration bonus compensation in the calculation of benefits. The Retirement Plan is funded completely by us.

Our objective with the Retirement Plan is to encourage employees to remain with us over the long term by providing the opportunity to continue to have an income following retirement with the inclusion of social security benefits and the amounts accumulated by the employee in our other retirement type program, the defined contribution plan discussed below.

Supplemental Executive Retirement Plan

The tax laws of the United States impose certain limits on income or wages that can be considered in calculating benefits under defined benefit plans. Without a supplemental executive retirement plan, it would be

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difficult, if not impossible, for a highly compensated NEO to achieve the same percentage of salary replacement on retirement on a relative basis as other employees. Our Supplemental Executive Retirement Plan, referred to as our SERP, attempts to address this issue and complements the Retirement Plan. The SERP is a non-qualified retirement plan designed solely as a restoration plan to offset the impact of regulatory limitations on retirement benefits available under the Retirement Plan. As a result, the SERP mirrors the Retirement Plan. It provides a lump sum or deferred cash payments in actuarially determined amounts upon retirement for officers whose participation in the SERP is approved by the Board of Directors of State Auto Mutual. Like the Retirement Plan, the SERP only considers base salary dollars in calculating the benefit due each participant, not total cash compensation.

In the case of Mr. Restrepo, an individual SERP has been created to offset the impact of the relatively shorter duration of employment available to him at our Company. We have a mandatory retirement age of 65 for executive officers. Mr. Restrepo is currently 56. The Retirement Plan and the SERP both use a career average plan formula for benefit determination. Under those plans, an employee's period of service has a significant impact on the amount of retirement benefits they would be eligible to receive. As a result, our regular plans may inhibit our ability to attract mid-career executives who would not have the same opportunity to earn benefits comparable to other employees. As a result, we developed, and the Compensation Committee approved, an individual SERP for Mr. Restrepo which is discussed under the caption Contractual Arrangements with Named Executive Officers Robert P. Restrepo, Jr.

Defined Contribution Plan

We maintain a defined contribution plan for our employees that is intended to be a qualified plan under Sections 401(a) and 401(k) of the Code. This defined contribution plan, which we refer to as our Capital Accumulation Plan, or CAP, is available to all of our employees on the same terms, including our NEOs. The CAP provides employees with another mechanism to save for retirement without imposing on our Company the liabilities associated with our defined benefit pension plan. In this manner, the CAP builds responsibility among employees for managing and planning for their ultimate retirement benefits. Under the CAP, each participant can elect to contribute from 1% to 50% of his or her salary to the CAP. The amount deferred by a participant is contributed to the trust fund for the CAP and invested in accordance with the election of the participant from among investment funds established under the trust agreement. Investment options include Common Shares, but only up to 20% of new contributions and the total account balance.

Each participant's contributions under the CAP are matched by us as described below. A participant's share of the matching contribution equals 75% of his or her salary reduction contributions up to 2% of compensation, plus 50% of his or her salary reduction contributions from 3% to 6% of compensation. This equates to a company contribution in the CAP of 58 cents for each dollar of salary contributed, up to 6% of an employee's salary. While a participant is always vested in his or her own salary reduction contributions, the right of a participant to amounts credited to his or her account as matching contributions vest in one third installments over a three-year period.

We have created the CAP as a supplemental retirement benefit. The NEOs and all other employees have the opportunity to save money on a tax deferred basis to use for their retirement. In addition to the concerns of enabling people to live reasonably comfortably following retirement, a defined contribution plan with the attendant match is a benefit most employers offer. Accordingly, to remain a competitive, attractive employer, we offer the CAP with our 58% match, as described above.

The compensatory element of the CAP is the Company match. The match has been fixed at the same 58% for at least 15 years. The CAP match is considered to be at an appropriate level when compared to that offered by other peer companies. Overall the CAP, along with the Retirement plan, is estimated to produce a benefit that equals 41% of an employee's final pay upon reaching age 62, which is slightly below the 50th percentile of a group of companies we were compared with by the compensation consultant of the Compensation Committee.

Table of Contents***Non-Qualified Deferred Compensation Plan***

Our Non-qualified Deferred Compensation Plan, which we refer to as our Shadow Plan, is a non-qualified, unfunded deferred compensation plan for eligible key employees, including those who are legally precluded from contributing a full 6% of compensation to the CAP or who choose to defer a portion of their salary beyond the amount matched by the CAP. Under the Shadow Plan, eligible employees who wish to participate enter into a salary reduction agreement to defer payment of an additional portion of the employee's salary as the employee prescribes on an election form executed annually in advance of the year in which such compensation would be earned. The total amount of salary deferred under the CAP and the Shadow Plan cannot exceed in the aggregate 50% of salary. The Shadow Plan also allows up to 100% of cash bonuses to be deferred, which is not the case with the CAP. Deferred amounts, along with the Company matching amounts on that portion deferred that is eligible for the match, are invested by State Auto P&C in a variety of mutual fund type investment options made available to participants in the Shadow Plan. Each employee who is eligible to participate in the Shadow Plan is credited annually with his or her allocable share of Company matching contributions on the same basis that contributions are matched under the CAP, provided that no more than 6% of any employee's base salary is subject to being matched under either the CAP or the Shadow Plan.

Because the tax laws impose limitations which may adversely affect highly compensated employees, it is necessary to create non-qualified plans to allow such highly compensated employees to be in the same place, relatively speaking, as other employees of State Auto, in terms of their ability to maximize their retirement savings opportunities. Participants in these non-qualified plans become unsecured creditors of us as part of the program and incur the credit risk associated with that status. Neither the Shadow Plan nor the CAP provides for above market or preferential earnings opportunities for any participant in either plan.

Perquisites

We provide our executive officers certain perquisites that are also not tied to individual or Company performance. We believe these benefits are set at a reasonable level, are highly valued by recipients, have limited cost, are part of a competitive reward program and help in attracting and retaining the best executives. Our executives receive the following perquisites:

We provide up to \$500 annually to an optionee for tax advice secured in the year such options were exercised. This is available to all optionees, not just NEOs. This recognizes the reality that stock options create tax issues for those who receive them, and it is an effort to offset part of the expense associated with that benefit.

We pay a portion of the premium payable on whole life insurance policies for our officers. The face amount of these policies does not exceed \$50,000. This perquisite has been offered since the time when the State Auto Group was in the life insurance business and has continued even though the life company was sold in 1997. It provides an additional form of financial security for officers, although in modest amounts. The company-paid portion of the premiums is included in the total reflected in the All Other Compensation column in the Summary Compensation Table.

We regularly sponsor incentive travel programs for our independent agents. The NEOs attend these programs in order to help us foster and improve our relationships with our independent agents, the only distribution force used by our Company. The cost of the NEO's spouse to attend these trips is also paid by us. The cost is determined by dividing the total cost of the agent incentive trip by the number of travelers. The cost of each NEO's spouse to attend the trip(s) as a host in 2006 is included in the total reflected in the All Other Compensation column in the Summary Compensation Table, for those NEOs whose spouses acted as hosts, except Mr. Miley, whose spouse is also an executive officer of our Company.

We also have a corporate membership in a club in Columbus, Ohio, which is not a golf club. The corporate membership in this club is used for business entertainment and meetings. Three persons have been designated to use the corporate membership at this club. We pay the dues for the three persons to use this club. One of these

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persons is Mr. Blackburn. The dues paid by us for this membership are included in the All Other Compensation column of the Summary Compensation Table.

The Compensation Committee believes that each of the major elements of the reward system described above reflects the objectives of that system, as noted at the outset of this discussion. The Compensation Committee has consistently made itself aware of compensation paid by similarly situated property casualty insurance companies. It is comfortable paying total compensation above the 75th percentile of peer companies when our NEOs or our performance warrants such payment. Otherwise, our objective is to compensate executive officers at the median levels of peer companies when target results are achieved.

Base salaries are set to ensure that an NEO's compensation is competitive with the market median, based on salary surveys completed by its compensation consultant. The NEO's performance and changes in responsibilities are intended to be material factors in any annual salary adjustments.

All forms of incentive compensation, such as the QPB and EBP bonuses and stock options, reward performance that is relative to pre-defined, objective measures. The QPB bonus is not paid at all unless we achieve a relatively high level of underwriting performance. Historically, the QPB Plan also reflected the egalitarian nature of State Auto's culture. Among corporate employees, everyone received the same percentage of QPB bonus from the mailroom clerk to the CEO. This made the benefit relatively unusual and a useful employee retention and development tool. The EBP depended solely on our underwriting performance, sales performance, and average three year shareholder return exceeding that of nine other well established, substantial competitors. As noted above, the Compensation Committee has not considered 2006 EBP bonuses as of the printing of this Proxy Statement.

