

State Auto Financial CORP  
Form PRE 14A  
March 16, 2010  
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

**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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**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 7, 2010, 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 Code of Regulations;
3. To ratify the selection of Ernst & Young LLP as the Company's independent registered public accounting firm for 2010; and
4. To transact such other business as may properly come before the meeting or any adjournment thereof.

The close of business on March 12, 2010, 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 [ \* ], 2010

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

	<b>Page</b>
<u>General</u>	1
<u>Proxies and Voting</u>	1
<u>Proposal One: Election of Directors</u>	2
<u>Nominees for Class I Directors</u>	2
<u>Backgrounds of Class I Director Nominees (Terms expiring in 2013)</u>	3
<u>Backgrounds of Continuing Class II Directors (Terms expiring in 2011)</u>	4
<u>Backgrounds of Continuing Class III Directors (Terms expiring in 2012)</u>	5
<u>Majority Voting Policy for Incumbent Directors</u>	5
<u>Beneficial Ownership Information for Directors and Named Executive Officers</u>	6
<u>Proposal Two: Approval of Amendments to Code of Regulations</u>	8
<u>Proposal</u>	8
<u>Summary of Proposed Amendments</u>	8
<u>Reasons for Shareholder Approval: Board Recommendation</u>	9
<u>Proposal Three: Ratification of Selection of Independent Registered Public Accounting Firm</u>	10
<u>Board of Directors and Board Committees</u>	11
<u>Board Meetings</u>	11
<u>Board Committees and Committee Meetings</u>	11
<u>Compensation of Outside Directors and Outside Director Compensation Table</u>	12
<u>Corporate Governance</u>	15
<u>Director Independence</u>	15
<u>Communications with the Board</u>	15
<u>Director Attendance at Annual Meeting of Shareholders</u>	15
<u>Executive Sessions of Independent Directors</u>	15
<u>Nomination of Directors</u>	15
<u>Board Leadership</u>	17
<u>Board's Role in Risk Oversight</u>	18
<u>Other Governance Issues of Interest</u>	18
<u>Availability of Corporate Governance Documents</u>	19
<u>Compensation Discussion and Analysis</u>	20
<u>Executive Summary</u>	20
<u>Strategic and Operational Objectives of Our Executive Compensation Program</u>	21
<u>2009 Developments Affecting Our Executive Compensation Program</u>	21
<u>How the Amount of Executive Compensation Is Determined</u>	22
<u>Elements of Our Executive Compensation Program</u>	25
<u>Contractual Arrangements with Named Executive Officers</u>	41
<u>Tax Deductibility of Executive Compensation</u>	46
<u>Stock Ownership Guidelines</u>	46
<u>Summary Compensation Table for 2009</u>	48
<u>Grants of Plan-Based Awards in 2009</u>	51
<u>Outstanding Equity Awards at Fiscal 2009 Year-End</u>	53
<u>Option Exercises and Stock Vested in Fiscal 2009</u>	54
<u>Pension Benefits in Fiscal 2009</u>	54
<u>Nonqualified Deferred Compensation for Fiscal 2009</u>	55
<u>Potential Payments Upon Termination or Change in Control</u>	56
<u>Compensation Committee Interlocks and Insider Participation</u>	65
<u>Compensation Committee Report</u>	65
<u>Report of the Audit Committee</u>	66
<u>Principal Holders of Voting Securities</u>	68
<u>Equity Compensation Plan Information</u>	68
<u>1998 State Auto Agent's Stock Option Plan</u>	69

**Table of Contents**

	<b>Page</b>
<u>Related Person Transactions</u>	70
<u>Policies and Procedures for Review and Approval of Related Person Transactions</u>	70
<u>Transactions Involving State Auto Mutual</u>	70
<u>Independent Registered Public Accounting Firm</u>	73
<u>General</u>	73
<u>Audit and Other Services Fees</u>	73
<u>Audit Committee's Pre-Approval Policies and Procedures</u>	74
<u>Future Shareholder Proposals</u>	74
<u>Section 16(a) Beneficial Ownership Reporting Compliance</u>	74
<u>Other Matters</u>	74
<u>Exhibit A First Amendment to Amended and Restated Code of Regulations of State Auto Financial Corporation</u>	A-1

**Table of Contents**

**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 or STFC) to be used at its Annual Meeting of Shareholders to be held May 7, 2010 (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 April [ \* ], 2010.

**This Proxy Statement, the form of proxy, and the Company's 2009 Annual Report to Shareholders are available at [www.proxyvote.com](http://www.proxyvote.com).**

**PROXIES AND VOTING**

The close of business on March 12, 2010 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 39,903,833 of the Company's common shares, without par value (the Common Shares). Each Common Share is entitled to one vote.

A quorum must be present at the Annual Meeting in order for the transaction of business to occur. A quorum is present if a majority of the outstanding Common Shares is present in person or by proxy at the Annual Meeting. Abstentions and broker non-votes will be considered as Common Shares present at the Annual Meeting for purposes of determining the presence of a quorum.

Broker non-votes and broker discretionary voting refer to the rules governing whether or not banks, brokers and other intermediaries (hereafter referred to collectively as brokers) may vote Common Shares held in street name for the benefit of their customers. In general, brokers have discretionary voting authority on behalf of their customers with respect to routine matters when they do not receive timely voting instructions from their customers. Brokers do not have discretionary voting authority on behalf of their customers with respect to non-routine matters, and a broker non-vote occurs when a broker does not receive voting instructions from its customer on a non-routine matter.

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. 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. Proposal One is considered a non-routine matter under recent changes to the broker discretionary voting rules, and therefore, brokers may not vote uninstructed

## **Table of Contents**

Common Shares in the election of directors. Accordingly, if you hold your Common Shares in street name and you do not provide voting instructions to your broker as to how you want your Common Shares voted in the election of directors, no vote will be cast on your behalf. Therefore, it is important that you provide voting instructions to your broker if you want your vote to count in the election of directors.

For Proposal Two (proposal to approve amendments to the Company's Code of Regulations (the Amended Code of Regulations)), the vote required to approve the Amended Code of Regulations is the favorable vote of a majority of the outstanding Common Shares. Abstentions will have the same effect as a vote against this Proposal. This Proposal is considered a routine matter, which means that if you hold your Common Shares in street name and do not provide, in a timely manner, voting instructions to your broker as to how you want your Common Shares voted on Proposal Two, your broker may vote your Common Shares on this Proposal at its discretion.

For Proposal Three (ratification of the selection of Ernst & Young LLP as the Company's independent registered public accounting firm), the vote required to approve such Proposal is the favorable vote of a majority of the outstanding Common Shares that are voted on such Proposal. Abstentions will have the same effect as a vote against this Proposal. This Proposal is considered a routine matter, which means that if you hold your Common Shares in street name and do not provide, in a timely manner, voting instructions to your broker as to how you want your Common Shares voted on Proposal Three, your broker may vote your Common Shares on this Proposal at its discretion.

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 Amended Code of Regulations; and (3) for the ratification of the selection of Ernst & Young LLP as the Company's independent registered public accounting firm for 2010. 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.

**STATE AUTOMOBILE MUTUAL INSURANCE COMPANY ( STATE AUTO MUTUAL ), WHICH OWNS APPROXIMATELY 64% OF THE OUTSTANDING COMMON SHARES, HAS EXPRESSED AN INTENTION TO VOTE FOR THE ELECTION OF THE NOMINEES LISTED IN THIS PROXY STATEMENT AND IN FAVOR OF EACH OF THE OTHER PROPOSALS DESCRIBED IN THIS PROXY STATEMENT.**

### **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. Robert E. Baker, Thomas E. Markert and Alexander B. Trevor, the three persons recommended by the Nominating and Governance Committee of our Board and each of whom is an incumbent Class I director, have been nominated for re-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 below as Class I directors, each to hold office until the 2013 annual meeting of shareholders and until a successor



## **Table of Contents**

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 below 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.

**THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE FOR THE ELECTION OF EACH OF THE THREE NOMINEES NAMED BELOW AS CLASS I DIRECTORS.**

### **Backgrounds of Class I Director Nominees (Terms expiring in 2013)**

#### **Robert E. Baker**

Robert E. Baker, 63, has been a director since 2007. Mr. Baker has served as President of Puroast Coffee Inc., a maker of specialty coffee products, since October 2004. He served as Vice President of Corporate Marketing for ConAgra Foods, Inc., one of North America's largest packaged food companies, from April 1999 until accepting his current position. Prior to that time, Mr. Baker held executive positions at Dean Foods and Kraft Foods. He was a director of CoolBrands International Inc., a publicly traded Canadian corporation focused on the marketing and selling of a broad range of ice cream and frozen snack products, from February 2006 to November 2007. He was also a director of Natural Golf Corporation, a publicly traded company offering golf instruction and equipment focused on delivering a total system for improving the play of golfers of all abilities, from January 2004 to July 2006.

In addition to meeting the minimum qualifications discussed under Corporate Governance Nomination of Directors, Mr. Baker has been nominated for re-election as a director because of his experience as a senior executive of both publicly traded and privately held companies and his former experience as a director of publicly traded companies. He also brings racial and geographic diversity to the Board. In addition, Mr. Baker brings significant expertise in marketing, strategic planning and branding to the Board.

#### **Thomas E. Markert**

Thomas E. Markert, 52, has been a director since 2007. Mr. Markert has served as Chief Marketing Officer of the Business Solutions Division of Office Depot, Inc., a global supplier of office products and services, since May 2008. He served as the Chief Executive Officer of Ipsos Loyalty Worldwide, a division of Ipsos, a leading global provider of survey-based research, from May 2007 until accepting his current position. He also served as Global Chief Marketing and Client Service Officer of AC Nielsen, a leading global provider of marketing research and information services, from January 2004 until May 2007. For more than five years prior thereto, Mr. Markert held various executive positions within AC Nielsen.

In addition to meeting the minimum qualifications discussed under Corporate Governance Nomination of Directors, Mr. Markert has been nominated for re-election as a director because of his experience as a senior executive of both publicly traded and privately held companies. He also brings geographic diversity to the Board. In addition, Mr. Markert brings significant expertise in marketing, branding and market research to the Board.

#### **Alexander B. Trevor**

Alexander B. Trevor, 65, has been a director since 2006. Mr. Trevor has served as President of Nuvocom Incorporated, a provider of patent litigation support services, since October 1996. He was a director of Applied Innovation Inc., a publicly traded provider of network management solutions for the communications industry, from 1997 to May 2007.

## **Table of Contents**

In addition to meeting the minimum qualifications discussed under Corporate Governance Nomination of Directors, Mr. Trevor has been nominated for re-election as a director because of his experience as a senior executive and his former experience as a director of a publicly traded company. He also brings geographic diversity to the Board. In addition, Mr. Trevor brings expertise in information technology and computer systems to the Board.

### **Backgrounds of Continuing Class II Directors (Terms expiring in 2011)**

#### **David J. D. Antoni**

David J. D. Antoni, 65, has been a director since 1995. Mr. D. Antoni served as Senior Vice President and Group Operating Officer for Ashland, Inc., a chemical, energy and transportation construction company, from March 1999 until his retirement in September 2004. He also served as President of APAC, Inc., a subsidiary of Ashland, Inc., from July 2003 until January 2004, and Senior Vice President of Ashland, Inc. and President, Ashland Chemical, a division of Ashland, Inc., from July 1988 until March 1999. Mr. D. Antoni is also a director of OMNOVA Solutions Inc., a publicly traded producer of decorative and functional surfaces, coatings and specialty chemicals, and Compass Minerals International, Inc., a publicly traded producer and distributor of inorganic minerals.

In addition to meeting the minimum qualifications discussed under Corporate Governance Nomination of Directors, Mr. D. Antoni was originally nominated to serve as a director because of his experience as a senior executive of a publicly traded company, his experience as a director of publicly traded companies, and his knowledge with general management, acquisitions and divestitures. In addition, Mr. D. Antoni brings significant expertise in regulatory and environmental, health and safety matters to the Board.

#### **David R. Meuse**

David R. Meuse, 65, has been a director since 2006. Mr. Meuse has served as Principal of Stonehenge Financial Holdings, Inc., a privately held provider of financial and advisory resources, since September 1999. Prior to that time, Mr. Meuse held executive positions at various investment banking firms, including Banc One Capital Holdings Corporation and Meuse, Rinker, Chapman, Endres & Brooks. He is also a director and currently serves as Non-Executive Chairman of the Board of Diamond Hill Investment Group, Inc., a publicly traded company providing investment advisory and fund administration services. Mr. Meuse also serves on the board of directors of several privately held companies and non-profit organizations.

In addition to meeting the minimum qualifications discussed under Corporate Governance Nomination of Directors, Mr. Meuse was originally nominated to serve as a director because of his experience as a senior executive, his experience as a director of publicly traded companies, and his knowledge with acquisitions and divestitures. In addition, Mr. Meuse brings significant expertise in investments, investment management, and financial market matters to the Board.

