

State Auto Financial CORP
Form DEF 14A
March 24, 2016
Table of Contents

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

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Definitive Proxy Statement

Definitive Additional Materials

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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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Table of Contents

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 6, 2016, at 11:00 a.m., local time, for the following purposes:

1. To elect two 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 Code of Regulations to provide an exclusive forum for the adjudication of certain legal actions;
3. To consider and vote upon a proposal to amend the Company's 2009 Equity Incentive Compensation Plan;
4. To consider and vote upon a proposal to adopt the Company's Outside Directors Restricted Share Unit Plan;
5. To consider and vote upon a proposal to adopt the Company's One Team Incentive Plan;
6. To ratify the selection of Ernst & Young LLP as the Company's independent registered public accounting firm for 2016;
7. 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 2016 Annual Meeting of Shareholders; and
8. To transact such other business as may properly come before the meeting or any adjournment thereof.

The close of business on March 8, 2016, 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

MELISSA A. CENTERS

Secretary

Dated: March 24, 2016

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 2016 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 March 24, 2016.

2016 ANNUAL MEETING OF SHAREHOLDERS

Time: May 6, 2016, 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 8, 2016 (page 1).

VOTING MATTERS AND BOARD RECOMMENDATIONS

	Board Vote	Page Reference
	Recommendation	(for more detail)
Election of Directors	FOR each Director Nominee	4
Vote on Proposed Amendment to Company's Code of Regulations to provide an exclusive forum for the adjudication of certain legal actions	FOR	10
Vote on Proposed Amendment to Company's 2009 Equity Incentive Compensation Plan	FOR	12
Vote on Proposed Adoption of Company's Outside Directors Restricted Share Unit Plan	FOR	19
Vote on Proposed Adoption of the Company's One Team Incentive Plan	FOR	23
Ratification of Ernst & Young LLP as Independent Registered Public Accounting Firm	FOR	26
Advisory Vote to Approve Compensation of STFC's Named Executive Officers	FOR	27

Our Board of Directors is not aware of any matter that will be presented for a vote at the 2016 Annual Meeting of Shareholders other than those shown above.

Table of Contents

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.

How to Cast Your Vote (as discussed on the proxy card)

You can vote by any of the following methods:

via the internet (www.proxyvote.com) until 11:59 p.m. Eastern time on May 5, 2016;

via telephone by calling 1-800-690-6903 until 11:59 p.m. Eastern time on May 5, 2016;

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 2016 Annual Meeting of Shareholders.

Director Nominees (pages 4 and 5)

Name	Age	Director	Principal	<u>Independent</u>		Current	Other Public Company Boards
		Since	Occupation	Yes	No	Committee	
Robert E. Baker	69	2007	Executive VP of DHR International, Inc.	X		Audit, Comp	Memberships*
Thomas E. Markert	58	2007	Executive	X		Comp, Indep, N&G, Risk	

Directors Continuing in Office (pages 5-7)

Name	Age	Director	Principal	<u>Independent</u>		Current	Other Public Company Boards
		Since	Occupation	Yes	No	Committee	
David J. D Antoni	71	1995	Retired	X		Comp, Indep, I&F, N&G	2
Michael J. Fiorile	61	2015	President and CEO of Dispatch Printing Co.	X		N&G, Risk	
Michael E. Fiorile	59	2015	Chairman, President and CEO of STFC		X	I&F	

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LaRocco						
Eileen A.	60	2010	Retired		X	Audit, Comp, 1 Indep
Mallesch						
David R.	70	2006	Principal of Stonehenge Partners Corp.		X	Audit, Indep, I&F
Meuse						
S. Elaine	63	2002	President and CEO of Columbus		X	Comp, Indep, N&G,
Roberts			Regional Airport Authority			Risk

*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 31-33)**

	Number of Members	Percent Independent	Number of Meetings During Fiscal 2015
Full Board	8*	87%	5
Audit Committee	4	100%	9
Compensation Committee	5	100%	7
Independent Committee	6	100%	1
Investment and Finance Committee	4	75%	4
Nominating and Governance Committee	4	100%	6
Risk Committee	4	100%	4

During 2015, five incumbent Board members attended 100% of the meetings of the Board and Board committees on which they served. Our other three incumbent Board members attended 90% or more of the meetings of the Board and Board committees on which they served.

GOVERNANCE FACTS

Size of Board	8*
Number of Independent Directors	7
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 is fixed at nine. Currently, there are eight incumbent directors. If both nominees are elected directors on May 6, 2016, there will be eight directors on the Board and one vacancy. Our Board of Directors believes it is desirable to have a vacancy available which could be filled by our Board without the time and expense involved in holding a special meeting of shareholders should a person who could make a valuable contribution as a director become available.