Finally, as respects stock options, this form of compensation clearly aligns the interest of management with shareholders because stock options have, if any, value unless we produce the kind of results that cause the stock price to appreciate in value. No effort has been made to time the grants of stock options, nor have any options been re-priced.

Stock Ownership Guidelines

We have created stock ownership guidelines (Ownership Guidelines) for senior officers and directors. The basic principle of the Ownership Guidelines is that each person subject to the Ownership Guidelines will attain and maintain ownership of a certain number of Common Shares based on the person's position with us (the Qualifying Amount).

The following Qualifying Amounts applicable to the category of management personnel will remain in place until otherwise amended by the Compensation Committee:

Chairman/CEO	100,000 Common Shares
Chief Operating Officer	50,000 Common Shares
Senior Vice President	30,000 Common Shares
Vice President/Regional Vice Presidents	7,000 Common Shares
Assistant Vice President	2,000 Common Shares

The Ownership Guidelines provide that one-third of all vested in-the-money stock options will be counted toward the Qualifying Amount of the option holder. The expectation in the Ownership Guidelines is that these levels of ownership will be reached within five years of assuming the position to which the ownership requirement pertains.

The outside directors are also subject to the Ownership Guidelines. Outside directors are expected to own 5,000 Common Shares and/or Restricted Share Units under the Outside Director Restricted Share Unit Plan within five years of becoming a director.

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Name and Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)	Option Awards (\$)(1)	Incentive Plan Compensation (\$)(2)	Change in	Non-Equity Compensation (\$)(3)	All Other Compensation (\$)	Total (\$)
							Pension Value and Nonqualified Deferred			
Robert P. Restrepo, Jr. Chairman, President and Chief Executive Officer	2006	521,539	550,000(4)	335,370(5)	446,100	78,022		87,900	190,256(6)	2,209,187
Steven E. English Vice President and Chief Financial Officer	2006	172,615	0	0	92,169	38,484		13,766	85,237(7)	402,271
Mark A. Blackburn Executive Vice President and Chief Operating Officer	2006	296,730	0	0	292,600	67,913		63,347	14,633(8)	735,223
Steven R. Hazelbaker Vice President	2006	194,000	0	0	92,169	42,673		43,937	63,088(9)	435,867
Richard L. Miley Vice President	2006	183,000	0	0	92,169	129,253(10)		68,470	7,546(11)	480,438
Cynthia A. Powell Vice President, Treasurer and Chief Accounting Officer	2006	189,846	0	0	205,609(12)	42,014		16,010	9,496(13)	462,975
Robert H. Moore Retired Chief Executive Officer	2006	269,461	0	0	0	55,752		295,192	1,716,674(14)	2,337,079
Steven J. Johnston Former Chief Financial Officer	2006	152,169	0	0	0	28,236		91,927	1,870,705(15)	2,143,037
John R. Lowther Acting General Counsel/Senior Advisor	2006	278,000	0	0	292,600	61,149		106,288	710,880(16)	1,448,917

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- (1) The dollar amounts shown in this column represent the total number of stock options granted to each NEO multiplied by the fair value of each stock option granted. The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes closed-form pricing model in accordance with SFAS 123R. For a discussion of the relevant SFAS 123R valuation assumptions, see Note 12 to our Company's Consolidated Financial Statements included in Item 8 of our Annual Report on Form 10-K for our fiscal year ended December 31, 2006. The fair value of each stock option granted to Mr. Restrepo was \$14.87. With the exception of Ms. Powell, the fair value of each stock option granted to the other NEOs was \$14.63.
- (2) The dollar amounts shown in this column reflect quarterly cash bonuses earned under our Quality Performance Bonus Plan for 2006. For Mr. Restrepo, the amount shown reflects \$52,338 of QPB bonuses and \$25,684 of a contractually contemplated QPB bonus substitute. Except for Mr. Miley, the dollar amounts shown in this column do not reflect bonuses which may be earned under the 2006 EBP for each NEO because these bonuses were not calculable as of the printing of this Proxy Statement. Two of the performance criteria for establishing 2006 bonuses under the EBP were peer comparisons as to underwriting results and premium growth. We rely on information from A.M. Best Company for those two components. We do not anticipate that this information will be available until late May or early June, 2007. We will calculate the 2006 bonuses for each NEO under the EBP when such information becomes available and present that information to the Compensation Committee for its consideration and approval. When the 2006 EBP bonuses are finally determined, we will file a Form 8-K filing with this information. With respect to Mr. Miley,

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his 2006 EBP bonus was based upon the performance of his business unit which is owned by State Auto Mutual and is not engaged in the insurance underwriting business.

- (3) The dollar amounts shown in this column reflect the change in the pension values for each of our NEOs, including amounts accruing under our Retirement Plan and SERP in which certain of our NEOs participate. None of our NEOs who participate in the non-qualified deferred compensation plan receive preferential or above market earnings.
- (4) (Restrepo) The dollar amount reflects the following amounts and items: (i) a signing bonus of \$400,000 to partially offset the loss of benefits with his prior employer and to allow him to repay certain obligations he had incurred to his former employer by accepting his position with State Auto; and (ii) \$150,000 of his 2006 EBP bonus, which amount was guaranteed under his employment agreement. See Contractual Arrangements with Named Executive Officers Robert P. Restrepo, Jr. for a further description of these bonus amounts.
- (5) (Restrepo) The dollar amount represents 10,500 restricted Common Shares granted to Mr. Restrepo on March 2, 2006, in conjunction with the execution of his employment agreement, multiplied by the closing price of the Common Shares on that day (\$31.94). These restricted Common Shares will cliff vest on March 2, 2009, unless his employment with State Auto terminates prior to March 2, 2009.
- (6) (Restrepo) The dollar amount includes the following amounts and items: (i) Company-paid matches under our 401(k) and non-qualified deferred compensation plans of \$16,961 (none of these amounts paid as matched contributions received preferential earnings or interest); (ii) spousal travel hosting on agent incentive trips of \$5,459; (iii) reimbursement of relocation expenses of \$104,651; (v) tax gross up payment on reimbursed relocation expenses of \$59,195; and (iv) dividends on restricted Common Shares of \$3,990. For a further description of these items, see Contractual Arrangements with Named Executive Officers Robert P. Restrepo, Jr.
- (7) (English) The dollar amount includes the following amounts and items: (i) a payment of \$70,000 (the third of five installments) under Mr. English's retention agreement; and (ii) Company-paid match under our 401(k) plan of \$6,042 (none of these amounts paid as matched contributions received preferential earnings or interest); (iii) reimbursement of relocation expenses of \$5,554; and (iv) tax gross up payment on reimbursed relocation expenses of \$3,641. For a further description of this retention agreement, see Contractual Arrangements with Named Executive Officers Steven E. English.
- (8) (Blackburn) The dollar amount includes the following amounts and items: (i) Company-paid matches under our 401(k) and non-qualified deferred compensation plans of \$7,700 (none of these amounts paid as matched contributions received preferential earnings or interest); (ii) Company-paid whole life insurance policy premiums of \$906; (iii) spousal travel hosting on agent incentive trips of \$5,459; and (iv) club membership dues (non-golfing) of \$568.
- (9) (Hazelbaker) The dollar amount includes the following amounts and items: (i) Company-paid match under our 401(k) plan of \$6,790 (none of these amounts paid as matched contributions received preferential earnings or interest); (ii) Company-paid whole life insurance policy premiums of \$858; (iii) spousal travel hosting on agent incentive trip of \$1,440; and (iv) a payment of \$54,000 (the third of five installments) under Mr. Hazelbaker's retention agreement. For a further description of this retention agreement, see Contractual Arrangements with Named Executive Officers Steven R. Hazelbaker.
- (10) (Miley) The dollar amount includes both Mr. Miley's QPB bonus (\$40,253) and EBP bonus (\$89,000) earned in 2006.
- (11) (Miley) The dollar amount includes the following amounts and items: (i) Company-paid match under our 401(k) plan of \$6,405 (none of these amounts paid as matched contributions received preferential earnings or interest); (ii) Company-paid whole life insurance policy

premiums of \$641; and (iii) optionee tax advice assistance of \$500.