#### **S. Elaine Roberts**

S. Elaine Roberts, 57, has been a director since 2002. Ms. Roberts has served as President and Chief Executive Officer of the Columbus Regional Airport Authority, a public port authority which oversees the operations of Port Columbus International, Rickenbacker International and Bolton Field airports in Franklin County, Ohio, since January 2003. She served as Executive Director of the Columbus Airport Authority from December 2000 until accepting her current position.

In addition to meeting the minimum qualifications discussed under Corporate Governance Nomination of Directors, Ms. Roberts was originally nominated to serve as a director because of her experience as a senior executive, in particular her senior management experience with the operation of a regulated entity. Ms. Roberts also has a legal background as an attorney, and she brings gender diversity to the Board.

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**Table of Contents**

**Backgrounds of Continuing Class III Directors (Terms expiring in 2012)**

**Robert P. Restrepo, Jr.**

Robert P. Restrepo, Jr., 59, has been a director since 2006, when he was appointed to the Board in connection with being retained as President and Chief Executive Officer of the Company. Mr. Restrepo has served as the Chairman of the Board, President 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 ( State Auto National ) and Farmers Casualty Insurance Company ( Farmers Casualty ), each a wholly owned subsidiary of the Company, and of State Auto Mutual, since 2006. He served as Senior Vice President, Insurance Operations, for Main Street America Group, a property and casualty insurance underwriting business, from April 2005 until accepting his positions with State Auto. He also served as President and Chief Executive Officer for two property and casualty insurance subsidiaries of Allmerica Financial Corporation (now known as Hanover Insurance Group) from 1998 to 2003.

In addition to meeting the minimum qualifications discussed under Corporate Governance Nomination of Directors, Mr. Restrepo was originally appointed to serve as a director because of his extensive and valuable experience in operations, marketing, sales, and general management of a property and casualty insurance company. He also has valuable experience in acquisitions, strategic planning and leadership development.

**Richard K. Smith**

Richard K. Smith, 65, has been a director since 1999. Mr. Smith was a Partner of KPMG, LLP, a public accounting firm, for more than five years prior to his retirement in June 1997.

In addition to meeting the minimum qualifications discussed under Corporate Governance Nomination of Directors, Mr. Smith was originally nominated to serve as a director because of his extensive experience and expertise in financial, audit, financial controls and accounting matters, in particular in the insurance industry. Mr. Smith also brings geographic diversity to the Board.

**Paul S. Williams**

Paul S. Williams, 50, has been a director since 2003. Mr. Williams has served as a Managing Director with Major, Lindsey & Africa, LLC, an attorney search consulting firm, since May 2005. He was an officer of Cardinal Health, Inc., a global provider of products and services to healthcare providers and manufacturers, for more than five years prior to that time, last serving as that company's Executive Vice President, Chief Legal Officer and Secretary. Mr. Williams is also a director of Bob Evans Farms, Inc., a publicly traded restaurant and food products company, and Compass Minerals International, Inc., a publicly traded producer and distributor of inorganic minerals.

In addition to meeting the minimum qualifications discussed under Corporate Governance Nomination of Directors, Mr. Williams was originally nominated to serve as a director because of his experience as a lawyer and as the General Counsel of a publicly traded company and his knowledge in acquisitions and divestitures, legal and regulatory matters. Mr. Williams also brings racial diversity to the Board. In addition, Mr. Williams brings significant expertise in human resources, leadership development and executive compensation policy matters to our Board. He is a well-respected leader in the area of diversity, frequently speaking on diversity-related issues.

**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

**Table of Contents**

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.

**Beneficial Ownership Information for Directors and Named Executive Officers**

The following table sets forth information with respect to Common Shares beneficially owned by directors, director nominees and our Named Executive Officers or NEOs (those persons listed in the Summary Compensation Table on page [ ] of this Proxy Statement) as of March 12, 2010:

Name	Common Shares Beneficially Owned(1)(2)	Stock Options(3)	Total Beneficial Ownership of Common Shares	Percent of Class
Robert E. Baker	800	0	800	*
David J. D. Antoni	44,710	11,400	56,110	*
Thomas E. Markert	500	0	500	*
David R. Meuse	45,000	0	45,000	*
Robert P. Restrepo, Jr.(4)	32,255	103,458	135,713	*
S. Elaine Roberts	1,000	7,400	8,400	*
Richard K. Smith	8,000	8,400	16,400	*
Alexander B. Trevor	500	0	500	*
Paul S. Williams	325	4,200	4,525	*
Steven E. English	4,087	36,527	40,614	*
Mark A. Blackburn(5)	36,536	131,443	167,979	*
Clyde H. Fitch(6)	8,183	23,455	31,638	*
James A. Yano	3,211	13,343	16,554	*
Directors and Executive Officers, as a group (16 persons)(4)(5)(6)	210,212	441,065	651,277	1.52%

\* Less than one (1%) percent.

(1) Except as indicated in the notes to this table, the persons named in the table and/or their spouses have sole voting and investment power with respect to all Common Shares shown as beneficially owned by them.

**Table of Contents**

- (2) The amounts reported for Messrs. Baker, D'Antoni, Markert, Meuse, Smith, Trevor and 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 Outside Directors and Outside Director Compensation Table for further information regarding this plan and the number of Restricted Share Units held by these directors.
- (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 12, 2010.
- (4) Includes 17,180 Common Shares which are subject to a risk of forfeiture if, prior to March 4, 2013, Mr. Restrepo's employment is terminated for a reason other than as a result of his death or disability (or if he violates any provision of the restricted share agreement prior to March 4, 2013). However, these restricted Common Shares will become fully vested if, prior to March 4, 2013, Mr. Restrepo's employment is terminated as a result of his death or disability. These Common Shares are also subject to restrictions on transfer until March 4, 2013.
- (5) Includes 25,000 Common Shares which are subject to a risk of forfeiture if, prior to October 4, 2010, Mr. Blackburn's employment is terminated for a reason other than without cause or as a result of his death or disability or a change in control of our Company or State Auto Mutual (or if he violates any provision of the restricted share agreement prior to October 4, 2010). However, these restricted Common Shares will become fully vested if, prior to October 4, 2010, Mr. Blackburn's employment is terminated without cause or as a result of death, disability or a change in control of our Company or State Auto Mutual. These Common Shares are also subject to restrictions on transfer until October 4, 2010.
- (6) Includes 7,000 Common Shares which are subject to a risk of forfeiture if, prior to November 4, 2010, Mr. Fitch's employment is terminated for a reason other than as a result of his death or disability (or if he violates any provision of the restricted share agreement prior to November 4, 2010). However, these restricted Common Shares will become fully vested if, prior to November 4, 2010, Mr. Fitch's employment is terminated as a result of his death or disability. These Common Shares are also subject to restrictions on transfer until November 4, 2010.

**Table of Contents**

**PROPOSAL TWO: APPROVAL OF AMENDMENTS TO CODE OF REGULATIONS**

**Proposal**

At the Annual Meeting, shareholders will be asked to consider and vote upon a proposal to approve certain amendments to the Amended and Restated Code of Regulations of State Auto Financial Corporation, which we refer to as the Current Regulations. A copy of the proposed amendments to the Current Regulations, which we refer to as the Proposed Amendments, showing the proposed additions and deletions is attached to this Proxy Statement as Exhibit A. The Board of Directors approved the Proposed Amendments on March 5, 2010. At the Annual Meeting, unless otherwise indicated, proxies will be voted for approval of the Proposed Amendments.

**Summary of Proposed Amendments**

The Current Regulations have not been modified since their adoption in 1991. Since that time, many public companies have instituted specific procedures for the conduct of meetings of shareholders and for the nomination and election of directors in order to improve corporate governance practices. In addition, revisions to Ohio corporate law since the adoption of the Current Regulations permit the increased use of communications equipment to facilitate meetings of shareholders and directors and as a means through which shareholders and directors may provide consents. Finally, revisions to Ohio corporate law since the adoption of the Current Regulations allow the issuance of classes and series of shares of a corporation as uncertificated shares. The Company wishes to avail itself of these more modern practices and corporate laws.

The following provides a summary of the Proposed Amendments and the material differences between the Proposed Amendments and the Current Regulations. This summary may not include some details that may be important to you. For this reason, you are encouraged to read the Proposed Amendments in their entirety.

***Procedures for Shareholders to Bring Business at Shareholder Meetings.*** The Proposed Amendments include a new Section 1.15 which describes the procedures to be followed in order for a shareholder to bring business at meetings of the Company's shareholders.

At any meeting of the Company's shareholders, the only business that may be conducted must have been properly brought before the meeting (a) by or at the direction of the Board of Directors, or (b) by a shareholder of the Company who is a shareholder of record at the time of the giving of the notice described below, who is entitled to vote at such meeting and who complies with the notice procedures described below.

In order for business to be properly brought before a meeting of shareholders by a shareholder, the shareholder must give timely notice in writing to the secretary of the Company. The term "business" includes a proposal to nominate and elect directors other than those proposed by the Board of Directors or a committee designated by the Board of Directors. To be considered timely, a shareholder's notice must be delivered either in person or by United States certified mail, postage prepaid, and received at the principal executive offices of the Company not less than 60 days nor more than 90 days prior to the meeting; provided, however, that in the event that notice or public disclosure of the date of the meeting is given or made by the Company at least 75 days prior to the meeting, notice by the shareholder, to be timely, must be received by the Company no later than the close of business on the 10th day following the day on which such notice or public disclosure of the date of the meeting was given or made by the Company.

A shareholder's notice to the secretary must set forth (i) a description in reasonable detail of the business desired to be brought before the meeting and reasons for conducting such business at the meeting, including the complete text of any resolutions to be presented at the meeting, (ii) the name and address, as they appear on the Company's books, of the shareholder proposing such business, (iii) the class and number of shares of the Company beneficially owned and of record by such shareholder, (iv) the name in which such shares are registered on the books of the Company, (v) a representation that the shareholder intends to appear at the meeting

## **Table of Contents**

in person or by proxy to submit the business specified in such notice, and (vi) any material interest of the shareholder in the business to be submitted. In addition, the shareholder making such proposal shall promptly provide any other information reasonably requested by the Company.

In addition to the information required above to be given by a shareholder who intends to submit business at a meeting of shareholders, if the business to be submitted is the nomination of a person or persons for election to the board of directors, then such shareholder's notice to the secretary must also set forth, as to each person whom the shareholder proposes to nominate for election as a director, (A) the name, age, business address and, if known, residence address of such person, (B) the principal occupation or employment of such person, (C) the class and number of shares of the Company which are beneficially owned by such person, (D) any other information relating to such person that is required to be disclosed in solicitations of proxies for election of directors or is otherwise required by the rules and regulations of the Securities and Exchange Commission promulgated under the Securities Exchange Act of 1934, as amended, (E) the written consent of such person to be named in the proxy statement as a nominee and to serve as a director if elected and (F) a description of all arrangements or understandings between such shareholder and each nominee and any other person or persons (naming such person or persons) pursuant to which the nomination or nominations are to be made by such shareholder.

***Use of Communication Equipment.*** Revisions to Ohio corporate law since the Current Regulations were adopted permit the increased use of communications equipment in meetings of shareholders and directors and in providing notices of such meetings. Under Ohio corporate law, shareholder and director meetings need not be held at a physical location. Instead, those meetings may be held through means of communications equipment that permit shareholders (or their proxies) or directors to participate in the applicable meeting, to count towards the quorum requirements of the applicable meeting, and to vote on matters submitted to the shareholders and directors at the applicable meeting. Consistent with these revisions to Ohio corporate law, Sections 1.3, 1.4, 1.6, 2.9 and 2.12 of the Proposed Amendments would permit this increased use of communications equipment in meetings of shareholders and directors and in providing notices of such meetings.

In addition to the use of communications equipment to facilitate shareholder and director meetings, Ohio corporate law modernized the means through which shareholders and directors may provide consent. Shareholders and directors may submit their consent to actions to be taken without a meeting via overnight delivery service, telegram, email or other transmissions capable of authentication. Consistent with these revisions to Ohio corporate law, Sections 1.14 and 2.16 of the Proposed Amendments would permit these means through which shareholders and directors may provide consent.

***Uncertificated Shares.*** Revisions to Ohio corporate law since the Current Regulations were adopted allow the board of directors of a corporation to pass a resolution providing that some or all of any or all classes and series of shares of that corporation may be uncertificated shares. Consistent with these revisions to Ohio corporate law, Section 4.3 of the Proposed Amendments would permit our Board of Directors to pass a resolution providing that some or all of any or all classes and series of shares of the Company may be uncertificated shares.

## **Reasons for Shareholder Approval; Board Recommendation**

The Company's shareholders are being asked to approve the Proposed Amendments in order to improve corporate governance practices and modernize the Current Regulations in a number of ways. The favorable vote of a majority of the outstanding Common Shares is required to approve the Proposed Amendments.

**THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE FOR APPROVAL OF THE PROPOSED AMENDMENTS.**

**Table of Contents**

**PROPOSAL THREE: RATIFICATION OF SELECTION OF  
INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

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 2010. 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 2010 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 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 2010.**

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.



**Table of Contents**

**BOARD OF DIRECTORS AND BOARD COMMITTEES**

**Board Meetings**

Our Board of Directors held five Board meetings during the fiscal year ended December 31, 2009. Five of our incumbent directors attended 100% of the Board meetings and the meetings of all committees on which they served. Our other four directors attended 85% or more of the Board meetings and the meetings of all committees on which they served. Eight of our nine 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, Board of Directors Ethical Principles, Employee Code of Business Conduct and Code of Ethics for Senior Financial Officers, are available on our website. To access these documents, go to <http://www.stateauto.com> and click on Investors and then Corporate Governance.

The Audit Committee is charged with several responsibilities, including: (1) appointment, compensation, retention and oversight of the work performed by our independent registered public accounting firm; (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 registered public accounting firm and with our financial and accounting personnel concerning the foregoing matters; (5) reviewing with our independent registered public accounting firm 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 Board of Directors 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 registered public accounting firm that it is permitted by law to perform for us. Present members of the Audit Committee are Chairperson Richard K. Smith, David J. D. Antoni, Thomas E. Markert, 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 2009.

The Compensation Committee is charged with several responsibilities, including: (1) approving stock-based compensation plans and grants thereunder to employees or members of the Board; (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. Present members of the Compensation Committee are Chairperson Paul S. Williams, Robert E. Baker, David J. D. Antoni, S. Elaine Roberts and Alexander B. Trevor. The Compensation Committee held six meetings during 2009.

Our executive officers also serve as executive officers of State Auto Mutual, and, in general, the compensation expenses associated with our executive officers are allocated 80% to us and our subsidiaries and 20% to State Auto Mutual and its subsidiaries and affiliates under the Pooling Arrangement. See also Related Person Transactions Transactions Involving State Auto Mutual. It is for this reason that a director of State Auto Mutual who is a member of State Auto Mutual's Nominating and Governance Committee attends the

## **Table of Contents**

meetings of our Compensation Committee as a non-voting member. This State Auto Mutual director, Roger P. Sugarman, is responsible to report matters discussed at our Compensation Committee meetings to State Auto Mutual's Nominating and Governance Committee. This person is independent as defined by the Nasdaq Marketplace Rules.

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 Guidelines and Board of Directors Ethical Principles. The members of the Nominating and Governance Committee are Chairperson David J. D'Antoni, David R. Meuse, S. Elaine Roberts, Richard K. Smith and Paul S. Williams. The Nominating and Governance Committee met four times in 2009. 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 David R. Meuse, Robert E. Baker, Thomas E. Markert, Robert P. Restrepo, Jr., Richard K. Smith, and Alexander B. Trevor. The Investment Committee met four times in 2009.

The standing Independent Committee principally serves to review related person transactions between or among us and our subsidiaries, on the one hand, and State Auto Mutual and its subsidiaries and affiliates, 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, Robert E. Baker, Thomas E. Markert, Richard K. Smith and Alexander B. Trevor. The Independent Committee, which only meets as needed, met five times in 2009.

## **Compensation of Outside Directors and Outside Director Compensation Table**

Non-employee directors, who we refer to as our "outside" directors, receive compensation for their services as members of our Board and of the Board Committees on which they serve. The charter for the Compensation Committee requires this Committee to annually review the compensation of outside directors and recommend any changes to our Board. In accordance with this requirement, the Compensation Committee reviewed director compensation at its November 2009 meeting with assistance from Towers Perrin, the compensation consultant utilized by the Compensation Committee. At this November meeting, Towers Perrin reviewed data from the prior year on outside director compensation programs and reported that little had changed in the competitive market during the past year due in large part to the economic environment. Towers Perrin concluded that, based on this data, total annual compensation to our outside directors was competitive and no changes were recommended. After reviewing the data and considering Towers Perrin's comments, the Compensation Committee concluded that the then-current levels of compensation were appropriate and no changes in director compensation presently are anticipated for 2010. Like 2009, the Compensation Committee targeted total compensation to outside directors for 2010 at \$100,000 annually, divided equally between an annual cash retainer and equity compensation. The Compensation Committee was also mindful of the current market conditions and the state of the nation's economy.

**Table of Contents**

Our outside directors receive two types of compensation – cash and equity in the form of Restricted Share Units ( RSUs ). In 2009, our outside directors received an annual cash retainer of \$50,000. No per meeting fees are payable to our directors, as our directors are expected to participate in all meetings of the Board and the committees on which they serve without the incentive of additional compensation. Each Committee chairperson also received an additional \$5,000 annual cash retainer (up to a maximum of \$5,000 for all Committees chaired), other than the chairpersons of the Audit Committee and the Compensation Committee, who received an additional annual cash retainer of \$15,000 and \$10,000, respectively. Our Lead Director, Mr. D Antoni, was also paid a supplemental annual cash retainer of \$20,000. Outside directors were also reimbursed for travel expenses incurred in attending Board and committee meetings.

Outside directors may defer all or a portion of the cash fees under our deferred compensation plan for directors. For 2009, one director, Mr. D Antoni, elected to defer payment of his cash fees. The amount of cash compensation earned by each director in 2009, whether or not deferred, is included in the amounts shown in the first column of the table set forth above.

Outside directors also receive RSUs pursuant to our Outside Directors Restricted Share Unit Plan (the Directors RSU Plan ). An RSU is a unit representing one Common Share. The value of each RSU, on any particular day, is equal to the last reported sale price of a Common Share on the Nasdaq Stock Market on the most recent previous trading day. Under the Directors RSU Plan, promptly following the 2009 annual meeting of our shareholders, each outside director was granted 1,850 RSUs. To determine the number of RSUs granted, the value of one RSU was equal to a Common Share s average daily price for the prior calendar year and divided into \$50,000, the targeted annual equity compensation for each director. In addition, whenever a dividend is made with respect to the Common Shares, participants receive, with respect to each RSU held in the account of the participant on the dividend record date, additional RSUs in an amount equal to the value of the dividend.

Our Compensation Committee, which functions as the administrative committee of the Directors RSU Plan, has the authority to decrease or increase the annual award of RSUs to outside directors to a minimum of 500 and a maximum of 5,000 without further shareholder approval. Under the Directors RSU Plan, outside directors must, in general, hold their RSUs until they conclude their Board service, after which time these RSUs 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. An outside director elected or appointed other than in connection with an annual meeting of our shareholders will be granted a pro rata amount of RSUs based upon the number of anticipated days to the next annual meeting of shareholders.

**Table of Contents**

In 2009, our outside directors received the following compensation:

<b>Name</b>	<b>Fees Earned or Paid in Cash (\$)</b>	<b>Stock Awards (\$)(1)</b>	<b>Total (\$)</b>
David J. D. Antoni	75,000	28,064.50	103,064.50
Robert E. Baker	50,000	28,064.50	78,064.50
Thomas E. Markert	50,000	28,064.50	78,064.50
David R. Meuse	55,000	28,064.50	83,064.50
S. Elaine Roberts	55,000	28,064.50	83,064.50
Richard K. Smith	65,000	28,064.50	93,064.50
Alexander B. Trevor	50,000	28,064.50	78,064.50
Paul S. Williams	60,000	28,064.50	88,064.50

(1) The total dollar amount shown in the Stock Awards column represents the cash value of the total number of RSUs awarded in 2009, valued at \$15.17 per RSU (\$15.17 was the closing price of Common Shares on the grant valuation date).

The following table sets forth the aggregate number of RSUs owned by each of our current outside directors as of March 12, 2010. The table also sets forth the aggregate number of stock options owned by current outside directors as of March 12, 2010. These outstanding options were awarded to our directors under prior director stock option plans, which were replaced by the Directors' RSU Plan in 2005. No stock options have been granted to any outside directors since 2004.

<b>Name</b>	<b>Number of Stock Options</b>	<b>Number of Restricted Share Units</b>
David J. D. Antoni	11,400	7,920.010
Robert E. Baker	0	4,869.139
Thomas E. Markert	0	4,869.139
David R. Meuse	0	6,387.352
S. Elaine Roberts	7,400	7,920.010
Richard K. Smith	8,400	7,920.010
Alexander B. Trevor	0	6,387.352
Paul S. Williams	4,200	7,920.010

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

## **Table of Contents**

### **CORPORATE GOVERNANCE**

#### **Director Independence**

The Nominating and Governance Committee has affirmatively determined that eight of our nine directors, namely Robert E. Baker, David J. D'Antoni, Thomas E. Markert, 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 a report by the Company's General Counsel.

Our Corporate Governance Guidelines 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 Committees meet this standard. Our Board of Directors has concluded that the Investment Committee does not need to be comprised solely of independent directors. Robert P. Restrepo, Jr., who is our employee and thus does not qualify as an independent director under the Nasdaq Marketplace Rules, is a member of the Investment Committee.

#### **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](mailto:corporatesecretary@stateauto.com) or in writing to the 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 attended last year's annual meeting of shareholders.

#### **Executive Sessions of Independent Directors**

Our Board meets in executive session, without management present, prior to each regular quarterly Board meeting. Consistent with our Corporate Governance Guidelines and the Nasdaq Marketplace Rules, during 2009 there were four executive sessions with only independent directors present. In addition, following each regular quarterly Board meeting, our Board meets in executive session with the State Auto Mutual board of directors, without management present. Our Corporate Governance Guidelines provide that the Lead Director acts as the presiding director at these executive sessions.

#### **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

## **Table of Contents**

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. 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 re-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.

As required by its charter, the Nominating and Governance Committee seeks to achieve diversity of occupational and personal backgrounds. The Nominating and Governance Committee considers diversity as a factor in director nominations. In making such selections, the Nominating and Governance Committee views diversity in a broad context to include race, gender, geography, industry experience and personal expertise.

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 to identify potential candidates. 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, including 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.

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 Corporate

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## **Table of Contents**

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).

## **Board Leadership**

We are managed under the direction of our Board in the interest of all shareholders. Our Board delegates its authority to our senior executive team to manage the day-to-day operations and ongoing affairs of our business. Our Board requires that our senior executive team review major initiatives and actions with our Board prior to implementation.

Mr. Restrepo serves as both Chairman and Chief Executive Officer under our leadership structure. He also holds these same positions with our parent, State Auto Mutual. Our Board believes this leadership structure is appropriate given the overall corporate structure of our Company and State Auto Mutual. We and our subsidiaries operate and manage our businesses in conjunction with State Auto Mutual and its subsidiaries and affiliates under various management and cost sharing agreements under the leadership and direction of the same senior management team. In addition, our insurance subsidiaries participate in a pooling arrangement with State Auto Mutual and certain of its insurance subsidiaries and affiliates which covers all of the property and casualty insurance written by our insurance subsidiaries. See Related Person Transactions Transactions Involving State Auto Mutual. Because of the way our business is operated, our Board believes separating the positions of Chairman and Chief Executive Officer would cause unnecessary complexity and complications and perhaps cause a split in our strategic direction, in particular since our Board has received no indication from the State Auto Mutual Board that it is considering, or would consider, separating these positions in its leadership structure.

Our Board has adopted a counterbalancing governance structure which includes:

A designated independent Lead Director;

A Board composed entirely of independent directors other than the Chairman and Chief Executive Officer;

A Board composed entirely of directors independent from State Auto Mutual other than the Chairman and Chief Executive Officer;

Committees composed entirely of independent directors, with the exception of our Investment Committee; and

Established governance structures and processes and ethics guidelines.

Our Lead Director's responsibilities include, among other things, leading the executive session of our independent directors, being a primary advisor to and principal point of contact with our Chairman and Chief Executive Officer, working with the Chairman and soliciting input from other Board members to develop a

## **Table of Contents**

regular board meeting schedule and an agenda for each meeting, securing input from other directors on agenda items, ensuring the adequate flow of information from management to our Board and delivering the Chief Executive Officer's performance evaluation on behalf of the Compensation Committee of our Board. In May 2009, our Board re-elected David J. D'Antoni to serve as Lead Director. Mr. D'Antoni has served in that position since March 2006.

We believe our Board leadership is effective and appropriate for our Company, given the specific circumstances of our overall corporate structure and operation in conjunction with State Auto Mutual, the established effectiveness of the Lead Director's role on the Board, the Nominating and Governance Committee's significant role in the nominee selection process for new or re-elected directors, the independence of eight of nine directors, and the effectiveness of the executive session meetings of independent directors at each regularly scheduled meeting of our Board.

### **Board's Role in Risk Oversight**

Our Board's role in the risk management process is one of oversight. Risk management activities are the responsibility of our management and include the development of strategies and implementation of actions intended to anticipate, identify, assess, manage and appropriately mitigate identified risks.

