

State Auto Financial CORP
Form DEF 14A
April 09, 2015
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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)

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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 or STFC) will be held at the Company's principal executive offices located at 518 East Broad Street, Columbus, Ohio, on May 8, 2015, at 11:00 a.m., local time, for the following purposes:

1. To elect four Class III 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;
3. To ratify the selection of Ernst & Young LLP as the Company's independent registered public accounting firm for 2015;
4. To consider and vote upon, on a non-binding and advisory basis, the compensation of the Company's named executive officers as disclosed in the Proxy Statement for the 2015 Annual Meeting of Shareholders; and
5. To transact such other business as may properly come before the meeting or any adjournment thereof.

The close of business on March 13, 2015, 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

JAMES A. YANO

Secretary

Dated: April 9, 2015

Table of Contents**STATE AUTO FINANCIAL CORPORATION****PROXY STATEMENT SUMMARY**

You have received this Proxy Statement because the Board of Directors of STFC is soliciting your proxy to vote your Common Shares at the 2015 Annual Meeting of Shareholders. This summary highlights information contained elsewhere in this Proxy Statement. Defined terms used in this summary have the meanings given to such terms elsewhere in this Proxy Statement. This summary does not contain all of the information that you should consider in voting your Common Shares, and you should read the entire Proxy Statement carefully before voting. Page references are supplied to help you find more detailed information in this Proxy Statement. The date this Proxy Statement and the related proxy materials are first being sent or given to shareholders and being made available on the internet is approximately April 9, 2015.

2015 ANNUAL MEETING OF SHAREHOLDERS

Time: May 8, 2015, 11:00 a.m., local time

Place: 518 East Broad Street, Columbus, Ohio 43215

Record Date: You may vote if you were a shareholder of record at the close of business on March 13, 2015 (page 1).

VOTING MATTERS AND BOARD RECOMMENDATIONS

	Board Vote	Page Reference
	Recommendation	(for more detail)
Election of Directors	FOR each Director Nominee	3
Vote on Proposed Amendment to Company's 1991 Employee Stock Purchase And Dividend Reinvestment Plan	FOR	9
Ratification of Ernst & Young LLP as Independent Registered Public Accounting Firm	FOR	12
Advisory Vote to Approve Compensation of STFC's Named Executive Officers	FOR	13

Our Board of Directors is not aware of any matter that will be presented for a vote at the 2015 Annual Meeting of Shareholders other than those shown above.

State Automobile Mutual Insurance Company (State Auto Mutual) owns approximately 62.6% of the outstanding Common Shares of STFC. State Auto Mutual has expressed an intention to vote FOR each of the voting matters listed above.

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You can vote by any of the following methods:

via the internet (www.proxyvote.com) until 11:59 p.m. Eastern time on May 7, 2015;

via telephone by calling 1-800-690-6903 until 11:59 p.m. Eastern time on May 7, 2015;

if you received a proxy card or voting instruction form in the mail, by completing, signing, dating, and returning your proxy card or voting instruction form in the return envelope provided to you in accordance with the instructions provided with the proxy card or voting instruction form; or

in person at the 2015 Annual Meeting of Shareholders.

Director Nominees (pages 3 and 4)

Name	Age	Director	Principal	Independent		Current Committee Memberships*	Other Public Company Boards
		Since	Occupation	Yes	No		
Michael J. Fiorile	60	Nominee	President and CEO of Dispatch Printing Co.	X		NA	
Michael E. LaRocco	58	Nominee	President and CEO of STFC, effective May 8, 2015		X	NA	
Eileen A. Mallesch	59	2010	Retired	X		Audit, N&G, Risk	1
Robert P. Restrepo, Jr.	64	2006	President and CEO of STFC until May 8, 2015, when Mr. LaRocco will succeed him, and Chairman of STFC		X	I&F	

Directors Continuing in Office (pages 5 and 6)