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- (12) (Powell) The dollar amount reflects the following two option grants: (i) a stock option grant for 6,300 Common Shares (the fair value of each stock option for this grant under SFAS 123R was \$14.63), and (ii) a stock option grant for 8,000 Common Shares (the fair value of each stock option for this grant under SFAS 123R was \$14.18).
- (13) (Powell) The dollar amount includes the following amounts and items: (i) Company-paid match under our 401(k) plan of \$6,645 (none of these amounts paid as matched contributions received preferential earnings or interest); (ii) Company-paid whole life insurance policy premiums of \$572; and (iii) spousal travel hosting agent incentive trip of \$2,279.
- (14) (Moone) The dollar amount includes the following amounts and items: (i) Company-paid matches under our 401(k) and non-qualified deferred compensation plans of \$9,431 (none of these amounts paid as matched contributions received preferential earnings or interest); (ii) Company-paid life insurance premiums of \$351; (iii) spousal travel hosting agent incentive trip of \$2,279; (iv) monthly benefits in the total amount of \$25,980 paid under the Retirement Plan during 2006; (v) monthly benefits in the total amount of \$6,028 paid under the Shadow Plan during 2006; (vi) a lump sum amount of \$708,749 paid or accrued for 2006 under the Shadow Plan; (vii) a lump sum amount of \$659,451 paid or accrued for 2006 under the Retirement Plan; (viii) a lump sum amount of \$296,086 paid or accrued for 2006 under the SERP; and (ix) monthly benefits in the total amount of \$8,319 paid under the SERP during 2006.
- (15) (Johnston) The dollar amount includes the following amounts and items: (i) Company-paid match under our 401(k) plan of \$5,326 (none of these amounts paid as matched contributions received preferential earnings or interest); (ii) Company-paid whole life insurance policy premiums of \$326; (iii) benefits of \$7,615 paid under the Shadow Plan during 2006; (iv) separation payment of \$1,743,849; (v) reimbursement of life and health insurance benefit expenses of \$44,175; (vi) tax gross up amount on the reimbursement of life and health insurance benefit expenses of \$36,806; and (vii) unused vacation pay of \$32,608. For a further description of these items, see Contractual Arrangements with Named Executive Officers Steven J. Johnston.
- (16) (Lowther) The dollar amount includes the following amounts and items: (i) Company-paid matches under our 401(k) and non-qualified deferred compensation plans of \$9,730 (none of these amounts paid as matched contributions received preferential earnings or interest); (ii) Company-paid whole life insurance premiums of \$672; (iii) spousal travel hosting agent incentive trips of \$5,459, and (iv) accrual for payments due under retirement agreement of \$695,000. For a further description of these items, see Contractual Arrangements with Named Executive Officers John R. Lowther.

Table of Contents**Grants of Plan-Based Awards in 2006**

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards Target (\$)	All Other Stock Awards: Number of Shares of Stock or Units (#)	All Other Option Awards:		Grant Date Fair Value of Stock and Option Awards (\$)
				Number of Securities Underlying Options (#)	Exercise or Base Price of Option Awards (\$/Sh)	
Robert P. Restrepo, Jr.	3-2-06	600,000(2)	10,500(3)	30,000(4)	31.94	446,100(4)
	3-2-06					
	3-2-06					
Steven E. English	5-17-06	92,500		6,300(5)	33.50	92,169(5)
	6-19-06					
Mark A. Blackburn	5-17-06	168,000		20,000(5)	33.50	292,600(5)
	6-19-06					
Steven R. Hazelbaker	5-17-06	97,000		6,300(5)	33.50	92,169(5)
	7-10-06					
Richard L. Miley	5-17-06	89,000		6,300(5)	33.50	92,169(5)
	6-19-06					
Cynthia A. Powell	5-17-06	100,000		6,300(5)	33.50	92,169(5)
	6-19-06					
	12-18-06					
Robert H. Moone	None					
Steven J. Johnston	None					
John R. Lowther	5-17-06	166,800		20,000(5)	33.50	292,600(6)
	6-19-06					

- (1) The dollar amounts shown in this column as "Target" reflect the maximum annual incentive award payable to each NEO under his or her EBP for 2006. As explained in the CD&A, the 2006 EBP bonuses are based on our performance on three measures in comparison to a set of nine peer companies. The performance measures are calendar year statutory combined ratio, calendar year written premium growth, and three-year average shareholder return. The range of possible bonuses payable under each NEO's EBP is \$0- to the maximum amount shown above, in 20% increments, depending on our performance on these measures in comparison to the peer companies' performance on those measures. In 2005, the EBP bonus formula was identical, and our performance produced an award percentage of 60% of each NEO's EBP bonus target, which targets ranged from 75% of salary to 50% of salary. The bonuses for each NEO's 2006 EBP are not calculable as of the printing of this Proxy Statement because we rely on A.M. Best Company to publish the statutory results of the peer companies with respect to statutory combined ratio and written premium growth. The dollar amounts shown in this column do not include quarterly bonuses earned in 2006 under our QPB Plan. See "Compensation Discussion and Analysis - Short-Term Incentive Plans" for additional information on our EBP and QPB Plan.
- (2) Mr. Restrepo's target includes 75% of his base salary in 2006 (\$600,000) to be determined based on the formula described in footnote (1) above, with the remaining 25% of the target based on a subjective assessment of his performance by the Compensation Committee. This assessment is typically performed after the formulaic bonus calculation is completed. However, Mr. Restrepo is guaranteed a minimum 2006 EBP bonus of \$150,000 under his employment agreement.

- (3) The stock award of 10,500 Common Shares was a grant of restricted Common Shares made in conjunction with the execution of Mr. Restrepo's employment agreement as described in Contractual Arrangements with Named Executive Officers Robert P. Restrepo, Jr. The grant includes the right to receive dividends on the full amount of the Common Shares, which dividends represent cash compensation to Mr. Restrepo. The amount of dividends paid on those Common Shares in 2006 was \$3,990. The grant date fair value for these restricted Common Shares was determined by multiplying the market price of the Common Shares on the date of grant by the number of restricted Common Shares granted.

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- (4) The options shown were granted on the date indicated at a meeting of the Compensation Committee held on that day. The grant was in accordance with the terms of Mr. Restrepo's employment agreement as described in Contractual Arrangements with Named Executive Officers Robert P. Restrepo, Jr. These options are non-qualified stock options which vest in equal annual installments over a three-year period and are exercisable over a ten-year term. The grant date fair value of these options was determined by multiplying the number of stock options by \$14.87, which was the fair value of each stock option granted based upon the Black-Scholes closed-form pricing model in accordance with SFAS 123R. These options have not been re-priced or otherwise materially amended. Our Corporate Governance Guidelines prohibit option re-pricing without shareholder approval.
- (5) The options shown were granted on the date indicated, at the closing price on that date, pursuant to action of the Compensation Committee at a meeting held on that day. These options vest in equal annual installments over a three-year period and are exercisable for a ten-year term. All of these options are non-qualified stock options, except that Mr. English's grant included 50% incentive stock options and Mr. Blackburn's grant included the maximum number of incentive stock options which could be received as permitted by the rules set forth in the Internal Revenue Code. The grant date fair value of these options was determined by multiplying the number of stock options by \$14.63, which was the fair value of each stock option granted based upon the Black-Scholes closed-form pricing model in accordance with SFAS 123R. These options have not been re-priced or otherwise materially amended.
- (6) The options shown were granted on the date indicated, at the closing price on that date, pursuant to action of the Compensation Committee at a meeting held on that day. These options vest in equal annual installments over a three-year period and are exercisable for a ten-year term. All of these options are all non-qualified stock options. The grant date fair value of these options was determined by multiplying the number of stock options by \$14.18, which was the fair value of each stock option granted based upon the Black-Scholes closed-form pricing model in accordance with SFAS 123R. These options have not been re-priced or otherwise materially amended.

Contractual Arrangements with Named Executive Officers

Robert P. Restrepo, Jr.

On February 10, 2006, Robert P. Restrepo, Jr. was appointed as our Chairman and Chief Executive Officer, as well as Chairman and Chief Executive Officer of all of the other State Auto companies, and on March 2, 2006, he was appointed President of State Auto. In connection with these appointments, we entered into an employment agreement with Mr. Restrepo dated as of March 2, 2006, as subsequently amended as of January 29, 2007 (collectively, the Employment Agreement). The following provides a brief description of the material terms of the Employment Agreement, as well as additional information relating to the compensatory aspects of that agreement.