The Nominating and Governance Committee has primary responsibility for oversight of enterprise risk management on behalf of our Board. The Nominating and Governance Committee communicates with our Board and other Board committees on significant enterprise risk management matters. The Nominating and Governance Committee meets quarterly with our director of enterprise risk management. The Nominating and Governance Committee also receives a quarterly report which assesses the current status of major risks inherent in our business, including credit risks, market risks, underwriting risks, operational risks and strategic risks. In addition to meeting with the director of enterprise risk management, the Nominating and Governance Committee also meets periodically with our officers responsible for the adequacy of business continuity and disaster recovery plans, information security and legal and regulatory compliance.

In addition to the enterprise risk management oversight provided by the Nominating and Governance Committee, a practice of the Audit Committee is to meet quarterly with the director of enterprise risk management for a report on selected risk areas. We also utilize an internal enterprise risk management committee comprised of senior officers. Among other things, this internal committee addresses the identification, assessment and mitigation of significant risks facing our Company.

Our Board reviews the enterprise risk management process annually, and risk assessment and management is reflected in our Board's strategic planning process. The independent structure of the Board of Directors enables objective oversight of the risk management process.

### **Other Governance Issues of Interest**

Our Corporate Governance Guidelines ( Guidelines ) reflect our Board of Directors' sensitivity to governance issues.

Our Guidelines require that directors who are elected by the Board to fill vacancies in our Board must stand for election by the shareholders at the next annual shareholders meeting. Specifically, Guideline #7 states:

*From time to time, the Board of Directors may elect qualified individuals to become Board members by filling vacancies that may arise. In such case, the Company's shareholders shall be given the opportunity to newly elect that director at the next annual meeting of shareholders.*

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.*



## **Table of Contents**

Our Guidelines also address the issue of service on other boards. Guideline #23 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 our Code of Regulations. This governance rule reflects Ohio law and is documented in Guideline #35 of our Guidelines.

Guideline #8 provides for annual performance evaluations of individual directors. The Nominating and Governance Committee has engaged in this process every year since 2006.

Our Guidelines encourage directors to periodically attend educational programs related to their service on the Board. We sponsored a continuing education program on corporate governance for our directors in September 2009 that was certified by RiskMetrics, formerly known as ISS. All of our directors, other than Ms. Roberts and Mr. Smith, attended that program. In lieu of attending this Company sponsored program, Ms. Roberts and Mr. Smith participated in continuing education programs sponsored by the National Association of Corporate Directors. Accordingly, all of our directors have participated in continuing education programs since our last shareholders meeting. We plan to host another director continuing education program in 2010.

All of our stock option plans prohibit the repricing of stock options after their grant date except with the prior approval of our shareholders.

Our 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.stateauto.com](http://www.stateauto.com) under Investors and then 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 Board of Directors Ethical Principles;

Our Employee Code of Business Conduct; and

Our Code of Ethics for Senior Financial Officers.

**Table of Contents**

**COMPENSATION DISCUSSION AND ANALYSIS**

Our executive compensation program covers a Leadership Team that includes our NEOs and approximately 200 other employees who are primarily executives and managers selected by management and approved by our Compensation Committee (the Committee). We believe that members of our Leadership Team are able to significantly impact the overall success of the Company and the State Auto Group and should be appropriately rewarded for their efforts. (See page of this Proxy Statement for the list of the Company's subsidiaries and affiliates comprising the State Auto Group.) Our executive compensation program is structured to offer a reasonable balance of cash and non-cash compensation and short-term and long-term compensation. The overall goals of our executive compensation program are to:

Align compensation with the strategic and operational objectives described below;

Offer compensation to our executives that is competitive, both in the aggregate and by individual compensation element, with the compensation offered by our competitive peers to executives in similar positions;

Provide more than the targeted amount of compensation for producing results exceeding our target performance objectives and less than the targeted amount of compensation for producing results falling below our target performance objectives;

Reinforce our employment strategies around leadership development;

Link executive compensation to executive performance and Company performance;

Attract, retain and motivate top-caliber executives;

Build appropriate share ownership among the executive team; and

Motivate our executives to focus on building long-term shareholder value.

This Compensation Discussion and Analysis describes (i) the relationship between the goals of our executive compensation program and the strategic and operational objectives of the Company, (ii) the process by which the compensation of our NEOs is determined, including our use of benchmarking data to determine the compensation of our NEOs and other employees; (iii) the elements of our executive compensation programs; (iv) our contractual arrangements with our NEOs; (v) the tax deductibility of executive compensation; and (vi) our stock ownership guidelines.

**Executive Summary**

Our current compensation program has been unchanged for the prior three years. We place significant emphasis on setting appropriate threshold, target and maximum performance goals, providing candid and timely performance feedback to our employees and ensuring that our employees have a clear understanding of our pay programs. Our executive compensation program also emphasizes the achievement of specific financial results that create value for our shareholders through improved performance in the market price of the Company's shares. We also make a considerable effort to award compensation to our executives that is reasonably benchmarked for pay competitiveness. We believe that our mix of compensation elements furthers the goals and achieves the objectives of our executive compensation program and provides appropriate reward opportunities.

For 2009, we:

Made merit-based increases to the base salaries of our NEOs of 2.8% (Mr. Restrepo), 12.9% (Mr. English), 3.3% (Mr. Blackburn), 3.2% (Mr. Fitch) and 7.1% (Mr. Yano);

Paid bonuses for the fourth quarter under our Quality Performance Bonus Plan equal to 4.54% of each employee's base salary for that quarter (Mr. Restrepo \$8,923; Mr. English \$4,278; Mr. Blackburn \$5,684; Mr. Fitch \$3,911; and Mr. Yano \$3,667). These bonuses were based on the comparative performance of our QPB Combined Ratio (as defined below in Quality Performance Bonus Plan ) for that quarter to benchmark performance;

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**Table of Contents**

Paid Company performance bonuses under our Leadership Bonus Plan of \$288,177 (Mr. Restrepo), \$138,167 (Mr. English), \$183,565 (Mr. Blackburn), \$126,324 (Mr. Fitch) and \$78,953 (Mr. Yano) based on our overall achievement of 70.2 % of our target performance goals under the plan. This outcome consists of premium growth at 194.3% of target, return on equity at 16.3% of target and LBP Combined Ratio (as defined below in Leadership Bonus Plan LBP Bonus 2009 Company Performance Component ) at less than threshold level or zero;

Paid individual performance bonuses under our Leadership Bonus Plan of \$196,390 (Mr. Restrepo), \$113,847 (Mr. English), \$125,097 (Mr. Blackburn), \$116,089 (Mr. Fitch) and \$60,083 (Mr. Yano) based on each individual s achievement of their individual performance goals;

Ended the first three-year performance period for Performance Award Units granted under our Long-Term Incentive Plan, the results of which are based on a comparison of our performance against industry peers and the payouts of which we expect to be in excess of target; and

Awarded equity and equity-based compensation (in the form of stock options) on terms and in amounts consistent with our practices for the past three years.

**Strategic and Operational Objectives of Our Executive Compensation Program**

Our executive compensation program is intended to directly link the individual compensation of our executives with the achievement of the following strategic and operational objectives of the State Auto Group and to reward our executives when the following objectives are achieved:

Consistent underwriting profits targeted at combined ratios in the 94% - 99% range;

Rational premium growth that matches or exceeds the premium growth rates of designated peer property and casualty insurance companies, as well as the property and casualty insurance industry as a whole;

Capital and risk management that targets a 10% - 15% return on equity; and

Investment performance that protects our strong capital position and builds long-term shareholder value.

**2009 Developments Affecting Our Executive Compensation Program**

***Effect of Market Conditions***

In 2009, we responded to the continued economic downturn by monitoring our industry and peer companies for trends in merit increases in executive compensation by our competitors. For 2009, we established a budget for the Leadership Team for merit increases in base salary equal to 2.75% of our total payroll. We established this budget based on the competitive market trend and our anticipated performance for the year, also taking into account the effect of increases in base salary on our overall cost structure. We targeted most of this budget to reward high performing employees. The Committee also reduced the recommended 2009 base salary amounts for the NEOs as a result of the depressed salary market conditions in effect at the time the Committee established the 2009 base salaries.

***Adoption of 2009 Equity Plan***

Our shareholders approved a new equity compensation plan, the State Auto Financial Corporation 2009 Equity Incentive Compensation Plan ( 2009 Equity Plan ), at our 2009 Annual Meeting of Shareholders. The 2009 Equity Plan is intended to replace the State Auto Financial Corporation Amended and Restated Equity Incentive Compensation Plan ( 2000 Equity Plan ), which expires on July 1, 2010.



## **Table of Contents**

The 2009 Equity Plan is materially similar to the 2000 Equity Plan and allows the Company to award stock options, restricted shares, performance shares, performance units and other stock-based awards to employees who, in the opinion of the Committee, are in positions that can significantly affect the Company's long-term financial results and, as a result, the value the Company creates for its shareholders.

A total of 2,000,000 of the Company's common shares ( Common Shares ) have been reserved for issuance under the 2009 Equity Plan. No more than 33% of the Common Shares authorized for issuance under the 2009 Equity Plan may be granted in the form of awards other than stock options. The maximum number of Common Shares subject to awards of stock options, restricted shares and performance shares that may be granted in any calendar year is equal to 1.5% of the total number of Common Shares of the Company outstanding as of December 31 of the prior year. The maximum number of Common Shares subject to awards of options, restricted shares and performance shares that may be granted in any calendar year to any individual is 250,000. The maximum number of performance units that may be granted in any calendar year to any individual is 100,000.

The 2009 Equity Plan is administered by the Committee. The Committee's authority to administer the 2009 Equity Plan includes, among other things, the authority to grant awards, including the number and type of awards, the frequency of award grants, the terms and conditions of the awards, the number of Common Shares subject to each award and the expiration date of each award. The Committee also is authorized to determine the vesting requirements, if any, that will apply to award grants. The Committee has the authority to grant options that are intended to qualify as incentive stock options under the Internal Revenue Code of 1986, as amended (the Code ), options that do not qualify as incentive stock options under the Code (these options are sometimes referred to as non-qualified stock options ), restricted shares, performance shares, performance units and other stock-based awards.

The Board may at any time suspend, amend or terminate the 2009 Equity Plan. However, except as otherwise provided in the 2009 Equity Plan, the Board may not take any action that materially and adversely affects any outstanding awards granted under the 2009 Equity Plan without obtaining the consent of the individuals who have been granted such awards. In addition, certain amendments to the 2009 Equity Plan require shareholder approval, including any amendment that would effect any change requiring shareholder approval under any applicable laws or regulations. By its terms, the 2009 Equity Plan will automatically terminate in 2019.

## **How the Amount of Executive Compensation Is Determined**

### ***Role of the Compensation Committee***

The Committee is responsible for setting the compensation of our NEOs. The Committee approves the base salary and short-term incentive compensation of the CEO based on the evaluation of his performance conducted by the Committee and the Nominating and Governance Committee of State Auto Mutual. The Committee approves the base salary and short-term incentive compensation of the other NEOs based on the recommendations of the CEO and a review of performance outcomes and market data. (See Base Salary and Short-Term Cash Incentive Compensation on pages and of this Proxy Statement.) In addition, the Committee approves all awards of stock options and stock grants of the Company's Common Shares, as well as performance award units. (See Long-Term Equity and Cash Incentive Plans on page of this Proxy Statement.) Finally, the Committee reviews management's recommendations regarding other aspects of our compensation and benefit programs for other employees and acts upon these recommendations if required by the terms of the relevant plan.

### ***Participation of Compensation Consultants and Other Advisors***

In carrying out its responsibilities, the Committee requests regular input and recommendations from the Board, management, an executive compensation consultant and other advisors. The Committee also regularly engages in discussions and continuing education to better understand compensation trends, regulatory

## **Table of Contents**

developments relating to compensation events and the Company's compensation issues and objectives. Management informs and assists the Committee in establishing and monitoring performance goals, and in refining our overall executive compensation program. In making compensation decisions related to both the form and the amount of compensation, the Committee has consistently relied upon competitive information obtained from a compensation consultant.

The Committee utilized the services of Towers Perrin (now, Towers Watson), a compensation consultant. Towers Perrin advises the Committee on the effectiveness and competitiveness of our overall executive compensation program and of specific compensation packages for our NEOs and other members of our Leadership Team. Towers Perrin also advises the Committee with regard to the competitiveness of compensation to our outside directors in comparison to their peers at similar public companies. From time to time, Towers Perrin may perform additional compensation or benefit analysis at the request of management. In 2009, Towers Perrin provided analysis on revising the structure of the Company's retirement package, including its retiree medical, pension and 401(k) programs. The additional services performed by Towers Perrin have been modest in scope and management and the Committee believe that Towers Perrin's performance of additional services has not compromised its independence. The Committee chairperson monitors these additional services and the monthly billings for any Towers Perrin services provided at the request of management or the Board.