Table of Contents**2015 BUSINESS RESULTS**

Our 2015 results (on a GAAP basis) include:

combined ratio of 101.5%, which represented a 4.0% improvement compared to 2014;

net income of \$51.2 million, which represented a decrease of \$56.2 million from 2014; (*Our 2014 net income included a non-cash income tax benefit of \$82.6 million related to the reversal of a valuation allowance against our net deferred tax assets.*)

earnings per diluted share of \$1.23, which represented a decrease of \$1.37 per share from 2014;

non-cat loss and loss adjustment expense (LAE) ratio of 63.9%, which represented a 4.9% improvement compared to 2014;

return on average equity of 5.8%, which represented a 7.2% decrease compared to 2014;

our stock price decreased approximately 7.3% from December 31, 2014 to December 31, 2015; and

book value per share of \$21.40 at December 31, 2015, which represented an increase of \$0.08 per share from December 31, 2014.

The portion of the performance-based compensation awarded to our Named Executive Officers (NEOs) for 2015 performance is determined by the results that we and the State Auto Group achieve with respect to certain of these and other 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 our NEOs in 2015.

PRIMARY COMPONENTS OF OUR 2015 EXECUTIVE COMPENSATION PROGRAM (page 49)

Component	Form	Key Features
<i>Base Salary</i>	Cash	Intended to attract and retain top-caliber executives. 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.
<i>Short-Term Incentive</i>	Cash	Intended to focus our executives on achieving the objectives of our annual operating plan and balance the focus of our long-term incentive plans. Consists of a Company performance component (65%-75% weighting in 2015) and an individual performance component (25%-35% weighting in 2015). Payouts range from 10% of target payout to 200% of target payout depending on performance.
<i>Performance Award Units</i>	Cash	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.

Payouts determined based on the performance of the State Auto Group compared to a peer group over a three-year performance period.

Payouts range from 40% of target payout to 200% of target payout depending on performance.

Represented 65% of the total long-term incentive opportunity awarded to each NEO in 2015, except for Mr. Garland whose long-term incentive opportunity was independently negotiated and determined in connection with his hiring.

Table of Contents

Component	Form	Key Features
<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> <p>One-third of the total options granted vests on each anniversary of the grant date.</p> <p>Represented 20% of the total long-term incentive opportunity awarded to each NEO in 2015, except for Mr. Garland whose long-term incentive opportunity was independently negotiated and determined in connection with his hiring.</p>
<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 2015, except for Mr. Garland whose long-term incentive opportunity was independently negotiated and determined in connection with his hiring.</p>
<i>Perquisites</i>	Cash; Benefits	<p>Intended to attract and retain top-caliber executives.</p> <p>Are limited in value and participation.</p>

IMPACT OF STATE AUTO GROUP ON 2015 COMPENSATION OF NEOs (page 42)

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 2015 for such services 65% to the Company and its subsidiaries and 35% to State Auto Mutual and certain of its subsidiaries and affiliates.

2015 EXECUTIVE COMPENSATION HIGHLIGHTS (page 40)

Base Salary. The base salaries of our NEOs increased by approximately 3% in 2015, except for Ms. Clark whose 17% increase was designed to move her compensation closer to the 75th percentile of the competitive market for similar executives to reward her for the results of her business unit and her strategic value to the Company. 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 2015 as a percentage of the target payout was 27.1%. Mr. LaRocco's Company performance LBP bonus was prorated to reflect the portion of the year during which he was employed by the Company. Mr. Garland's Company performance LBP bonus was paid at target in accordance with the terms of his hiring arrangement. In February 2016, the Compensation Committee adjusted the LBP Combined Ratio and return on equity performance measures originally selected for the Company performance component of the LBP for 2015. The adjustments excluded from the LBP Combined Ratio and return on equity performance measure calculations \$15.3 million in severance and retirement expenses (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 2015 reflected the Adjusted LBP Combined Ratio, Adjusted Return on Equity and Non-Catastrophe Loss Ratio we achieved in 2015.

Table of Contents

Short-Term Incentive Individual Performance Goals. The payout on the individual performance goals under the LBP as a percentage of the target individual performance LBP bonus for 2015 (where the target percentage equals 100%) was 140% for Mr. LaRocco, 115% for Mr. English, 150% for Ms. Clark and 90% for Mr. Fitch. Mr. LaRocco's individual performance LBP bonus was prorated to reflect the portion of the year during which he was employed by the Company. Mr. Garland's individual performance LBP bonus was paid at target in accordance with the terms of his hiring arrangement. The payouts on the individual performance goals reflected the individual contributions of each NEO to our results.