Mr. Restrepo serves as Chairman, President and Chief Executive Officer of State Auto. As such, Mr. Restrepo performs duties that are customarily performed by an executive officer in his position, including duties prescribed by State Auto's governance documents, as well as other duties, consistent with his position, requested or directed by any State Auto board of directors.

Mr. Restrepo's term of employment ends on March 1, 2009, unless sooner terminated due to Mr. Restrepo's disability or death, voluntary termination of employment, termination by State Auto for cause, or termination by State Auto without cause. The Employment Agreement may be renewed at the end of its initial term for additional one-year terms with the mutual consent of the parties. If Mr. Restrepo desires to renew the Employment Agreement at the end of any term, but State Auto does not, then this situation will constitute a termination of Mr. Restrepo's employment without cause. On the other hand, if State Auto desires to renew the Employment Agreement at the end of any term, but Mr. Restrepo does not, then that situation will constitute a voluntary termination of Mr. Restrepo's employment.

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Mr. Restrepo's base salary for 2006 was \$600,000 per year. As of January 1, 2007, Mr. Restrepo's base salary increased to \$675,000 per year. The initial \$600,000 base salary was based upon (i) input received by the Compensation Committee from its compensation consultant regarding the competitive landscape for newly hired CEOs; (ii) Mr. Restrepo's salary at his previous employer, Main Street America Insurance (MSA); and (iii) the 2006 base salary of Robert H. Moone, our retiring chief executive officer. The \$600,000 base salary reflected an amount slightly below the 50th percentile of base salaries for CEOs included in a group of peer companies to State Auto.

Under the Employment Agreement, Mr. Restrepo is eligible to receive a cash incentive bonus up to 100% of his then-current base salary, with 75% of this incentive bonus tied to the performance of State Auto in comparison to a group of peer companies and 25% of this incentive bonus awarded at the discretion of the Compensation Committee. The Employment Agreement stipulated that Mr. Restrepo was guaranteed an incentive bonus equal to 25% of his 2006 base salary.

The Compensation Committee implemented Mr. Restrepo's incentive bonus by establishing an EBP for Mr. Restrepo that mirrored the EBP for other NEOs, with the exception that the portion of his incentive bonus tied to the peer group performance comparison could equal up to a maximum of 75% of his base salary and his discretionary bonus award could equal up to a maximum of 25% of his base salary. The Compensation Committee uses information from A.M. Best Company to determine Mr. Restrepo's bonus tied to the peer group performance comparison. However, this information was not available as of the printing of this Proxy Statement. In addition, the Compensation Committee decided not to establish the discretionary award portion of his incentive bonus until after the formulaic amount of his incentive bonus was determined from the peer group performance comparison. Accordingly, the full amount of Mr. Restrepo's EBP bonus for 2006 was not available as of the printing of this Proxy Statement. However, as noted above, the Summary Compensation Table reflects the contractually guaranteed amount of \$150,000, or 25% of Mr. Restrepo's 2006 base salary.

Mr. Restrepo's 2006 EBP used the same peer group comparison and generally mirrored the EBP plan for Mr. Moone that was in effect for 2005. The annual maximum incentive bonus percentage of 100% of base salary was consistent with past practice. However, according to the compensation consultant of the Compensation Committee, Mr. Restrepo's maximum incentive bonus percentage of base salary is below the maximum bonus percentages for CEOs at peer group companies, which ranged from 135% to 180% of base salary.

Since Mr. Restrepo was not eligible to participate in the QPB until the performance period beginning in October 2006, Mr. Restrepo was made de facto eligible for any QPB payments for the first, second and third quarters of 2006. The Compensation Committee believed that it was important for the CEO to be invested in the QPB since it was a company-wide bonus plan in which all employees were eligible to participate after completing two full quarters of service. In addition, Mr. Restrepo is entitled to participate in all State Auto retirement plans and fringe benefits which are currently or in the future generally made available to executives of State Auto. The EBP cash incentive bonus arrangement, the QPB Plan or similar cash incentive plan, and any long term incentive compensation plan are collectively referred to as the Incentive Compensation Plans.

At the time of his appointment, Mr. Restrepo received a cash payment of \$400,000 to partially offset the loss of benefits he was foregoing at MSA and to allow him to repay obligations he had incurred to MSA by accepting his position with State Auto. For example, he had to secure his release from a contract with MSA, the terms of which included his commitment to repay relocation costs MSA had incurred when it hired him in 2005.

At the time of his appointment, Mr. Restrepo received 10,500 Common Shares which are subject to restrictions on transfer until March 2, 2009, and an equity award of options to purchase 30,000 Common Shares at an exercise price of \$31.94 per share, which was the closing price of our Common Shares on the Nasdaq National Market System on March 2, 2006. Of these options, options to purchase 15,000 Common Shares represented additional consideration in contemplation of Mr. Restrepo's lost opportunities in long term plans sponsored by his former employer. The grant of the restricted Common Shares and options was made pursuant to our Equity Incentive Compensation Plan and the terms set forth in separate Equity Plan Award Agreements with

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Mr. Restrepo. The options vest in one-third increments over a three-year period. Unvested options automatically terminate upon Mr. Restrepo's termination of employment, except upon retirement, death or disability, or if his employment is terminated without cause under the Employment Agreement, in which case all options become fully vested. There were no stock appreciation rights, performance units, or other instruments granted in tandem with these options, nor were there any reload provisions, tax reimbursement features or performance-based conditions to exercisability.

As calculated by the compensation consultant to the Compensation Committee, the Black-Scholes value of options to purchase 30,000 Common Shares represented approximately 60% of Mr. Restrepo's initial base salary. The value of these stock options, together with the value of the restricted Common Shares at their date of grant, equaled approximately 110% of the value of his base salary, which was consistent with the market median, based on information made available to the Compensation Committee.

As is the case with most executive employment agreements, the Employment Agreement addresses separation or severance benefits in connection with the termination of Mr. Restrepo's employment, either prior to, or at the end of the employment term. These provisions benefit both us and the executive in that they provide a clear understanding of the rights and obligations of the parties with respect to events resulting in the termination of the employment relationship. In a competitive environment for qualified and skilled management personal, these provisions are also necessary in the recruitment of executives who may not otherwise be willing to relocate their families and undertake the responsibilities of a new position without such financial commitments from their new employers. These provisions are also necessary for the retention of executives in that they provide a level of financial security in the event of an involuntary termination of employment.

In the event Mr. Restrepo is terminated for cause, he will be entitled to receive his base salary through the date of termination plus any compensation to which he may be entitled under the Incentive Compensation Plans. The Employment Agreement describes those events which would permit State Auto to terminate Mr. Restrepo's employment for cause. In general, a for cause termination means that Mr. Restrepo has willfully failed to perform his duties in accordance with the standards set forth in the agreement. In that situation, he does not receive any separation or severance benefits, He is paid only that amount of compensation which was earned prior to the termination for cause. The same result occurs if Mr. Restrepo voluntarily terminates his employment, although in that event he would incur certain obligations to us, as described below.

In the event Mr. Restrepo is terminated without cause (other than for death, disability or retirement), he will be entitled to receive the continuation of his base salary and benefits under his Employment Agreement for a 24-month period and the payment of the average annual bonus payments earned under the Incentive Compensation Plans for the prior two years. This provision provides us with the flexibility to terminate Mr. Restrepo's employment if such action was determined to be in our best interests, yet provides Mr. Restrepo with a level of financial security until he secures new employment.

In the event Mr. Restrepo becomes disabled, which disability continues for more than six consecutive months in any 12-month period, State Auto may terminate Mr. Restrepo's employment, in which case Mr. Restrepo will be entitled to receive his base salary and payments under the Incentive Compensation Plans to the date of termination. Thereafter, Mr. Restrepo will be entitled to receive 80% of his base salary, less any disability benefits received from any of State Auto's long-term disability benefit plans, throughout the period of his disability or until he attains age 65, whichever first occurs. In the event of Mr. Restrepo's death, his beneficiaries will receive payment of his base annual salary for twelve months plus a pro-rata share of the compensation earned by Mr. Restrepo under the Incentive Compensation Plan as of the date of death. These two provisions reflect State Auto's sense of fairness in addressing unfortunate events which may transpire during the employment term.

The Employment Agreement also imposes a post-employment confidentiality covenant and a non-competition covenant on Mr. Restrepo. The confidentiality covenant has a three-year term, while the

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non-compete has a one-year term and includes a company size factor and a geographic factor as respects the scope of the non-compete. In addition, Mr. Restrepo has agreed that, for a period of two years following termination of his employment, he will not hire, solicit for hire or otherwise induce any employee of State Auto to leave State Auto's employment.