### ***Benchmarking***

We believe that to accomplish the objectives of our executive compensation program, including retaining our executive talent, we must pay competitive compensation. To determine competitive compensation for our NEOs, we consider data from (i) proxy statements filed by other publicly-held insurance companies comparable in size and type of business to the Company (the NEO Peer Group) and (ii) published pay surveys of the insurance and financial services industry, which include both public and private/mutually-owned insurance companies (the Survey Data). The proxy statements of the companies within the NEO Peer Group provide pay information regarding their NEOs, which allows us to directly compare the compensation we provide to our NEOs to the compensation that NEO Peer Group members provide to their NEOs. These proxy statements also allow for pay and performance comparisons that help us understand the expectations of NEO Peer Group companies regarding incentive payouts and to evaluate the Company's executive compensation program. The Survey Data complements the NEO Peer Group information by providing broader comparisons. While the compensation data regarding the NEO Peer Group relates to only public companies and their NEOs, the Survey Data includes publicly-traded, mutual and privately-held insurers and compensation data for employees beyond the NEOs. The broader scope of the information provides a more comprehensive assessment of competitive practices and pay levels for insurers of the Company's size.

The Committee targets the total amount of compensation payable to our NEOs at or close to the median compensation level of the NEO Peer Group and the Survey Data by setting the target amount of each element of compensation at or near the median level of compensation in the NEO Peer Group and the Survey Data. Total compensation and each element of compensation for each of our NEOs for 2009 was competitive with (i.e., within approximately 10% of) our targeted range, except for Mr. Yano, whose total compensation for 2009 was approximately equal to 83% of the median level of compensation in the NEO Peer Group and the Survey Data. The NEO Peer Group is used to benchmark the compensation of our NEOs. In addition, we examine the Survey Data to benchmark the compensation of our NEOs and members of our Leadership Team other than our NEOs. If we have relevant data from both the NEO Peer Group and the Survey Data, we average the results to determine the median level of compensation. For example, if the median level of base salary for chief executive officers reported by the NEO Peer Group and the Survey Data was \$735,000 and \$800,000, respectively, we would average the two results to establish a median base salary target of \$767,500. When setting base salaries, short-term and long-term incentive compensation, we use data reported in the NEO Peer Group and Survey Data for individuals in similar positions at similarly sized insurers (which we refer to as our competitive market).

**Table of Contents**

We believe that superior performance should be rewarded and we are willing to provide our NEOs with an opportunity to earn total compensation in the 75th percentile (or higher) of the competitive market if performance is exceptional. Conversely, if Company or individual performance is substantially below target or planned results, we believe NEOs should receive substantially less than the median level of total compensation in the competitive market (i.e., in the bottom quartile).

Determinations with respect to certain elements of compensation for Mr. Restrepo and Mr. Blackburn, such as base salaries, retirement benefits, employee benefits and executive perquisites, are subject to the terms of their respective employment agreements. (See Contractual Arrangements with Named Executive Officers Employment Agreements Robert P. Restrepo, Jr. and Mark A. Blackburn on pages and of this Proxy Statement.)

*NEO Peer Group*

With input from our compensation consultant and management, the Committee approves property and casualty insurance companies to be part of the NEO Peer Group based on their status as public companies and their size and business overlap with the State Auto Group. Public companies are selected because, as discussed above, their NEO compensation and executive compensation programs are disclosed in their SEC filings, which allows us and our shareholders to compare the competitiveness of our NEO compensation and executive compensation program with those of our public company competitors. In considering business overlap, companies are selected that have a significant portion of their business in personal and commercial automobile, homeowners, and commercial property and casualty insurance. In considering company size, the focus is on companies similar to the State Auto Group in terms of premium volume, total assets, market capitalization and number of employees. Some of these companies are substantially larger than the State Auto Group while others are smaller. The size of the median company within the NEO Peer Group, as shown on the chart below, is comparable to the State Auto Group. The members of the NEO Peer Group change periodically because of mergers, acquisitions, start-ups, spinoffs and similar transactions.

The NEO Peer Group used for 2009 compensation decisions was comprised of the following 22 companies:

- |  |  |                                   |
|--|--|-----------------------------------|
| Affirmative Insurance                    | American Financial Group, Inc.         | Argo Group International          |
| Cincinnati Financial Corporation         | EMC Insurance Group                    | Erie Indemnity Company            |
| Hanover Insurance Group                  | Harleysville Group, Inc.               | Horace Mann Educators Corporation |
| Infinity Property & Casualty Corporation | Kingsway Financial Services            | Mercury General Corporation       |
| Montpelier Re Holdings                   | Old Republic International Corporation | OneBeacon Insurance               |
| Safety Insurance Group, Inc.             | Selective Insurance Group, Inc.        | Tower Group                       |
| United Fire & Casualty Company           | Unitrin, Inc.                          | White Mountains Insurance Group   |
| W. R. Berkley Corporation                |  |                                   |

Companies used in the 2008 NEO Peer Group that are no longer listed were acquired by other entities.

The following chart compares 2008 data (the companies in the NEO Peer Group used for 2009 compensation decisions were selected on the basis of 2008 financial data) for revenue, total assets, market capitalization and employee count of the median company within the NEO Peer Group to that of the State Auto Group:

	<b>Median Peer Company</b>	<b>State Auto Financial</b>
Revenue	\$ 1.3 billion	\$ 1.2 billion
Total Assets	\$ 4.5 billion	\$ 2.4 billion
Market Capitalization	\$ 1.0 billion	\$ 1.2 billion
Employees	2,350	2,165



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## **Table of Contents**

### *Survey Data*

Towers Perrin reviews and analyzes compensation surveys covering executive officers at both public and private insurance and financial services companies. The published pay survey information contained in the Survey Data allows us to assess the relative position of compensation paid to our Leadership Team. This information is also used, in combination with information for the NEO Peer Group, to provide a more complete and thorough assessment of competitive pay levels and practices with regard to our NEOs.

### *Use of Tally Sheets*

The Committee uses tally sheets to review total compensation and each element of compensation in conjunction with its annual review of our NEOs' total compensation. The tally sheets used by the Committee in its review of NEO compensation for 2009 (i) listed each individual element of compensation along with the amount earned in each category for 2006, 2007 and 2008; (ii) listed the target and maximum amounts of incentive compensation payable for 2008; and (iii) summarized the current value of employee benefits and perquisites. The tally sheets provide a valuable perspective on the total value of NEO compensation and show how potential changes in one element of compensation may influence the other elements. The Committee also used tally sheets to evaluate each NEO's total compensation for 2010.

## **Elements of Our Executive Compensation Program**

Our executive compensation program includes the following key elements:

Base salary;

Short-term cash incentive compensation;

Long-term cash and equity incentive compensation;

Retirement and deferred compensation benefits;

Employee benefits; and

Executive perquisites.

Each of these elements is separately discussed below, other than employee benefits, which are offered to NEOs on the same basis as all other employees, except for certain additional long-term disability benefits provided to Messrs. Restrepo and Blackburn pursuant to their respective employment agreements in the event they are terminated by reason of their disability. (See Restrepo Employment Agreement Disability and Blackburn Employment Agreement Disability on pages and of this Proxy Statement.)

The Company does not have a prescribed mix between cash and non-cash compensation and short- and long-term compensation. As discussed above, the Company positions each element of executive compensation at the median level of the competitive market so that total compensation is also positioned at median levels. Current and short-term incentive compensation provides personal liquidity, focuses our NEOs on short-term priorities and lessens the impact of volatility in our stock price. We balance the incentives to focus on short-term decision-making created by the short-term incentive compensation we provide to our NEOs by structuring a significant portion of the total compensation we provide to our NEOs in the form of long-term cash- and equity-based compensation.

Some of our NEOs' compensation is governed by the terms of specific agreements between the NEO and the Company. (See Contractual Arrangements with Named Executive Officers beginning on page of this Proxy Statement.)



**Table of Contents****Base Salary**

The Committee believes that a competitive base salary is fundamental to attracting and retaining talented executives needed to achieve both short- and long-term success for our Company.

Each NEO receives a base salary intended to compensate the NEO for his or her skills, competencies, experience, level of responsibility and job performance relative to our competitive market. The amount of base salary may be annually adjusted for merit, based in part on a subjective assessment of the NEO's performance and contributions to the success of the State Auto Group. Overall merit increase budgets are influenced by the Company's anticipated performance and overall cost structure. The Committee also may adjust the amount of an NEO's base salary based on the median level of base salary in our competitive market or, in unusual circumstances, to reflect a change in the NEO's scope of responsibility or unique skills or expertise possessed by an NEO.

Because the Company attempts to set the target amount of compensation at or near the median level of our competitive market, neither the Committee nor the CEO considers the other elements of compensation available to NEOs, such as annual bonuses, option gains and equity ownership, when setting base salary. However, as NEOs become more highly compensated, an increasing percentage of their total compensation is performance-based. Base salary increases impact both short- and long-term incentive compensation opportunities because the amounts of those opportunities are expressed as a percentage of base salary. Base salary increases also impact the amount of retirement benefits because a key component of our tax-qualified and non-qualified defined benefit pension plan formula is career average salary. (See Retirement and Deferred Compensation Benefits on page of this Proxy Statement.)

**2009 Base Salaries of NEOs**

The Committee established the 2009 base salaries of the NEOs in March 2009 as follows:

<b>Named Executive Officer</b>	<b>2008 Base Salary</b>	<b>2009 Base Salary</b>	<b>Increase</b>
	<b>(\$)</b>	<b>(\$)</b>	<b>(Decrease) (%)<sup>(1)</sup></b>
Robert P. Restrepo, Jr.	710,000	730,000	2.8
Steven E. English	310,000	350,000	12.9
Mark A. Blackburn	450,000	465,000	3.3
Clyde H. Fitch	310,000	320,000	3.2
James A. Yano	280,000	300,000	7.1

(1) The salary increases for Messrs. English and Yano represent both merit-based increases and market-based increases intended to address disparities between the respective salaries of Messrs. English and Yano and the median levels of base salary in our competitive market. Each member of the Board and the Board of Directors of State Auto Mutual (other than Mr. Blackburn) conducted a subjective and confidential assessment of Mr. Restrepo's performance as CEO in 2008, the format of which included Mr. Restrepo's annual performance objectives, the Company's leadership competencies, the Board's specific performance categories for Mr. Restrepo, summary questions (e.g., major strengths and accomplishments and areas for improvement), the Company's corporate values and an overall performance rating. The format of the performance assessment also encouraged commentary on these topics and any other issues that influenced the overall performance rating. Working from a summary of these reviews, the Committee and the Nominating and Governance Committee of State Auto Mutual jointly evaluated Mr. Restrepo's overall performance. The Committee and the Nominating and Governance Committee of State Auto Mutual gave Mr. Restrepo a favorable performance assessment as CEO. The Committee established the CEO's base salary for 2009 based on salary data from both the NEO Peer Group and the Survey Data and the evaluation of his performance conducted by the Committee and the Nominating and Governance Committee of State Auto Mutual.

**Table of Contents**

Mr. Restrepo evaluated the performance of the other NEOs and presented to the Committee his assessment of their individual performances and recommendations for their 2009 salary adjustments. The Committee also considered salary data from both the NEO Peer Group and the Survey Data. Based upon this information, the Committee established 2009 salaries for the other NEOs.

The 2009 base salaries established by the Committee for each NEO reflect a \$5,000 reduction from the base salary amounts recommended to the Committee. The Committee reduced the recommended base salary amounts as a result of the depressed salary market conditions in effect at the time the Committee established the 2009 base salaries.

*2010 Base Salaries of NEOs*

The Committee set the 2010 base salaries of the NEOs in March 2010 using the same process as in 2009. The 2010 base salaries of the NEOs are as follows:

Named Executive Officer	2009 Base Salary (\$)	2010 Base Salary (\$)	Increase (Decrease) (%)
Robert P. Restrepo, Jr.	730,000	755,000	3.4
Steven E. English	350,000	360,000	2.9
Mark A. Blackburn	465,000	475,000	2.2
Clyde H. Fitch	320,000	330,000	3.1
James A. Yano	300,000	310,000	3.3

***Short-Term Cash Incentive Compensation***

We maintain two short-term cash incentive plans for our NEOs the Quality Performance Bonus Plan ( QPB ) and the Leadership Bonus Plan ( LBP ).

For members of our Leadership Team, other than our NEOs, the QPB and the LBP operate in tandem with the total amount of quarterly QPB bonuses paid for a year reducing the amount of any annual LBP bonus payable for that year. If the total amount of quarterly QPB bonuses paid to an employee for any year exceeds the annual LBP bonus that would otherwise be payable to the employee, no LBP bonus is paid to that employee. The Company does not, however, require that the employee repay any difference between the QPB bonuses paid and the LBP bonus.