Name	Age	Director	Principal	Independent		Current Committee Memberships*	Other Public Company Boards
		Since	Occupation	Yes	No		
Robert E. Baker	68	2007	Executive VP of DHR International, Inc.	X		Audit, Comp	
David J. D Antoni	70	1995	Retired	X		Comp, N&G, Indep	2

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Thomas E.	57	2007	Executive VP of Research Now Group, Inc.	X	Risk I&F, N&G,
Markert					Risk
David R.	69	2006	Principal of Stonehenge Partners Corp.	X	Audit, I&F
Meuse					
S. Elaine	62	2002	President and CEO of Columbus Regional Airport Authority	X	I&F, N&G,
Roberts					Risk
Alexander	69	2006	President of Nuvocom Inc.	X	Comp, I&F, Indep

B. Trevor

*Audit = Audit Committee; Comp = Compensation Committee; Indep = Independent Committee;

I&F = Investment and Finance Committee; N&G = Nominating and Governance Committee; Risk = Risk Committee

Table of Contents**INFORMATION ABOUT OUR BOARD AND BOARD COMMITTEES (pages 17-19)**

	Number of Members	Percent Independent	Number of Meetings During Fiscal 2014
Full Board	9*	89%	5
Audit Committee	4	100%	8
Compensation Committee	4	100%	5
Independent Committee	3	100%	3
Investment and Finance Committee	5	80%	4
Nominating and Governance Committee	4	100%	6
Risk Committee	4	100%	1

During 2014, seven Board members attended 100% of the meetings of the Board and Board committees on which they served. Our other two Board members attended 88% or more of the meetings of the Board and Board committees on which they served.

GOVERNANCE FACTS

Size of Board	9*
Number of Independent Directors	8
Audit Committee Comprised Entirely of Independent Directors	YES
Compensation Committee Comprised Entirely of Independent Directors	YES
Nominating and Governance Committee Comprised Entirely of Independent Directors	YES
Risk Committee Comprised Entirely of Independent Directors	YES
Independent Lead Director	YES
Majority Voting for Election of Directors	NO
Annual Advisory Vote on Executive Compensation	YES
Annual Board and Committee Self-Evaluations	YES
Stock Ownership Guidelines for Directors and Executive Officers	YES
All Current Directors Own Company Stock	YES
Restrictions on Pledging of Company Shares by Directors and Executive Officers	YES
Clawback Obligations Imposed on Named Executive Officers	YES
Directors and Executive Officers Permitted to Hedge Company Shares	NO
Directors Involved in Related Party Transactions	NO
Super Majority Vote to Approve Amendments to Charter or Bylaws	NO
Shareholder Rights Plan (Poison Pill)	NO

*The size of the Board was increased to ten on March 27, 2015 to accommodate the nomination of Mr. LaRocco as a director. If all four nominees are elected directors on May 8, 2015, there will be ten directors on the Board.

2014 BUSINESS HIGHLIGHTS

Highlights of our 2014 results (on a GAAP basis) include:

net income of \$107.4 million, which represented an increase of \$46.6 million from 2013;

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earnings per share of \$2.63, which represented an increase of \$1.13 from 2013;

combined ratio of 105.5%, which represented a 3.7% deterioration compared to 2013;

non-cat loss and loss adjustment expense (LAE) ratio of 68.8%, which represented a 4.0% deterioration compared to 2013;

return on average equity of 13.0%, which represented a 5.0% improvement compared to 2013;

book value per share of \$21.32 at December 31, 2014, which represented an increase of \$2.05 from December 31, 2013; and

our stock price increased approximately 4.6% from December 31, 2013 to December 31, 2014.

The portion of the performance-based compensation awarded to our named executive officers (NEOs) in 2014 that will ultimately be earned is determined based on the results we and the State Auto Group achieve with respect to certain of these and other GAAP and non-GAAP financial measures. See the Compensation Discussion and Analysis section of this Proxy Statement for more information regarding our executive compensation program and the performance-based compensation awarded to and earned by our NEOs in 2014.