An important point of consideration in the employment relationship between public companies and their senior executive officers is the situation of a potential or actual change of control of the public company. A public company may receive an offer from a third party, either solicited or unsolicited, which seeks the public company's participation in a transaction which would result in a change in the voting and operational control of the public company from its current shareholders and directors to the third party. Senior executive officers, faced with uncertainty and insecurity about the possible loss of their employment, reduction in their responsibilities or compensation arrangements or other adverse changes in their employment situation, may decide to leave the public company before the consummation of the proposed transaction. This result would be particularly damaging to the public company if the proposed transaction did not come to fruition. In order to protect themselves from the loss of valuable senior executives, and as a method of providing a level of security to senior executives, many public companies enter into change of control agreements with their senior executive officers to address the situation of a potential or actual change of control of the public company. These agreements also serve the shareholders' interests by ensuring that any potential transaction will be viewed objectively by the senior executives, since the loss of their employment or adverse change in their employment situation would not adversely affect them personally. At State Auto, these change of control agreements are called Executive Agreements. We enter into Executive Agreements with our senior executive officers as part of our corporate strategy to provide protection for, and thus retain, our well-qualified senior executive officers, notwithstanding a potential or actual change of control of our Company or State Auto Mutual.

Concurrently with entering into the Employment Agreement, we entered into an Executive Agreement with Mr. Restrepo. The term of the Executive Agreement coincides with the term of Mr. Restrepo's employment under the Employment Agreement, subject to an extension for 36 months after any month in which a Change of Control occurs, as defined below. The Executive Agreement will terminate if Mr. Restrepo's employment terminates prior to a Change of Control.

A Change of Control of our Company generally includes:

The acquisition by any person of beneficial ownership of 25% or more of our outstanding voting securities;

A change in the composition of our Board of Directors such that a majority of our Board of Directors is comprised of other than continuing directors (as defined in the Employment Agreement);

A merger involving our Company where our shareholders immediately prior to the merger own less than 51% of the combined voting power of the surviving entity immediately after the merger;

A sale, exchange, lease or other disposition of all or substantially all of our assets, including a sale of assets or earning power aggregating more than 50% of our assets or earning power on a consolidated basis; or

A disposition of assets, reorganization or other corporate event involving our Company which would have the same effect as any of the above-described events.

As respects State Auto Mutual, a Change of Control includes:

State Auto Mutual affiliates with or merges with a third party and a majority of the board directors of State Auto Mutual or the surviving corporation, as the case may be, is comprised of other than continuing directors;

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State Auto Mutual converts to a stock corporation and a majority of the board of directors of the converted corporation is comprised of other than continuing directors of State Auto Mutual; or

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State Auto Mutual is subject to an order of rehabilitation or liquidation issued by the Ohio Department of Insurance, so long as such order has been entered prior to February 9, 2008.

Under the Executive Agreement, we must provide severance benefits to Mr. Restrepo if his employment is terminated (other than on account of Mr. Restrepo's death or disability or termination for cause):

By us at any time within 24 months after a Change of Control;

By Mr. Restrepo for Good Reason (as defined below) at any time within 24 months after a Change of Control; or

By us at any time after an agreement has been reached with an unaffiliated third party, the performance of which agreement would result in a Change of Control involving such third party, if such Change of Control is actually consummated within 12 months after the date of such termination.

Good Reason generally means the assignment to Mr. Restrepo of duties which are materially and adversely different from or inconsistent with the duties, responsibility or status of Mr. Restrepo's position during the 12 months prior to the Change of Control, a reduction in Mr. Restrepo's salary, benefits or incentive bonus or a demand by us that Mr. Restrepo relocate more than 35 miles from his current location. Mr. Restrepo's determination of Good Reason will be conclusive and binding upon the parties if made in good faith.

In addition to accrued compensation, bonuses, and vested benefits and stock options, Mr. Restrepo's severance benefits payable under the Executive Agreement include:

A lump-sum cash payment equal to three times Mr. Restrepo's annual base salary;

A lump-sum cash payment equal to three times the highest annual incentive compensation to which Mr. Restrepo would be entitled;

Thirty-six months of continued insurance benefits;

Thirty-six months of additional service credited for purposes of retirement benefits; and

Out-placement benefits in an amount equal to 15% of Mr. Restrepo's annual base salary.

The Executive Agreement also provides that State Auto will pay Mr. Restrepo such amounts as would be necessary to compensate Mr. Restrepo for any excise tax paid or incurred due to any severance payment or other benefit provided under the Executive Agreement. However, in the event Mr. Restrepo's contractual severance payments and benefits were subject to any excise tax, but otherwise would not be subject to such tax if the total of such payments and benefits were reduced by 10% or less, then such payments and benefits will be reduced by the minimum amount necessary (not to exceed 10% of such payments and benefits) so that we will not have to pay an excess severance payment and Mr. Restrepo will not be subject to an excise tax.

The Executive Agreement provides that, for a period of five years after any termination of Mr. Restrepo's employment, we will provide Mr. Restrepo with coverage under a standard directors' and officers' liability insurance policy at our expense, and will indemnify, hold harmless, and defend Mr. Restrepo to the fullest extent permitted under Ohio law against all expenses and liabilities reasonably incurred by Mr. Restrepo in connection with or arising out of any action, suit, or proceeding in which he may be involved by reason of having been our director or officer.

We must pay the cost of counsel (legal and accounting) for Mr. Restrepo in the event he is required to take any action to enforce any of the rights granted under his Executive Agreement. In addition, Mr. Restrepo is entitled to prejudgment interest on any amounts found to be due to him in connection with any action taken to enforce his rights under the Executive Agreement at a rate equal to the prime commercial rate of our

principal bank or its successor in effect from time to time plus 4%.

Our Executive Agreement with Mr. Restrepo mirrored the change of control agreement we had with Mr. Moone, except that Mr. Restrepo's agreement requires a dual trigger (change of control plus termination by

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the Company or termination by Mr. Restrepo for Good Reason), while Mr. Moore's was a single trigger agreement (change of control only). Also, while the Executive Agreement continues in force for 36 months following a change of control, the right to severance benefits ceases 24 months following a change of control, which is more restrictive than Mr. Moore's agreement. The Compensation Committee's compensation consultant indicated that these arrangements were generally competitive except for two provisions: (i) the calculation of the payment based on maximum bonus payouts, and (iii) the three years of additional credited service. Nevertheless, principally because Mr. Restrepo's Executive Agreement contemplated the payment of benefits following a change of control only if he were adversely affected by the change, it was generally regarded as more conservative than Mr. Moore's agreement.

In January 2007, the Compensation Committee agreed to amend Mr. Restrepo's Employment Agreement to address relocation matters in a more specific way than was possible at the time he was appointed Chief Executive Officer of State Auto. Originally, the Employment Agreement required State Auto to provide Mr. Restrepo with relocation benefits generally equivalent to those provided to other employees who relocate because of their job. The original Employment Agreement specifically provided that State Auto would not be involved in the disposition of the residence Mr. Restrepo owned in Worcester, Massachusetts (the Worcester House). When he moved to Jacksonville, Florida to take a position with MSA, Mr. Restrepo began to market the Worcester House for sale, while renting a residence in Jacksonville. When he accepted the position at State Auto, the Worcester House was still not sold. MSA's contractual obligations regarding Mr. Restrepo's relocation to Florida ended when he accepted his position with State Auto. He continued to try to sell the Worcester House without success. It became a significant distraction to him and his family, while precluding him from re-locating to Columbus, Ohio from Jacksonville. It became apparent to the Compensation Committee that the Worcester House was preventing Mr. Restrepo from re-locating to Columbus, and the Compensation Committee considered his presence in Columbus to be important to us. Our Board of Directors intended and desired for State Auto to have a more visible presence in the community when it hired Mr. Restrepo. However, his living in Florida and commuting to Columbus made it difficult for State Auto to achieve that larger presence or recognition. Simply put, the Compensation Committee believes the position of CEO of State Auto is a 24x7 job, and with its CEO living in Florida, State Auto was not achieving the full value of Mr. Restrepo serving in that role.

After weeks of discussions and investigation by the Compensation Committee, it agreed to have the Worcester House valued and to arrange for Mr. Restrepo to be released from the burden of ownership of the Worcester House, so long as he agreed to move to Columbus within a specific time frame. Appraisals were secured and State Auto and Mr. Restrepo executed an amendment to the Employment Agreement on January 24, 2007 (the Amendment).