For our NEOs, the total amount of quarterly QPB bonuses paid during any year first reduces the NEO s individual performance LBP bonus, with any difference reducing the NEO s Company performance LBP bonus. The different treatment of NEOs and the other members of our Leadership Team is due to the application of Section 162(m) of the Code to the Company performance LBP bonus for our NEOs, as described below in greater detail.

Annual bonus payments do not increase payments under our other compensation or benefit programs, except for benefits under change of control agreements. (See Potential Payments Upon Termination or Change in Control on page of this Proxy Statement.)

**Table of Contents**

The following chart shows the amount of short-term cash incentive compensation paid to each NEO for 2009 under both the QPB and LBP. The total amount of 2009 short-term cash incentive compensation paid to each NEO in the fourth column is equal to the sum of the amounts shown in the first three columns.

Named Executive Officer	Company	Individual	QPB Bonus	Total	Total
	Performance	Performance		Short-Term	Short-Term
	LBP Bonus	LBP		Bonus (\$)	Bonus (%) (2)
	(\$)	Bonus \$(1)	(\$)		
Robert P. Restrepo, Jr.	288,177	196,390	8,923	493,490	90
Steven E. English	138,167	113,847	4,278	256,292	98
Mark A. Blackburn	183,565	125,097	5,684	314,346	90
Clyde H. Fitch	126,324	116,089	3,911	246,324	103
James A. Yano	78,953	60,083	3,667	142,703	95

(1) The amount of the individual performance bonus shown in this column is net of the amount of the QPB bonuses (shown in the third column) paid for 2009.

(2) Expressed as a percentage of target where target is set at 100%.

*Quality Performance Bonus Plan*

The QPB is a quarterly profit-sharing program that has been in place since 1991. All employees are eligible to participate in the QPB after one full calendar quarter of employment. Any employee who is employed on the first date of the quarter and remains employed on the payment date, and who is not on probation, is entitled to receive a QPB bonus.

The QPB is intended to motivate employees to focus on the Company's annual underwriting profit, which is a key performance measure associated with our operating success. We believe that the QPB plays a material role in the underwriting, pricing discipline and expense management we consider critical in profitably underwriting our insurance business. Every eligible employee, regardless of their position, is paid the same percentage of their quarterly salary for any fiscal quarter in which a QPB bonus is earned. This approach reinforces the importance of the team effort required across the State Auto Group to achieve our strategic goals. The quarterly payout feature of the QPB ensures prompt feedback on our Company's performance and profitability.

Bonuses under the QPB are payable for any fiscal quarter only to the extent that our QPB Combined Ratio for that quarter is better than the Combined Ratio Trigger for that quarter.

The QPB Combined Ratio is the direct (i.e., without considering the impact of reinsurance) statutory combined ratio for all of our affiliated insurance companies. The QPB Combined Ratio is the sum of our allocated loss adjustment expense ratio, plus an expense ratio including unallocated loss adjustment expenses based upon the previous rolling four quarters. We use the unallocated loss adjustment expenses for the immediately preceding four quarters, plus internal claims handling costs, to approximate the expense ratio for the current quarter. The QPB Combined Ratio includes positive or negative development related to catastrophes or non-catastrophes.

The Combined Ratio Trigger is set annually based on our underwriting performance goals and historical results and may vary for each quarter based on how historical results have differed from one quarter to the next during the course of a year.

To the extent that the QPB Combined Ratio for a quarter is less than the Combined Ratio Trigger for any quarter, the difference is multiplied by the direct earned premium (in essence, the amount of our underwriting profit in excess of the Combined Ratio Trigger) for that quarter. An amount equal to fifteen percent of the product is placed in the QPB bonus pool, and the QPB bonus pool is divided by the total salaries of all eligible participants to determine the QPB bonus for that quarter. The QPB bonus is expressed as a percentage of each participant's quarterly salary. Each participant receives the same percentage of their quarterly salary as a QPB bonus for that quarter.



**Table of Contents****QPB Bonuses 2009**

A QPB bonus was earned only in the fourth quarter of 2009, as shown in the chart below illustrating the Combined Ratio Trigger and the actual QPB Combined Ratio for each quarter in 2009:

	<b>First Quarter 2009</b>	<b>Second Quarter 2009</b>	<b>Third Quarter 2009</b>	<b>Fourth Quarter 2009</b>
Combined Ratio Trigger	94.0%	99.0%	99.0%	94.0%
QPB Combined Ratio	110.5%	108.7%	100.5%	91.1%

Under the QPB, eligible employees received the following QPB bonuses, expressed as a percentage of their quarterly salary, for each quarter in fiscal year 2009:

	<b>First Quarter 2009</b>	<b>Second Quarter 2009</b>	<b>Third Quarter 2009</b>	<b>Fourth Quarter 2009</b>
QPB Payout as % of Participant's Quarterly Base Salary	0%	0%	0%	4.54%

For the full year 2009, the total QPB bonus payout was 1.14% of all eligible salaries.

**QPB Bonuses 2010 Opportunities**

For 2010, the Combined Ratio Trigger has been set at an annual average of 99% based on quarterly results of 96% (Q1), 102% (Q2), 102% (Q3) and 96% (Q4).

**Leadership Bonus Plan**

The Company adopted the LBP in 2007 as an annual cash incentive program for members of the Leadership Team, including the NEOs. For our NEOs, the LBP consists of two components: (i) a Company performance component that is intended to constitute qualified performance-based compensation for purposes of Section 162(m) of the Code and (ii) an individual performance component that is not intended to constitute qualified performance-based compensation for purposes of Section 162(m) of the Code. (See Tax Deductibility of Executive Compensation on page of this Proxy Statement.) For 2009, 75% of an NEO's LBP target bonus opportunity was based on Company performance and 25% was based on individual performance. The Committee believes that this allocation appropriately focuses our NEOs on attaining objective, quantitative financial results based on the Company's consolidated results and business plan, while also providing for the recognition of individual achievements, and is consistent with the strategic and operational objectives of our executive compensation program.

Awards made in prior years or in other parts of our compensation program have not influenced the opportunities or payments made available to the NEOs under the LBP for 2009. We do not target a specific level for bonuses as a percent of an executive's total compensation. Instead we position the target amount of each element of compensation—base salary and short- and long-term incentive compensation—at or near the median level paid by our competitive market for employees who are in similar positions at similarly sized property and casualty insurers, so that the target amount of total compensation is at or near the median level of compensation for our competitive market.

Each year, the Committee confirms the results of the Company performance component of the LBP for the NEOs based on the achievement of various performance goals selected by the Committee at the beginning of that year from a list contained in the LBP. The Committee may establish threshold, target and maximum levels of achievement of the performance goals that determine the amount of the Company performance bonus that is ultimately payable. At the end of the year, management provides the Committee with the actual results achieved by the Company with respect to each financial measure underlying the performance goals for the Company

**Table of Contents**

performance component of the LBP for that year. Based on the information provided to it by management, the Committee certifies the extent to which the performance goals were achieved before payment of the Company performance bonus is made. The Committee retains the power to reduce, but not increase, the amount of any Company performance bonus payable to an NEO subject to Section 162(m) of the Code.

Each year, the Committee, with input from the Board of Directors of State Auto Mutual, establishes, and evaluates the satisfaction of, the individual performance goals applicable to the CEO, and the CEO establishes, and evaluates the satisfaction of, the individual performance goals applicable to the other NEOs, for the individual performance component of the LBP. The Committee and CEO allocate a specific weight for each of the individual performance goals that they establish. The individual performance goals established for each NEO relate to specific strategic and business objectives relevant to that NEO's area of responsibility and, as a result, the individual performance goals applicable to the individual performance LBP bonuses are unique for each NEO. The Committee, with respect to the CEO, and the CEO, with respect to the other NEOs, evaluate the satisfaction of each individual performance goal by designating the NEO's performance with respect to the individual performance goal into one of the following categories: (i) does not meet; (ii) somewhat meets; (iii) meets; (iv) somewhat exceeds; and (v) exceeds. The Committee and the CEO then determine, based on their evaluation of the satisfaction of the individual performance goals, whether the NEO's overall performance met the threshold, target or maximum performance levels applicable to the individual performance component of the LBP and therefore merits the award of an individual performance LBP bonus.

**LBP Bonus 2009 Company Performance Component**

For 2009, the Committee selected LBP Combined Ratio, return on equity and premium growth as the performance goals for the Company performance component of the LBP. The Committee selected the performance goals because they are among the most important drivers of the Company's success.

LBP Combined Ratio is a measure of our profitability and is equal to the sum of (i) our loss and loss adjustment expense ratio (i.e., losses and loss expenses as a percentage of net earned premium) and (ii) our expense ratio (i.e., underwriting expenses and miscellaneous expenses offset by miscellaneous income). The LBP Combined Ratio includes positive or negative catastrophe development from the prior year. LBP Combined Ratio is expressed as a percentage and a LBP Combined Ratio of less than 100% indicates profitability.

Return on equity is a measure of our return to shareholders on their capital investment in the Company.

Premium growth is a measure of the growth in our total premium volume from existing sources and merger and acquisitions. We measure our premium growth on a direct basis (i.e., by excluding the impact of any reinsurance arrangements). The Committee assigned each of these performance goals an equal weight in determining the amount of any Company performance LBP bonus to balance profitability, shareholder return and growth.

The following chart shows the threshold, target and maximum payout percentages and performance goals applicable to each performance measure for the Company performance component of the LBP for 2009:

	LBP Combined Ratio		Return on Equity		Premium Growth	
	Payout as (%) of Target	Performance Goal (%)	Payout as (%) of Target	Performance Goal (%)	Payout as (%) of Target	Performance Goal (%)
Threshold	10	104.0	10	0.8	10	0.65
Target	100	99.0	100	7.2	100	3.9
Maximum	200	93.0	200	12.0	200	6.0



**Table of Contents**

Target performance is equal to the goal for the financial measure set forth in the 2009 business plan presented by management and approved by the Board following review and discussion of the business plan in March 2009. The Committee believes that target performance is reasonable to attain but includes an element of stretch performance. Maximum performance goals are intended to reflect superior performance and, although possible, may be extremely difficult to attain. Threshold performance, which the Committee views as an acceptable level of performance, is the lowest level of performance meriting any form of financial reward. The Committee recognizes that target performance may not be attained and believes that providing for payments to be made for threshold performance mitigates the incentive for NEOs and others to take excessive risks to achieve the target level of performance.

Each year, Towers Perrin evaluates the consistency of the performance goals and payout percentages applicable to the Company performance component of the LBP with the competitive market and raises any issues it identifies in its evaluation with the Committee. The Committee considers any issues raised by Towers Perrin in its review and determination of the LBP performance goals and payout percentages applicable to the Company performance component of the LBP.

The following chart shows (i) the result achieved for each Company performance measure in 2009, (ii) the percentage payout for that result relative to the target payout for that performance measure, (iii) the weight of each performance measure within the Company performance component of LBP and (iv) the value of the actual payout for the result achieved as a percentage of the NEO's target bonus for the Company performance component of the LBP:

Performance Measure	2009 Result (%)	% of Target Payout for Result	Weight	Payout Value (% of Target)
LBP Combined Ratio	108.7	0	.3334	0
Return on Equity	1.3	16.3	.3334	5.4
Premium Growth	5.8	194.3	.3334	64.8

The following chart shows the threshold, target and maximum amounts of 2009 Company performance LBP bonuses, both as a percentage of the NEO's annual base salary and as a dollar amount, for each of the NEOs based on the potential achievement of the Company's performance goals.