PRIMARY COMPONENTS OF OUR 2014 EXECUTIVE COMPENSATION PROGRAM (page 35)

Component	Form	Key Features
<i>Base Salary</i>	Cash	<p>Intended to attract and retain top-caliber executives.</p> <p>Generally based on the median level of base salary for the executive in our competitive market, but may vary based on the executive's scope of responsibility or unique skills or expertise.</p>
<i>Short-Term Incentive</i>	Cash	<p>Intended to focus our executives on achieving the objectives of our annual operating plan.</p> <p>Consists of a Company performance component (65%-75% weighting in 2014) and an individual performance component (25%-35% weighting in 2014).</p> <p>Payouts range from 10% of target payout to 200% of target payout depending on performance.</p>
<i>Performance Award Units</i>	Cash	<p>Intended to encourage business behaviors that drive appreciation in the price of our Common Shares over the long term, align the interests of our executives with the interests of our shareholders and balance the focus of our annual operating plan.</p> <p>Payouts determined based on the performance of the State Auto Group compared to a peer group over a three-year performance period.</p> <p>Payouts range from 40% of target payout to 200% of target payout depending on performance.</p> <p>Represented 65% of the total long-term incentive opportunity awarded to each NEO in 2014.</p>
<i>Stock Options</i>	Equity	<p>Intended to encourage business behaviors that drive appreciation in the price of our Common Shares over the long term, align the interests of our executives with the interests of our shareholders and build appropriate levels of Common Share ownership among our executive team.</p>

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One-third of the total options granted vests on each of the first three anniversaries of the grant date.

Represented 20% of the total long-term incentive opportunity awarded to each NEO in 2014.

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Component	Form	Key Features
<i>Restricted Common Shares</i>	Equity	<p>Intended to reduce our usage of Common Shares under our equity compensation plans, align the interests of the NEOs with the interests of our shareholders and encourage associate retention.</p> <p>Vest on the third anniversary of the grant date.</p> <p>Represented 15% of the total long-term incentive opportunity awarded to each NEO in 2014.</p>
<i>Perquisites</i>	Cash; Benefits	<p>Intended to attract and retain top-caliber executives.</p> <p>Are very limited in value and participation.</p>

IMPACT OF STATE AUTO GROUP ON 2014 COMPENSATION OF NEOs (page 27)

Because our NEOs perform services for the Company, State Auto Mutual and other members of the State Auto Group, we generally allocated the compensation expenses in 2014 for such services 65% to the Company and its subsidiaries and 35% to State Auto Mutual and certain of its subsidiaries and affiliates.

2014 EXECUTIVE COMPENSATION HIGHLIGHTS (page 26)

Base Salary. The base salaries of our NEOs increased by approximately 3% in 2014. The increases were based on: (i) each NEO's performance; (ii) increases in the median base salaries for individuals in similar roles at peer companies and other insurers comparable in size to the State Auto Group; and (iii) the Company's overall merit increase budget and policies.