The following provides a brief description of the material terms of the Amendment:

Pursuant to the terms of his original Employment Agreement, State Auto had agreed to implement a Supplemental Executive Retirement Plan (a SERP) for Mr. Restrepo. As set forth in the Amendment, the SERP will generally provide Mr. Restrepo with supplemental retirement benefits to enable Mr. Restrepo's overall retirement benefits from State Auto to equal 50% of his final three-year average total cash compensation, proportionately reduced for less than 20 years of service at retirement. State Auto has a mandatory retirement for executive officers of 65, and given that he began his employment with State Auto at age 55, Mr. Restrepo will have at most 10 years of service, which will reduce the SERP benefits accordingly.

The Amendment confirmed and clarified State Auto's obligations with respect to reimbursing Mr. Restrepo for his moving, temporary living and house hunting expenses incurred in connection with relocating himself and his family from Jacksonville, Florida to Columbus, Ohio (the Relocation Expense). Mr. Restrepo has agreed to reimburse State Auto 100% of all Relocation Expenses paid by State Auto if he voluntarily terminates his employment with State Auto on or prior to March 1, 2009. Under the terms of his initial Employment Agreement, this reimbursement obligation decreased annually pursuant to the following schedule: termination in year one - 100% reimbursement; termination in year 2 - 50% reimbursement; termination in year 3 - 0% reimbursement.

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The Compensation Committee concluded that, based upon its review of the independent appraisals of the Worcester House and a representation from Mr. Restrepo as to his cost basis in the Worcester House, Mr. Restrepo would most likely suffer a significant financial loss in connection with his sale of the Worcester House. Accordingly, in order to facilitate, expedite and encourage Mr. Restrepo's relocation to Columbus, Ohio, to partially mitigate Mr. Restrepo's financial loss with respect to his sale of the Worcester House, and to provide a source of equity with which to purchase a residence in Columbus, Ohio metropolitan area, State Auto agreed to (i) purchase, or cause to be purchased the Worcester House for a purchase price of \$1,815,000, and (ii) pay Mr. Restrepo a one-time payment of \$500,000. The purchase price for the Worcester House represents the average appraised value of the Worcester House based upon two independent appraisals performed at the direction of the Compensation Committee.

The terms of Mr. Restrepo's Employment Agreement and Executive Agreement were the result of arm's length negotiations between the Compensation Committee and Mr. Restrepo.

Steven E. English

In 2004, we entered into a retention agreement with Steven E. English, who is now our Chief Financial Officer and who at that time was one of our Assistant Vice Presidents. Mr. English was previously an executive officer with Meridian Insurance Group, Inc. (MIGI), which was acquired by State Auto Mutual in 2001. After the acquisition, Mr. English became our employee, but he retained certain rights under a change in control agreement with MIGI. In consideration of Mr. English relinquishing his rights under this change in control agreement with MIGI, we have agreed to make an annual payment to Mr. English of \$70,000 for five years, provided that he remains employed by us during that period, unless we terminate his employment without good cause (as defined in his retention agreement) or as a result of his death or total disability. The payment in 2006 was the third annual payment to Mr. English. In addition, Mr. English was also granted non-qualified stock options on May 31, 2004, as shown in the 2006 Outstanding Equity Awards at Fiscal Year End Table. These options vest in equal annual installments over a five-year period.

Mark A. Blackburn

Mark A. Blackburn is Executive Vice President and Chief Operating Officer of State Auto. Like Mr. Restrepo, we have entered into an Executive Agreement with Mr. Blackburn providing him with certain severance benefits if his employment is terminated within 36 months after a change of control of either us or State Auto Mutual or 12 months prior to a change of control under certain circumstances, as further described below. Mr. Blackburn's Executive Agreement has been in place since 2001. As discussed above, we entered into the Executive Agreement with Mr. Blackburn as part of our corporate strategy to protect ourselves from the loss of his valuable services, and as a method of providing a level of personal and financial security to Mr. Blackburn, if we or State Auto Mutual were to consider or engage in a transaction resulting in a change of control of our Company or State Auto Mutual. The following provides a brief description of the material terms of Mr. Blackburn's Executive Agreement.

A Change of Control of our Company generally includes:

The acquisition by any person of beneficial ownership of 25% or more of our outstanding voting securities;

A change in the composition of our Board of Directors such that a majority of our Board of Directors is comprised of other than continuing directors (as defined in the Executive Agreement);

A merger involving our Company where our shareholders immediately prior to the merger own less than 51% of the combined voting power of the surviving entity immediately after the merger;

A sale, exchange, lease, or other disposition of all or substantially all of our assets, including a sale of assets or earning power aggregating more than 50% of our assets or earning power on a consolidated basis;

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Our dissolution; or

Our involvement with a disposition of assets, reorganization or other corporate event which would have the same effect as any of the above-described events.

As respects State Auto Mutual, a Change of Control includes:

A person who is not a continuing director (as defined in the Executive Agreement) becomes empowered to vote the proxy of the members of State Auto Mutual;

A person who has not been an officer of State Auto Mutual for at least the preceding 12 months becomes empowered to vote the proxy of the members of State Auto Mutual;

State Auto Mutual affiliates with or merges with a third party and a majority of the board of directors of State Auto Mutual or the surviving corporation, as the case may be, is comprised of other than continuing directors;

State Auto Mutual is subject to an order of rehabilitation or liquidation issued by the Ohio Department of Insurance; or

State Auto Mutual converts to a stock corporation and a majority of the board of directors of the converted corporation is comprised of other than continuing directors of State Auto Mutual.

Under the Executive Agreement, we must provide severance benefits to Mr. Blackburn if his employment is terminated (other than on account of Mr. Blackburn's death or disability or termination for cause):

By us at any time within 36 months after a Change of Control;

By us at any time prior to a Change in Control but after commencement of any discussions with a third party relating to a possible Change in Control involving such third party (Change in Control Discussion) if Mr. Blackburn's termination is in contemplation of such possible Change in Control and such Change in Control is actually consummated within 12 months after the date of Mr. Blackburn's termination;

By Mr. Blackburn for Good Reason (as defined below) at any time within 36 months after a Change of Control; or

By Mr. Blackburn for Good Reason at any time after commencement of Change in Control Discussions if such Change in Control is actually consummated within 12 months after the date of Mr. Blackburn's termination.

Each of these triggering events is a materially significant event manifesting that the people who set our policies as an ongoing business enterprise have changed from those in place when the agreement was first signed. The right to exercise control over the company and its property and affairs has been changed to a new person or set of persons who may have completely different attitudes and practices with respect to how best to run our business. Hence, there is, in our minds, justification to provide some form of economic security to the executive who has had the company undergo a change of control and who has suffered in his or her employment as a result of such change.

Good Reason generally means the assignment to Mr. Blackburn of duties which are materially and adversely different from or inconsistent with the duties, responsibility or status of Mr. Blackburn's position during the 12 months prior to the Change of Control, a reduction in

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Mr. Blackburn's salary, benefits or incentive bonus or our demand that Mr. Blackburn relocate to more than 35 miles from Mr. Blackburn's current location. Mr. Blackburn's determination of Good Reason will be conclusive and binding upon the parties if made in good faith.

In addition to accrued compensation, bonuses, and vested benefits and stock options, Mr. Blackburn's severance benefits payable under the Executive Agreement include:

A lump-sum cash payment equal to three times Mr. Blackburn's annual base salary;

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A lump-sum cash payment equal to three times the highest annual incentive compensation to which Mr. Blackburn would be entitled;

Thirty-six months of continued insurance benefits;

Thirty-six months of additional service credited for purposes of retirement benefits; and

Out-placement benefits in an amount equal to 15% of Mr. Blackburn's annual base salary.

The Executive Agreement also provides that we will pay Mr. Blackburn such amounts as would be necessary to compensate Mr. Blackburn for any excise tax paid or incurred due to any severance payment or other benefit provided under the Executive Agreement. However, in the event Mr. Blackburn's contractual severance payments and benefits were subject to any excise tax, but otherwise would not be subject to such tax if the total of such payments and benefits were reduced by 10% or less, then such payments and benefits will be reduced by the minimum amount necessary (not to exceed 10% of such payments and benefits) so that we will not have to pay an excess severance payment and Mr. Blackburn will not be subject to an excise tax.