Named Executive Officer	Company Performance Threshold		Company Performance Target		Company Performance Maximum	
	% of Salary	Dollar Amount	% of Salary	Dollar Amount	% of Salary	Dollar Amount
Robert P. Restrepo, Jr.	5.625	41,063	56.25	410,625	112.5	821,250
Steven E. English	5.625	19,688	56.25	196,875	112.5	393,750
Mark A. Blackburn	5.625	26,156	56.25	261,563	112.5	523,125
Clyde H. Fitch	5.625	18,000	56.25	180,000	112.5	360,000
James A. Yano	3.75	11,250	37.5	112,500	75	225,000

**Table of Contents****LBP Bonus 2009 Individual Performance Component**

For 2009, the Committee, with the input of the Board of Directors of State Auto Mutual, established the individual performance goals applicable to the CEO's individual performance LBP bonus and the CEO established the individual performance goals applicable to each of the other NEO's individual performance LBP bonus. The following chart shows the 2009 threshold, target and maximum payouts, both as a percentage of salary and as a dollar amount, for each of the NEOs assuming attainment of each respective level of these individual performance goals:

Named Executive Officer	Individual Performance Bonus Threshold		Individual Performance Bonus Target		Individual Performance Bonus Maximum	
	% of Salary	Dollar Amount	% of Salary	Dollar Amount	% of Salary	Dollar Amount
Robert P. Restrepo, Jr.	1.875	13,688	18.75	136,875	37.5	273,750
Steven E. English	1.875	6,563	18.75	65,625	37.5	131,250
Mark A. Blackburn	1.875	8,719	18.75	87,188	37.5	174,375
Clyde H. Fitch	1.875	6,000	18.75	60,000	37.5	120,000
James A. Yano	1.25	3,750	12.5	37,500	25.0	75,000

**Table of Contents**

The following chart shows (i) the actual payout to each NEO for the individual performance component of the LBP for 2009, (ii) the value of the actual payout as a percentage of the NEO's 2009 target bonus for the individual performance component of the LBP, (iii) a description of each individual performance goal established for each NEO for 2009; and (iv) the weight of each performance goal within the individual performance component of LBP:

Named Executive Officer	2009 Individual Performance LBP Bonus (\$)	Payout Value (% of Target)	Performance Goal	Weight (%)
Robert P. Restrepo, Jr.	205,313	150	1. Profitable Growth: (1)	25
			2. Cost Structure: (1)	20
			3. Employee Development: (1)	10
			4. Strategic Plan: Provide regular strategic plan updates to the Board.	10
			5. IT Strategy: Develop an IT architecture that guides the development and deployment of all future strategic initiatives.	10
			6. Mergers and Acquisitions: (1)	10
			7. Risk Management: Develop and implement risk mitigation plans.	10
			8. Board Communications: Improve the quality and effectiveness of Board governance by enhancing communications, providing training and education and promoting interaction.	5
Steven E. English	118,125	180	1. Capital Management: Develop a cash forecast and management process.	20
			2. Capital Allocation Strategy: Implement appropriate strategy.	20
			3. Expense Management: Implement monthly expense analysis and quarterly plan analysis for management reporting.	10
			4. Investment Allocation: Maintain appropriate investment allocation.	20
			5. Reinsurance: Implement appropriate reinsurance strategy and agreements.	10
			6. Innovate State Auto: (1)	20
Mark A. Blackburn	130,781	150	1. Merger Integration: Integrate Rockhill Insurance Group and Patrons Insurance Group operations.	25
			2. IT Strategy and Architecture: Develop an IT architecture that guides the development and deployment of all future strategic initiatives.	10
			3. Risk Management: Develop and implement risk mitigation plans and processes.	10
			4. Claims Management: Recruit and hire new Claims Vice President and ensure successful transition of leadership and implementation of claims reorganization.	15
			5. Cost Structure: (1)	40
Clyde H. Fitch	120,000	200	1. Sales and Distribution: Design and implement best practice techniques and metrics to manage existing agencies.	35
			2. New Sales and Distribution: (1)	15
			3. Management Information: Create monthly reporting for CEO and operating reviews.	15
			4. Remodel Field Organization: Implement new regional alignments to balance workloads, optimize technology, engineer processes and develop back-up support.	35
James A. Yano	63,750	170	1. Legal Advice: Provide sound legal advice as requested to executive team and operational divisions within timeframes requested.	30
			2. Board Relations: Continue with organization and innovation in the conduct of Board and committee meetings. Support and promote positive relationships with all Board members.	30
			3. Rockhill Insurance Group: Secure regulatory approvals and close the transaction in first quarter, and then support full integration of legal, government affairs and Board functions.	15

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4. Innovate State Auto: Provide legal support for Innovate State Auto initiatives and fully implement all legal, government affairs and internal audit ideas.	15
5. Organization: Continue to learn the business and build relations with the executive team, Board and operating divisions. Continue to build legal and government affairs teams.	10

## **Table of Contents**

(1) We are not disclosing a more specific description of this performance goal because doing so would reveal confidential information that we do not disclose to the public, and we believe that disclosure of this information would cause us competitive harm.

For 2009, the Committee awarded Mr. Restrepo an individual performance bonus for, among other things, his strong leadership in a difficult environment, outstanding communication skills, progress in advancing various strategic objectives, success in assembling an excellent managerial team and impressive knowledge of the industry, all of which we expect to contribute in a meaningful way to increasing shareholder value in the future.

Mr. Restrepo recommended, and the Committee approved, individual performance bonuses for the other NEOs based primarily on the following accomplishments during 2009.

Mr. English exceeded target performance by improving capital management and financing flexibility, restructuring debt, improving the company's risk management capability through a new aggregate reinsurance catastrophe program and significantly enhancing corporate financial planning and monitoring processes.

Mr. Blackburn somewhat exceeded target performance based on excellent progress implementing the operations of the recently acquired Rockhill Insurance Group, implementing new leadership and operational improvements to the claim operation and significantly enhancing productivity and effectiveness throughout the Company's corporate operations.

Mr. Fitch exceeded target performance by producing superior growth results, segmenting agency performance and potential, strengthening agency plant management and performance monitoring and implementing a new field organizational structure for personal and business insurance.

Mr. Yano exceeded target performance by championing enhanced corporate governance practices and processes, improving communications between management and the Board and successfully anticipating and working through a myriad of contractual and regulatory issues surrounding the integration of the Rockhill Insurance Group.

### **LBP Bonus Opportunities 2010 Company and Individual Performance Bonuses**

On March 4, 2010, the Committee established the total 2010 LBP bonus opportunities for NEOs, including the Company performance and individual performance components of the LBP. The Committee used the same performance measures for the 2010 Company performance component of the LBP and assigned each performance measure the same weight as in 2009. The Committee also established the threshold, target and maximum payout percentages for 2010, including a range of payout levels between threshold and maximum. We believe that the disclosure of the specific performance measures and the range of awards related to the achievement of such measures are reflective of our 2010 business plan, and as such constitute confidential information. We believe that the disclosure of this information in this Compensation Discussion and Analysis would cause us competitive harm. The Committee believes that the target performance goals are difficult but attainable. For 2008 and 2009, the payout on the Company performance goals was 54% and 70.2%, respectively, of the target LBP bonus (where the target percentage equals 100%). For 2010, the payment of an individual performance LBP bonus for our NEOs, if any, will be determined by the Committee and the CEO at the end of the Company's 2010 fiscal year on the same basis as in 2009.

### ***Long-Term Equity and Cash Incentive Compensation***

We award NEOs and other members of the Leadership Team long-term incentive compensation in the form of stock options and cash-based performance award units ( PAUs ).

Stock options were awarded in 2009 pursuant to the terms of the 2000 Equity Plan and in 2010 pursuant to the terms of the 2009 Equity Plan. The 2000 Equity Plan and the 2009 Equity Plan were approved by our



## **Table of Contents**

shareholders. PAUs are awarded pursuant to the terms of the State Auto Financial Corporation Long-Term Incentive Plan, as amended ( Long-Term Incentive Plan ), the material terms of which have been approved by our shareholders. Awards of stock options made under the 2000 and 2009 Equity Plans and PAUs made under the Long-Term Incentive Plan are intended to constitute qualified performance-based compensation under Section 162(m) of the Code. (See Tax Deductibility of Executive Compensation on page of this Proxy Statement.)

The amount of the long-term incentive opportunity we award is based on data from our competitive market and is set consistent with our philosophy on setting each element of compensation at the median level of our competitive market. Individual performance is not currently a factor in determining the number of options granted, nor is consideration given to the level of previous grants or their market performance to date. The percentage of base salary that we award as long-term incentive opportunity does vary depending on the level of the participant within our management structure, recognizing that managers at a higher level in our Company should be more accountable for the results produced for shareholders.

Except for Mr. Restrepo's long-term incentive opportunity for 2010 (see Stock Options on page of this Proxy Statement), the Committee provides 50% of a Leadership Team member's total long-term incentive compensation opportunity in the form of stock options and 50% in the form of target PAUs. Together, these two forms of long-term incentive compensation reward employees for results over a multi-year period, balance the focus of our short-term incentive compensation plans, enhance our retention of key executives, build stock ownership among our executives and strike a balance between cash and non-cash rewards as well as between rewards tied solely to stock price appreciation and rewards based on sustained long-term financial performance. The Committee determined that the allocation of long-term incentive compensation between stock options and target PAUs is consistent with our competitive market. In addition, because the PAUs are paid in cash, they provide a source of funds that can be used by NEOs to exercise options and retain shares upon exercise, further building share ownership. The Company occasionally makes special grants of restricted stock to reward or retain key executives or to attract executives to join the Company, but the Company did not make any such special grants in 2009 to NEOs or other Leadership Team members. The Company did grant restricted stock to Mr. Restrepo in 2010 (see Stock Options on page of this Proxy Statement).

### *Stock Options*

We believe that issuing stock options to our executives (i) encourages business behaviors that drive appreciation in the price of our Common Shares over the long-term, because options have no value to the optionee unless the price of the underlying Common Shares increases from the date of grant, and (ii) helps align the interests of our executives who hold options, including our NEOs, with the interests of our shareholders. The alignment of the interests of our executives and our shareholders is further strengthened by our employee stock purchase plan in which all of our employees are eligible to participate. Stock options also represent a significant element of the total direct compensation paid to executives at peer companies with which we compete for executive talent.

**Table of Contents**

In 2009 and in 2010, the Committee granted stock options to our NEOs representing the number of our Common Shares as set forth in the table below. Each grant of options consisted of non-qualified stock options with a ten-year exercise period, a three-year graduated vesting schedule (i.e., one third of the total options granted vests each year for three years), and an option exercise price of \$14.49 and \$18.78, respectively, which was equal to the closing price of our Common Shares on the grant date.

Named Executive Officer	2009		2010	
	Stock Option Awards (# of Common Shares)	Exercise Price (\$)	Stock Option Awards (# of Common Shares)	Exercise Price (\$)
Robert P. Restrepo, Jr.(1)	52,088	14.49	54,015	18.78
Steven E. English	12,025	14.49	18,601	18.78
Mark A. Blackburn	27,035	14.49	41,535	18.78
Clyde H. Fitch	10,994	14.49	17,051	18.78
James A. Yano	7,929	14.49	12,322	18.78

(1) The Committee also granted 17,180 shares of restricted stock to Mr. Restrepo as part of his 2010 long-term incentive opportunity. The stock options were granted at the first regular Committee meeting of the year, as required by the Committee's charter. This timing supports the Company's overall emphasis on pay-for-performance by providing for a year-end Company and individual performance review and annual salary increases and option grants in March of each year. While the CEO makes recommendations to the Committee regarding option grants to our Leadership Team, the Committee retains the discretion to set the terms of any options granted, including the number of options granted to any optionee.

For both 2009 and 2010, the Committee intended to grant stock options whose total value was approximately equal to 50% of each optionee's total long-term incentive compensation opportunity, except that Mr. Restrepo's long-term incentive mix for 2010 was modified to enhance his ability to build Company stock ownership. For 2010, Mr. Restrepo was granted one-third of his long-term incentive opportunity in the form of stock options, one-third in the form of restricted stock and one-third in the form of PAUs. The number of stock options granted was determined by multiplying (i) the average daily closing price of our Common Shares for the prior fiscal year (ii) by a Black-Scholes factor. The Black-Scholes factor is a financial model that is used to determine the current value of stock options and was provided to the Company by Towers Perrin. The Black-Scholes factor provided by Towers Perrin for both 2009 and 2010 grants of stock options was 35%. The number of restricted shares granted to Mr. Restrepo was determined by dividing one-third of his target long-term incentive opportunity by \$19.78, which amount represents the sum of (a) \$17.98 (the average daily trading price of our Common Shares during 2009) and (b) \$1.80 (the estimated value of three years of anticipated cash dividends).

Before the Committee used the average daily closing price of our Common Shares in 2008 to calculate the number of stock options to grant in 2009, the Committee discussed and considered the dramatic fluctuations in the price of our Common Shares in 2008. Towers Perrin advised the Committee that relying on the 2008 average daily closing price provided stability in option grants, was similar to the practices of other companies and would prevent significant inflation in the number of options granted. Similarly, in light of continued deflation in the price of our Common Shares in 2009, the Committee sought the opinion of Towers Perrin before it used the average daily closing price of our Common Shares in 2009 to calculate the number of stock options to grant in 2010.

*Performance Award Units*

PAUs reward participants for sustained financial results that should increase the price of our Common Shares over the long term and balance the internal focus on our annual operating plan by rewarding participants



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**Table of Contents**

for financial results relative to the financial results of other property and casualty insurers. The Committee grants PAUs to each NEO with a target value equal to approximately 50% of the NEO's total long-term incentive compensation opportunity, except that Mr. Restrepo was only granted one-third of his long-term incentive opportunity for 2010 in the form of PAUs.

PAUs are awarded annually and are paid in cash at the end of a three-year performance period. The amount payable at the end of the performance period is determined by multiplying the number of PAUs by the value of the PAU at the end of the performance period. PAUs are granted with a target value of \$1.00, although the final value of each PAU can range from \$0.00 to \$2.00. The final value of a PAU depends on the State Auto Group's relative performance to a peer group of other property and casualty insurers during the performance period (the LTIP Peer Group). For 2009 grants of PAUs, the LTIP Peer Group consisted of approximately 600 companies included in the A.M. Best Total U.S. P&C Agency Companies Composite.