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 2013-2015 performance period relative to a peer group fell within the 30th percentile, we currently expect that the performance award units awarded to our NEOs (except for Ms. Clark) for the 2013-2015 performance period will be valued significantly below target. We currently expect that the PAUs awarded to Ms. Clark for the 2013-2015 performance period will be valued significantly above target as a result of the differences in the NEO Peer Group and performance measures applicable to her PAU award. The anticipated payouts on the PAUs awarded to the NEOs other than Ms. Clark for the 2013-2015 performance period reflected the direct 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, 2012 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. Clark for the 2013-2015 performance period reflected the direct statutory combined ratio, direct written premium growth and surplus growth of the State Auto Group relative to a peer group.

Long-Term Incentive Equity Compensation. In 2015, we awarded stock options and restricted common shares to our NEOs. Based on the approval of the say-on-pay vote at our 2015 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 2015 say-on-pay vote.

Table of Contents**PROXY STATEMENT TABLE OF CONTENTS**

	Page
<u>General</u>	1
<u>Proxies and Voting</u>	1
<u>Proposal One: Election of Directors</u>	4
<u>Nominees for Class I Directors</u>	4
<u>Board Recommendation</u>	4
<u>Backgrounds of Class I Director Nominees (Terms expiring in 2019)</u>	4
<u>Backgrounds of Continuing Class II Directors (Terms expiring in 2017)</u>	5
<u>Backgrounds of Continuing Class III Directors (Terms expiring in 2018)</u>	6
<u>Majority Voting Policy for Incumbent Directors</u>	7
<u>Beneficial Ownership Information for Directors and Named Executive Officers</u>	8
<u>Proposal Two: Amendment to the Company's Code of Regulations</u>	10
<u>Summary of Proposed Amendment</u>	10
<u>Reasons for Shareholder Approval: Board Recommendation</u>	11
<u>Proposal Three: Amendment to the 2009 Equity Incentive Compensation Plan</u>	12
<u>Proposal</u>	12
<u>Shares Available for Issuance under the Plan</u>	12
<u>Summary of the Plan</u>	12
<u>Stock Price</u>	16
<u>Number of Awards</u>	16
<u>Federal Income Tax Information</u>	16
<u>Reasons for Shareholder Approval: Board Recommendation</u>	18
<u>Proposal Four: Approval of Material Terms of the Outside Directors Restricted Share Unit Plan</u>	19
<u>Proposal</u>	19
<u>Restricted Share Units to be Granted under the Proposed RSU Plan</u>	19
<u>Summary of the Proposed RSU Plan</u>	19
<u>Federal Income Tax Information</u>	22
<u>Reasons for Shareholder Approval: Board Recommendation</u>	22
<u>Proposal Five: Approval of Material Terms of the One Team Incentive Plan</u>	23
<u>Proposal</u>	23
<u>Reason for One Team Incentive Plan</u>	23
<u>Description of One Team Incentive Plan</u>	23
<u>Reasons for Shareholder Approval: Board Recommendation</u>	25
<u>Proposal Six: Ratification of Selection of Independent Registered Public Accounting Firm</u>	26
<u>Reasons for Shareholder Approval: Board Recommendation</u>	26
<u>Proposal Seven: Advisory Vote on Compensation of Named Executive Officers as Disclosed in this Proxy Statement</u>	27
<u>Reasons for Shareholder Approval: Board Recommendation</u>	27
<u>Corporate Governance and Board of Directors</u>	28
<u>Relationship with State Auto Mutual and Changes in Board Structure</u>	28
<u>Director Independence</u>	29
<u>Board and Executive Leadership: CEO Succession</u>	29
<u>Board Meetings and Board Committee Meetings</u>	31
<u>Independent Committees of STFC and State Auto Mutual</u>	32
<u>Executive Sessions of Independent Directors</u>	33
<u>Compensation of Outside Directors and Outside Director Compensation Table</u>	33
<u>2015 Outside Director Compensation</u>	34
<u>Outside Directors' Ownership of Restricted Share Units</u>	35
<u>Communications with the Board</u>	35
<u>Director Attendance at Annual Meeting of Shareholders</u>	35

Table of Contents

	Page
<u>Nomination of Directors</u>	35
<u>Other Governance Issues of Interest</u>	37
<u>Availability of Corporate Governance Documents</u>	37