The Executive Agreement provides that, for a period of five years after any termination of Mr. Blackburn's employment, we will provide Mr. Blackburn with coverage under a standard directors' and officers' liability insurance policy at our expense, and will indemnify, hold harmless, and defend Mr. Blackburn to the fullest extent permitted under Ohio law against all expenses and liabilities reasonably incurred by Mr. Blackburn in connection with or arising out of any action, suit, or proceeding in which he may be involved by reason of having been our director or officer.

We must pay the cost of counsel (legal and accounting) for Mr. Blackburn in the event he is required to take any action to enforce any of the rights granted under his Executive Agreement. In addition, Mr. Blackburn is entitled to prejudgment interest on any amounts found to be due to him in connection with any action taken to enforce his rights under the Executive Agreement at a rate equal to the prime commercial rate of our principal bank or its successor in effect from time to time plus 4%.

The terms of Mr. Blackburn's Executive Agreement were the result of arm's length negotiations between the Compensation Committee and Mr. Blackburn.

Steven R. Hazelbaker

In 2004, we entered into a retention agreement with Steven R. Hazelbaker, who is and was at that time was one of our Vice Presidents. Mr. Hazelbaker was previously an executive officer with MIGI, which was acquired by State Auto Mutual in 2001. After the acquisition, Mr. Hazelbaker became our employee, but he retained certain rights under a change in control agreement with MIGI. In consideration of Mr. Hazelbaker relinquishing his rights under this change in control agreement with MIGI, we have agreed to make an annual payment to Mr. Hazelbaker of \$54,000 for five years, provided that he remains employed by us during that period, unless we terminate his employment without good cause (as defined in his retention agreement) or as a result of his death or total disability. The payment in 2006 was the third annual payment to Mr. Hazelbaker. In addition, Mr. Hazelbaker was also granted non-qualified stock options on May 31, 2004, as shown in the 2006 Outstanding Equity Awards at Fiscal Year End Table. These options vest in equal annual installments over a five-year period.

Robert H. Moone

In connection with his previously announced intention to retire, Robert H. Moone resigned as our Chairman and Chief Executive Officer on February 10, 2006, and as President on March 3, 2006, and he retired from our Company on May 31, 2006. For 2006, Mr. Moone was paid a base salary of \$261,461 and a QBP bonus of \$55,752 through his retirement date. These amounts were paid pursuant to the terms of an Employment Agreement we previously entered into with Mr. Moone. We are also parties to an Executive Agreement with Mr. Moone. Except for post-termination confidentiality and noncompetition covenants, this Executive

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Agreement automatically terminated upon Mr. Moore's retirement. Mr. Moore's noncompetition covenant expired on November 30, 2006, and Mr. Moore's confidentiality covenant will expire on May 31, 2007.

The terms of Mr. Moore's Employment Agreement and Executive Agreement were the result of arm's length negotiations between the Compensation Committee and Mr. Moore.

Steven J. Johnston

On June 5, 2006, Steven J. Johnston, who at that time was our Senior Vice President and Chief Financial Officer, gave notice that he was leaving State Auto as of June 19, 2006 (the Separation Date). On June 19, 2006, we entered into an agreement with Mr. Johnston regarding his separation of employment from State Auto (the Separation Agreement). The following provides a brief description of the material terms of the Separation Agreement.

On the Separation Date, Mr. Johnston's employment with State Auto was terminated, and Mr. Johnston resigned all of his positions with State Auto.

For a period of 24 months from the Separation Date (the Noncompetition Period), Mr. Johnston will be prohibited from engaging in the property and casualty insurance underwriting business as conducted by State Auto as of Separation Date in any of the states that State Auto conducted its property and casualty insurance business as of the Separation Date. However, Mr. Johnston will be permitted to provide consulting services to Small Insurers (defined as an insurance holding company system in which the aggregate direct written premiums of all property and casualty insurers included in that insurance holding company system is \$500 million or less as of the end of the immediately preceding calendar year).

During the Noncompetition Period, Mr. Johnston will be prohibited from divulging, furnishing or using any confidential information obtained by him while employed by State Auto. During the Noncompetition Period, Mr. Johnston will be prohibited from soliciting, recruiting, or attempting to induce employees of State Auto to leave their employment with State Auto or from employing or attempting to employ any employees of State Auto. During the Noncompetition Period, Mr. Johnston has agreed to cooperate and to make himself available to answer questions concerning his knowledge of the business, operations, and/or finances of State Auto, and for a period of five years from the Separation Date, Mr. Johnston has agreed to cooperate and assist State Auto in litigation matters.

In consideration for entering into the Separation Agreement, Mr. Johnston received a lump sum payment from State Auto in the amount of \$1,743,849 (less applicable payroll taxes and withholdings), representing the aggregate amount of (i) three times Mr. Johnston's then current annual base salary, (ii) three times the target amount of Mr. Johnston's 2005 bonus under his EBP for 2005, and (iii) three times the amount of Mr. Johnston's 2005 QPB bonus. He also received a lump sum payment from State Auto in the amount of \$80,981 (less applicable payroll taxes and withholdings), representing reimbursement for Mr. Johnston's cost to maintain life and health insurance coverages for a three-year period comparable to those coverages he received from State Auto. Mr. Johnston will receive coverage under State Auto's long-term disability program for a three-year period from the Separation Date.

Mr. Johnston will be entitled to receive retirement benefits so that the total retirement benefits he receives from State Auto will approximate the total retirement benefits that he would have received under the defined benefit retirement plans of State Auto in which he participated were he fully vested under such retirement plans and had he continued to be employed by State Auto for 36 months following the Separation Date.

State Auto agreed to reimburse Mr. Johnston for outplacement services up to a maximum amount of \$47,100 and job search travel expenses up to a maximum of \$5,000, in both cases, actually incurred within 24 months of the Separation Date.

There was no accelerated vesting of any stock options held by Mr. Johnston as of the Separation Date. The parties agreed to mutually release each other from claims arising out of Mr. Johnston's employment and

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separation arrangement with State Auto, except for claims arising under the Separation Agreement or based upon conduct as to which a release cannot be effected under applicable law or public policy. For a period of five years from the Separation Date, State Auto has agreed to provide Mr. Johnston with coverage under a standard directors and officers liability insurance policy at its expense.

State Auto has agreed to indemnify Mr. Johnston if he is made, or threatened to be made, a party to any litigation matter by reason of his having served as a director, officer or employee of State Auto. Finally, the parties agreed to a mutual nondisparagement covenant.

As part of the terms of the Separation Agreement, the parties agreed to terminate Mr. Johnston's Executive Agreement. However, the provisions of the Separation Agreement generally mirrored those in Mr. Johnston's Executive Agreement (i.e., change of control agreement), which had been in place since 2001. In negotiating the Separation Agreement, State Auto desired to achieve an amicable separation arrangement with Mr. Johnston in recognition of his many years of service to State Auto, obtain his cooperation and assistance, if needed, in litigation, finance and other company matters, and receive greater protections with respect to Mr. Johnston competing with State Auto, maintaining the confidentiality of State Auto information and soliciting employees away from State Auto. For example, the noncompetition covenant in the Separation Agreement has broader application and extends for a period of two years as compared to six months as was in Mr. Johnston's change of control agreement. The Compensation Committee consulted with its compensation consultant regarding the benefits set forth in the Separation Agreement and satisfied itself that, in the aggregate, such benefits were not outside the parameters set by the marketplace for such agreements, particularly in light of the expanded protections afforded State Auto under the Separation Agreement.

The terms of Mr. Johnston's Separation Agreement were the result of arm's length negotiations between the Compensation Committee and Mr. Johnston.

John R. Lowther

On November 3, 2006, we announced that John R. Lowther, our Senior Vice President, Secretary and General Counsel, would be retiring from State Auto in 2007. Prior to this announcement, Mr. Lowther had negotiated the terms of a Retirement Agreement with Mr. Restrepo, the material terms of which are summarized below. The fundamental consideration underlying the Retirement Agreement was Mr. Lowther's agreement to terminate his Executive Agreement (i.e., change of control agreement) that he had entered into with us in 2001, along with his commitment to remain in our active employ while we conducted a search for his successor and then to facilitate the onboarding of that successor, after which time he would serve as a senior advisor to Mr. Restrepo. Mr. Restrepo believed that it was important for us to continue to have access to Mr. Lowther during 2007 because of his long service to State Auto as our General Counsel, as well as his long services as a director of our Company and of State Auto Mutual. The following provides a brief description of the material terms of Mr. Lowther's Retirement Agreement dated as November 3, 2006 (the Retirement Agreement).