Granting PAUs with a new performance period every year provides the Company with greater flexibility to determine participants, awards, measures of performance and objectives for each performance metric that may need to change based on market conditions. The peer-comparison approach reduces the subjectivity involved in setting performance goals for a three-year period, which can be difficult. The grants of PAUs also are consistent with the Company's stated intent to provide Leadership Team members with high levels of pay for relatively high levels of performance and low levels of pay for relatively low levels of performance.

PAUs are valued based on the State Auto Group's achievement of performance measures selected by the Committee compared against the average results of the LTIP Peer Group during the performance period and can be achieved at threshold, target and maximum levels of performance. The target level for each performance measure is achieved if the State Auto Group's performance is equal to the mean level of performance of the companies in the LTIP Peer Group for such performance measure. The maximum level for each performance measure is achieved if the State Auto Group performs at or above the 80<sup>th</sup> percentile of the LTIP Peer Group for such performance measure. The threshold level of performance is achieved if the State Auto Group performs at the 20<sup>th</sup> percentile of the LTIP Peer Group for such performance measure. No amount is payable with respect to a performance measure if the State Auto Group performs below the 20<sup>th</sup> percentile of the LTIP Peer Group for such performance measure.

For example, if at the end of the 2009-2011 performance period there are 600 insurance companies in the LTIP Peer Group, and if such companies are ranked 1-600 (best to worst) in average statutory combined ratio, each NEO will receive a target award if the State Auto Group's three-year average statutory combined ratio is between the 300/301st ranked insurance companies in the LTIP Peer Group for such performance measure, a maximum award if the State Auto Group's three-year average statutory combined ratio equals or exceeds the 120th ranked insurance company for such performance measure, and a threshold award if the State Auto Group's three-year average statutory combined ratio equals the 480th ranked insurance company for such performance measure. No amount is payable if the State Auto Group's three-year average statutory combined ratio is below the threshold level (i.e., the lowest quintile of performance). The same comparison is performed for total premium growth and surplus growth, with the results equally weighted to determine the total PAU value awarded to each NEO.

**PAU Awards 2007-2009 Performance Period**

We first awarded PAUs in 2007 with a three-year performance period that ended December 31, 2009. The Committee approved three equally weighted measures to determine the number of PAUs earned for the three-year performance period beginning in 2007 and ending in 2009: statutory combined ratio for the State Auto Group, the Company's book value per share growth and total State Auto Group revenue growth.

For 2007 grants of PAUs, the LTIP Peer Group consists of the following public property and casualty insurance companies: Selective Insurance Group, Inc., EMC Insurance Group, Cincinnati Financial Corporation, Harleysville Group, Inc., The Hanover Insurance Group, Inc. and United Fire & Casualty Company (collectively, the 2007 LTIP Peer Group). For the 2007-2009 performance period, each NEO will earn points based upon our rank for each of these three performance measures in comparison to the 2007 LTIP Peer Group. Points are

**Table of Contents**

awarded based on a first place through last place finish. The objective is to accumulate the greatest number of points (three first place finishes in the three categories).

We have not determined whether the NEOs earned any PAUs for the 2007-2009 performance period because the final 2007 LTIP Peer Group data for the 2007-2009 performance period has not been released as of the date of this Proxy Statement. However, based on preliminary performance information for the 2007-2009 performance period, we estimate that the 2007 PAUs will be valued in excess of target performance. We will pay any PAUs earned by the NEOs for the 2007-2009 performance period in May 2010 after the final 2007 LTIP Peer Group data for the 2007-2009 performance period is released.

**PAU Awards 2009**

PAUs granted for the 2009-2011 performance period are valued based on the achievement of three equally-weighted performance measures: (i) direct, statutory combined ratio for the State Auto Group, (ii) the State Auto Group's direct written premium growth and (iii) the State Auto Group's surplus growth. The performance measures selected by the Committee focus on our ability to appropriately price and underwrite business, control expenses, develop new products and services, invest in assets that best balance risks and rewards and enter new markets. They also assess long-term profitability and the capital we need to underwrite future business. We believe sustained, high levels of performance in each of these areas should create value for our shareholders.

For the 2009-2011 performance period, our NEOs received PAUs in the number and with the target, threshold and maximum values described below:

<b>Named Executive Officer</b>	<b>2009 Target Units(#)</b>	<b>Target Award Value(\$)*</b>	<b>Threshold Award Value(\$)*</b>	<b>Maximum Award Value(\$)*</b>
Robert P. Restrepo Jr.	492,750	492,750	197,100	985,500
Steven E. English	113,750	113,750	45,500	227,500
Mark A. Blackburn	255,750	255,750	102,300	511,500
Clyde H. Fitch	104,000	104,000	41,600	208,000
James A. Yano	75,000	75,000	30,000	150,000

\* Units have a target value equal to \$1.00, a threshold value of \$0.40 and a maximum value of \$2.00.

**PAU Awards 2010**

PAUs granted for the 2010-2012 performance period are valued based on the achievement of three equally-weighted performance measures. The Committee selected the same performance measures for the 2010-2012 performance period as it did for the 2009-2011 performance period for the reasons discussed above in PAU Awards 2009.

For the 2010-2012 performance period, our NEOs received PAUs in the number and with the target, threshold and maximum values described below:

<b>Named Executive Officer</b>	<b>2010 Target Units(#)</b>	<b>Target Award Value(\$)*</b>	<b>Threshold Award Value(\$)*</b>	<b>Maximum Award Value(\$)*</b>
Robert P. Restrepo Jr.	339,750	339,750	135,900	679,500
Steven E. English	117,000	117,000	46,800	234,000
Mark A. Blackburn	261,250	261,250	104,500	522,500
Clyde H. Fitch	107,250	107,250	42,900	214,500
James A. Yano	77,500	77,500	31,000	155,000

\* Units have a target value equal to \$1.00, a threshold value of \$0.40 and a maximum value of \$2.00.



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**Table of Contents**

***Retirement and Deferred Compensation***

*Retirement Plan*

We maintain a defined benefit pension plan, referred to as our Retirement Plan. The Retirement Plan is intended to be a qualified plan under Section 401(a) of the Code and is subject to the minimum funding standards of Section 412 of the Code. All of our current NEOs and other employees hired before January 1, 2010 are eligible to participate in the Retirement Plan. Benefits payable under the Retirement Plan are funded entirely through Company 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. Only base salary, not incentive compensation, is taken into consideration in the calculation of benefits under our Retirement Plan.

*Supplemental Executive Retirement Plans*

Tax laws place limits on the amount of income or wages that can be considered in calculating benefits under traditional defined benefit pension plans, such as our Retirement Plan. With a supplemental executive retirement plan, it is possible for a highly compensated officer to achieve the same percentage of salary replacement as other employees upon retirement. Our Supplemental Executive Retirement Plan, referred to as our SERP, is a non-qualified retirement plan designed solely to offset the impact of regulatory limitations on retirement benefits available under the Retirement Plan. As a result, the SERP mirrors the Retirement Plan. The SERP provides a lump sum or deferred cash payments in actuarially determined amounts upon retirement for certain officers. Like the Retirement Plan, the SERP considers only base salary, not incentive compensation, in calculating the benefit due each participant. The Committee previously approved participation in this SERP for all NEOs. Executives are now automatically enrolled in the SERP when his or her annual base salary exceeds the limit that can be considered in calculating benefits under the Retirement Plan.

In addition to the standard SERP discussed above, we have entered into individual SERP agreements with Mr. Restrepo and Mr. Blackburn to offset the impact of the relatively shorter duration of employment available to them at our Company. We have a mandatory retirement age of 65 for certain officers. Mr. Restrepo is currently 59 and has been an employee for four years. Mr. Blackburn is 58 years old and has been an employee for ten years. The Retirement Plan and the standard SERP, discussed above, both use a career average plan formula for benefit determinations. 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. For this reason, the Committee approved the individual SERP agreements for Messrs. Restrepo and Blackburn (See Contractual Arrangements with Named Executive Officers Employment Agreements on page of this Proxy Statement.)

*Defined Contribution Plan/401(k) Plan*

We maintain a defined contribution plan intended to be a qualified plan under Sections 401(a) and 401(k) of the Code that we refer to as our Capital Accumulation Plan or CAP. We changed the name of the CAP from The State Auto Insurance Companies Capital Accumulation Plan to The State Auto Insurance Companies Retirement Savings Plan effective on January 1, 2010. Participation in the CAP is available on the same terms to all of our employees, including our NEOs. Each participant can elect to contribute from 1% to 50% of his or her base salary to the CAP. The deferred amount is contributed to the CAP trust fund 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 may be invested in Common Shares.

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**Table of Contents**

The Company may make a discretionary matching contribution of 100% of each participant's CAP contributions for the first 1% of base salary, plus 50% of each participant's CAP contribution between 2% and 6% of base salary, subject to an annual maximum of \$16,500. This equates to a Company contribution in the CAP of 58 cents for each salary dollar contributed by an employee who contributed a full 6% of salary to CAP. 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 is subject to vesting as provided by the 401(k) Plan.

Our current NEOs and all other employees hired before January 1, 2010 will have to decide between April 1, 2010 and May 31, 2010 whether (i) to continue participating in the Retirement Plan and CAP on the terms discussed above or (ii) to cease participating in the Retirement Plan as of June 30, 2010 in favor of participating in an expanded benefit under the CAP beginning on July 1, 2010, pursuant to which the Company would annually contribute to the CAP an amount equal to 5% of their annual base salary until the termination of their employment with the Company. If an NEO or other employee elects to participate in the expanded CAP benefit, they would continue to be eligible to receive upon retirement their accrued benefit under the Retirement Plan as of June 30, 2010.

*Non-Qualified Deferred Compensation Plan/Supplemental 401(k) 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. Eligible employees include those who are precluded by regulatory limitations from contributing a full 6% of salary 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. The election form is executed annually in advance of the year in which such compensation would be earned. 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 in the aggregate under the CAP and the Shadow Plan.

The total amount of salary deferred under the CAP and the Shadow Plan cannot exceed in the aggregate 50% of a participant's base salary. The Shadow Plan also allows participants to defer up to 100% of short-term and long-term incentive compensation, although bonuses remain ineligible for a Company match. Amounts deferred under the Shadow Plan, along with the Company match on any portion of salary deferral eligible for the match, are invested by State Auto P&C in a variety of mutual fund-type investment options in accordance with the election of the participants, which the participants may modify on a daily basis. Participants may choose from either a five or ten-year payout option or a date-certain option and no other distributions or withdrawals of funds from the Shadow Plan are permitted.

Non-qualified plans allow highly compensated employees to be in the same place, relatively speaking, as other employees of the Company, in terms of their ability to maximize their retirement savings opportunities. Participants in these non-qualified plans become unsecured creditors 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.

*Executive Perquisites*

We provide our executive officers certain minimal perquisites not tied to individual or Company performance. We believe these benefits are well below the typical practices of other insurers and companies of comparable size, are highly valued by recipients, have limited cost and are part of a competitive reward program that aids in attracting and retaining the best executives.

## **Table of Contents**

### *Tax Advisory Services*

We provide up to \$500 annually for tax advice to an optionee in the year they exercise qualified stock options. This benefit is available to all optionees, not just NEOs. It provides these employees access to professional advice in dealing with the tax and financial consequences associated with exercising options. We also believe it helps optionees accurately determine their tax liabilities and the number of shares they may need to sell to cover those costs. As a result, this program helps optionees retain more of the shares associated with their award, building greater stock ownership among our employees. None of the NEOs used this perquisite in 2009.

### *Life Insurance*

Effective November, 2009, as a cost saving measure, we eliminated our 75% premium contribution toward our officers' whole life insurance policies if the officers elect to purchase such policy. The portion of the premium that we paid for NEOs is included in the total listed under "All Other Compensation" in the Summary Compensation Table on page 10 of this Proxy Statement. The face amount of these policies does not exceed \$50,000 and provided a modest form of additional financial security to officers who choose the benefit.

### *Travel Expenses*

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 or guest 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 or guest to attend the trip(s) as a host in 2009 is included in the total reflected in the "All Other Compensation" column in the Summary Compensation Table on page 10 of this Proxy Statement for any NEO whose spouse or guest acted as a host.

### *Club Memberships*

During 2009, we also had corporate memberships in two clubs in central Ohio, one of which was a golf club. The corporate memberships in these clubs were used for business entertainment and meetings, and we paid the dues. The designated users were Messrs. Restrepo and Blackburn. The dues we paid for these memberships are included in the "All Other Compensation" column of the Summary Compensation Table on page 10 of this Proxy Statement.

## **Contractual Arrangements with Named Executive Officers**

### ***Employment Agreements***

We have entered into employment agreements with Robert P. Restrepo, Jr., our Chairman, President and Chief Executive Officer, and Mark A. Blackburn, our Executive Vice President and Chief Operating Officer. The terms