Short-Term Incentive – Company Performance Goals. The payout on the Company performance goals for 2014 as a percentage of the target payout was 146.2% for Messrs. Restrepo, English, Fitch and Yano and 157.5% for Ms. Buss compared to a payout on the Company performance goals for 2013 as a percentage of the target payout of 57.5% for Messrs. Restrepo, English and Yano, 64.3% for Mr. Fitch and 136.0% for Ms. Buss. In August 2014, the Compensation Committee made adjustments to the LBP Combined Ratio, Non-Catastrophe Loss Ratio and specialty insurance combined ratio performance measures originally selected for the Company performance component of the LBP for 2014. These adjustments excluded from the LBP Combined Ratio, Non-Catastrophe Loss Ratio and specialty insurance combined ratio performance measures \$129.7 million in charges related to reserve strengthening for our terminated Risk Evaluation & Design LLC (RED) program business and also excluded from the LBP Combined Ratio performance measure \$10.6 million in information technology reorganization-related severance expenses and vendor fees (see Short-Term Incentive Compensation Leadership Bonus Plan Bonuses LBP Award Process for more information regarding these adjustments). Accordingly, the payouts on the Company performance goals for 2014 reflected the Adjusted LBP Combined Ratio (and Adjusted specialty insurance combined ratio in the case of Ms. Buss), return on equity and Adjusted Non-Catastrophe Loss Ratio (and specialty insurance rate change in the case of Ms. Buss) we achieved in 2014. The payouts on the Company performance goals for 2013 reflected the combined ratio (or specialty insurance combined ratio in the case of Ms. Buss), return on equity and non-catastrophe loss ratio (or specialty insurance rate change and standard lines non-catastrophe loss ratio in the case of Ms. Buss and Mr. Fitch, respectively) we achieved in 2013. The Compensation Committee exercised negative discretion to reduce the payouts on the Company performance goals for 2013 to members of certain of the Company's business units (including the business units of Mr. Fitch and Ms. Buss) by fifteen percent to more equitably allocate the results of RED across all of our business units. As a result, the Compensation Committee reduced the payouts to Mr. Fitch and Ms. Buss for 2013 on the Company performance goals as a percentage of the target payout from 75.6% and 159.3%, respectively.

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Short-Term Incentive Individual Performance Goals. The payout on the individual performance goals for 2014 as a percentage of the target payout was 50% for Mr. Restrepo, 170% for Mr. English, 170% for Mr. Fitch, 180% for Ms. Buss and 180% for Mr. Yano compared to a payout on the individual performance goals for 2013 as a percentage of the target payout of 90% for Mr. Restrepo, 170% for Mr. English, 144.5% for Mr. Fitch, 136% for Ms. Buss and 180% for Mr. Yano. The payouts on the individual performance goals reflected the individual contributions of each NEO to our results. The Compensation Committee exercised negative discretion to reduce the payouts on the individual performance goals for 2013 to members of certain of the Company's business units (including the business units of Mr. Fitch and Ms. Buss) by fifteen percent to more equitably allocate the results of RED across all of our business units. As a result, the Compensation Committee reduced the payouts to Mr. Fitch and Ms. Buss for 2013 on the individual performance goals as a percentage of the target payout from 170% and 160%, respectively.

Long-Term Incentive Performance Award Units. Based on preliminary performance information (final information is not yet available) indicating that the State Auto Group's overall performance for the 2012-2014 performance period relative to a peer group fell within the 40th percentile, we currently expect that the performance award units awarded to our NEOs (except for Ms. Buss) for the 2012-2014 performance period will be valued significantly below target. We currently expect that the PAUs awarded to Ms. Buss for the 2012-2014 performance period will be valued significantly above target. The anticipated payouts on the PAUs awarded to each of the NEOs other than Ms. Buss for the 2012-2014 performance period reflected the statutory combined ratio, net written premium growth (excluding the impact of the quota share reinsurance agreement entered into by the State Auto Group on December 31, 2011 relating to its homeowners book of business (the Quota Share Agreement)) and surplus growth of the State Auto Group during the performance period relative to a peer group (excluding the impact of the Quota Share Agreement). The anticipated payout on the PAUs awarded to Ms. Buss for the 2012-2014 performance period reflected the combined ratio, direct written premium growth and surplus growth for our Specialty Group relative to a peer group.

Long-Term Incentive Equity Compensation. In 2014, we awarded stock options and restricted common shares to our NEOs. As of December 31, 2014, the value of the equity compensation we awarded to our NEOs in 2014 was approximately 48% of the targeted value of such equity compensation.

Based on the approval of the say-on-pay vote at our 2014 Annual Meeting of Shareholders (approximately 99% of the votes cast), the Compensation Committee did not make any changes to our executive compensation program as a result of the 2014 say-on-pay vote. See Compensation Discussion and Analysis Executive Summary Modifications to Executive Compensation Program on page 30 of this Proxy Statement for a description of the changes we did make to our executive compensation program and practices in 2014.

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