Mr. Lowther will remain an employee of State Auto until his retirement in 2007. Mr. Lowther's retirement date will be mutually agreed to by the parties, but will not be later than December 31, 2007. If Mr. Lowther has not retired on or prior to December 31, 2007, then his employment with State Auto will automatically terminate on December 31, 2007. Until his retirement, Mr. Lowther will serve as senior advisor to our chief executive officer and, until his successor as general counsel is named, as acting general counsel.

From the time of the announced retirement until December 31, 2006, Mr. Lowther continued to receive his compensation package, including salary, bonus and fringe benefits, as was then in effect.

During 2007, Mr. Lowther will receive a base salary in the amount of \$278,000 per year, participate in the QPB or any similar cash incentive compensation plan generally made available to our employees, and participate in any and all employee benefit plans and arrangements and receive any and all fringe benefits generally made available to our employees. In the event of Mr. Lowther's death or disability prior to December 31, 2007, State

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Auto is obligated to continue to pay Mr. Lowther's base salary to him or his estate, as the case may be, until December 31, 2007. In addition, Mr. Lowther will participate in the 2007 Executive Bonus Plan of State Auto and will receive 100% of his bonus target of \$278,000 under that plan. State Auto is obligated to make this bonus payment to Mr. Lowther under any circumstance.

After his retirement, but in no event later than March 15, 2008, Mr. Lowther will receive a lump sum payment in an amount equal to 1.5 times the amount of his 2007 cash compensation (i.e., salary and bonus), which is expected to be \$834,000, less applicable payroll taxes and withholdings, as a separation benefit. State Auto is obligated to make this separation payment to Mr. Lowther under any circumstance.

As part of his separation benefits, Mr. Lowther will be entitled to receive retirement benefits so that the total retirement benefits he receives from State Auto will approximate the total retirement benefits that he would have received under the defined benefit retirement plans of State Auto in which he participated were he fully vested under such retirement plans and had he continued to be employed by State Auto for 24 months following his retirement date at his 2007 base salary.

As a condition precedent to Mr. Lowther's receipt of his separation benefits, at the time of his retirement the parties will enter into an agreement to mutually release each other from claims arising out of Mr. Lowther's employment and separation arrangement with State Auto, except for claims arising under the Retirement Agreement or based upon conduct as to which a release cannot be effected under applicable law or public policy.

During the remaining period of Mr. Lowther's employment and for a period of 18 months following his retirement (the Noncompetition Period), Mr. Lowther will be prohibited from (i) providing legal services to any Person (as defined in the Retirement Agreement) engaged in the property and casualty insurance underwriting business as conducted, or proposed to be conducted, by State Auto as of his retirement date in any state that State Auto conducts, or plans to conduct, its property and casualty insurance business as of his retirement date (the P&C Business), or (ii) engaging in the P&C Business. As an example, during the Non-competition Period, Mr. Lowther may not associate himself, directly or indirectly, with any law firm which provides legal services to any person engaged in the P&C Business. However, Mr. Lowther will be permitted to provide legal services to a Small County Mutual Insurer (as defined in the Retirement Agreement) during the Non-competition Period.

During the Non-competition Period, Mr. Lowther will be prohibited from divulging, furnishing or using any confidential information obtained by him while employed by State Auto.

During the Noncompetition Period, Mr. Lowther will be prohibited from soliciting, recruiting, or attempting to induce employees of State Auto Insurance Companies to leave their employment with State Auto or from employing or attempting to employ any employees of State Auto.

During the Noncompetition Period, Mr. Lowther has agreed to cooperate and to make himself available to answer questions concerning his knowledge of the legal, regulatory, business and/or operations of State Auto, and for a period of five years from his retirement date, Mr. Lowther has agreed to cooperate and assist State Auto in litigation matters. For a period of five years from his retirement date, State Auto has agreed to provide Mr. Lowther with coverage under a standard directors' and officers' liability insurance policy at their expense. State Auto has agreed to indemnify Mr. Lowther if he is made, or threatened to be made, a party to any litigation matter by reason of his having served as a director, officer or employee of State Auto. The parties agreed to a mutual non-disparagement covenant.

The Retirement Agreement did not modify or change the vesting or any other terms of any stock options held by Mr. Lowther as of November 3, 2006. All stock options held by Mr. Lowther as of November 3, 2006, remained exercisable by Mr. Lowther in accordance with the terms of our applicable equity compensation plan under which such stock options were granted and any applicable stock option agreement between us and Mr. Lowther related to such stock options.

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As noted above, as part of the terms of the Retirement Agreement, the parties terminated Mr. Lowther's Executive Agreement. The Executive Agreement provided Mr. Lowther with certain severance benefits if his employment was terminated within 36 months after a change of control of either our Company or State Auto Mutual (including Mr. Lowther's voluntary termination of employment for good reason) or 12 months prior to a Change of Control under certain circumstances (including Mr. Lowther's voluntary termination of employment for good reason).

Mr. Restrepo secured the input of the compensation consultant to the Compensation Committee in negotiating the factors applicable to the separation benefit described above. The compensation consultant advised him that a multiple of 1.5 times cash compensation was consistent with the provisions of such agreements for persons at Mr. Lowther's level within senior management.

The terms of Mr. Lowther's Retirement Agreement were the result of arm's length negotiations between State Auto and Mr. Lowther.

Outstanding Equity Awards at Fiscal 2006 Year-End

Name	Option Awards				Stock Awards			Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested
	Number of Securities Underlying Unexercised Options (#)	Number of Securities Underlying Unexercised Options (#)(1)	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#)	Option Exercise Price (\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested (\$)	Unearned Shares, Units or Other Rights That Have Not Vested (#)	Value of Unearned Shares, Units or Other Rights That Have Not Vested (\$)
Robert P. Restrepo, Jr.	0	30,000	0	31.94	3-1-16	10,500(2)	364,140	0	0
Steven E. English	2,334	0	0	16.00	5-22-12				
	2,500	0	0	18.74	5-21-13				
	1,666	834	0	30.86	5-26-14				
	1,951	1,301	0	30.75	5-31-14				
	832	1,668	0	26.45	5-9-15				
	0	6,300	0	33.50	5-16-16				
Mark A. Blackburn	6,000	0	0	12.06	8-18-09				
	7,200	0	0	10.38	5-24-10				
	9,100	0	0	16.47	5-23-11				
	10,400	0	0	16.00	5-22-12				
	14,500	0	0	18.74	5-21-13				
	9,666	4,834	0	30.86	5-26-14				
	4,832	9,668	0	26.45	5-9-15				
	0	20,000	0	33.50	5-16-16				
Steven R. Hazelbaker	5,000	0	0	16.00	5-22-12				
	4,500	0	0	18.74	5-21-13				
	3,000	1,500	0	30.86	5-26-14				
	1,317	878	0	30.75	5-31-14				
	1,500	3,000	0	26.45	5-9-15				
	0	6,300	0	33.50	5-16-16				

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Name	Option Awards					Stock Awards			
	Number of Securities Underlying Unexercised Options(#)	Number of Securities Underlying Unexercised Options(#)(1)	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Options (#)	Option Exercise Price (\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested (\$)	Equity Incentive Plan Awards: Number of Shares, Units or Other Rights That Have Not Vested (#)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested (\$)
Richard L. Miley	6,000	0	0	17.00	2-12-08				
	6,000	0	0	11.88	5-26-09				
	7,200	0	0	10.38	5-24-10				
	4,400	0	0	16.47	5-23-11				
	5,000	0	0	16.00	5-22-12				
	7,500	0	0	18.74	5-21-13				
	5,000	2,500	0	30.86	5-26-14				
	2,500	5,000	0	26.45	5-9-15				
	0	6,300	0	33.50	5-16-16				
Cynthia A. Powell	3,000	0	0	17.00	2-12-08				
	3,000	0	0	11.88	5-26-09				
	7,200	0	0	10.38	5-24-10				
	4,400	0	0	16.47	5-23-11				
	5,000	0	0	16.00	5-22-12				
	4,500	0	0	18.74	5-21-13				
	5,000	2,500	0	30.86	5-26-14				
	2,500	5,000	0	26.45	5-9-15				
	0	6,300	0	33.50	5-16-16				
	0	8,000	0	34.02	12-17-16				
Robert H. Moone(3)	10,200	0	0	17.00	2-12-08				
	13,580	0	0	11.88	5-26-09				
	23,962	0	0	10.38	5-24-10				