

State Auto Financial CORP
Form DEF 14A
April 07, 2008
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)

Payment of Filing Fee (Check the appropriate box):

Edgar Filing: State Auto Financial CORP - Form DEF 14A

x No fee required.

.. Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

.. Fee paid previously with preliminary materials.

.. Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

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

(3) Filing Party:

(4) Date Filed:

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) will be held at the Company's principal executive offices located at 518 East Broad Street, Columbus, Ohio, on May 7, 2008, at 10:00 a.m., local time, for the following purposes:

1. To elect three Class II directors, each to hold office for a three-year term and until a successor is elected and qualified;
2. To consider and vote upon a proposal to amend the Company's 1991 Employee Stock Purchase and Dividend Reinvestment Plan and Trust;
3. To ratify the selection of Ernst & Young LLP as the Company's independent registered public accounting firm for 2008; and
4. To transact such other business as may properly come before the meeting or any adjournment thereof.

The close of business on March 14, 2008, 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 7, 2008

Table of Contents

PROXY STATEMENT TABLE OF CONTENTS

	Page
<u>General</u>	1
<u>Proxies and Voting</u>	1
<u>Proposal One: Election of Directors</u>	2
<u>Nominees for Class II Directors</u>	2
<u>Majority Voting Policy for Incumbent Directors</u>	2
<u>Backgrounds and Beneficial Ownership Information for Nominees and Continuing Directors</u>	4
<u>Beneficial Ownership Information for Named Executive Officers and Executive Group</u>	7
<u>Proposal Two: Approval of Amendment to Employee Stock Purchase Plan</u>	8
<u>Proposal Three: Ratification of Selection of Independent Registered Public Accounting Firm</u>	12
<u>Board of Directors and Board Committees</u>	13
<u>Board Meetings</u>	13
<u>Board Committees and Committee Meetings</u>	13
<u>Compensation of Outside Directors and Outside Director Compensation Table</u>	14
<u>Corporate Governance</u>	17
<u>Director Independence</u>	17
<u>Communications with the Board</u>	17
<u>Director Attendance at Annual Meeting of Shareholders</u>	17
<u>Executive Sessions of Independent Directors; Lead Director</u>	17
<u>Nomination of Directors</u>	18
<u>Other Governance Issues of Interest</u>	19
<u>Availability of Corporate Governance Documents</u>	20
<u>Compensation of Executive Officers</u>	21
<u>Compensation Discussion and Analysis</u>	21
<u>Summary Compensation Table</u>	38
<u>Grants of Plan-Based Awards in 2007</u>	41
<u>Contractual Arrangements with Named Executive Officers</u>	42
<u>Outstanding Equity Awards at Fiscal 2007 Year-End</u>	48
<u>Option Exercises and Stock Vested in Fiscal 2007</u>	49
<u>Pension Benefits in Fiscal 2007</u>	49
<u>Nonqualified Deferred Compensation Table in Fiscal 2007</u>	50
<u>Potential Payments Upon Termination or Change in Control Table</u>	51
<u>Compensation Committee Interlocks and Insider Participation</u>	54
<u>Compensation Committee Report</u>	54
<u>Report of the Audit Committee</u>	55
<u>Principal Holders of Voting Securities</u>	57
<u>Equity Compensation Plan Information</u>	57
<u>1998 State Auto Agent's Stock Option Plan</u>	58
<u>Related Person Transactions</u>	59
<u>Policies and Procedures for Review and Approval of Related Person Transactions</u>	59
<u>Transactions Involving State Auto Mutual</u>	59
<u>Other Related Person Transactions</u>	61
<u>Independent Registered Public Accounting Firm</u>	62
<u>General</u>	62
<u>Audit and Other Services Fees</u>	62
<u>Audit Committee's Pre-Approval Policies and Procedures</u>	63
<u>Future Shareholder Proposals</u>	63
<u>Section 16(a) Beneficial Ownership Reporting Compliance</u>	63
<u>Other Matters</u>	64
<u>Exhibit A 1991 Employee Stock Purchase and Dividend Reinvestment Plan and Trust, with Proposed Amendment</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) to be used at its Annual Meeting of Shareholders to be held May 7, 2008 (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 7, 2008.

PROXIES AND VOTING

The close of business on March 14, 2008, 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 40,036,870 of the Company's common shares, without par value (the Common Shares). Each Common Share is entitled to one vote.

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

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

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.

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 II directors; (2) for the approval of the amendment to the Employee Stock Purchase Plan; and (3) for the ratification of the selection of Ernst & Young LLP as the Company's independent registered public accounting firm for 2008. 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.

Table of Contents

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

If your Common Shares are held in street name, you will need to instruct your broker regarding how to vote your Common Shares. If you do not provide voting instructions to your broker, and if your broker does not have discretion to vote your Common Shares without your instructions, a broker non-vote will occur. Broker non-votes will not be counted in determining the votes cast for the election of directors or with respect to Proposal Three and will not have a positive or negative effect on the outcome of these Proposals. With respect to Proposal Two, because passage of this Proposal requires the favorable vote of a majority of the outstanding Common Shares, broker non-votes will have the same effect as a vote against Proposal Two.

STATE AUTOMOBILE MUTUAL INSURANCE COMPANY (STATE AUTO MUTUAL), WHICH OWNS APPROXIMATELY 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 II 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 II directors expires concurrently with the holding of the Annual Meeting. David J. D Antoni, David R. Meuse and S. Elaine Roberts, the three persons recommended by the Nominating and Governance Committee of our Board and each of whom is an incumbent Class II director, have been nominated for re-election as Class II directors at the Annual Meeting.

At the Annual Meeting, it is the intention of the persons named in the accompanying form of proxy, unless a contrary position is indicated on such proxy, to vote the proxy for the election of the three nominees named in the following table as Class II directors, each to hold office until the 2011 annual meeting of shareholders and until a successor is elected and qualified. Each of the nominees has consented to being named in this Proxy Statement and to serve if elected. In the event that any nominee named in the table as a Class II director is unable to serve (which is not anticipated), the persons named in the proxy may vote it for another nominee of their choice.

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

Majority Voting Policy for Incumbent Directors

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

Table of Contents

director's election or, in the case where the number of nominees exceeds the number of directors to be elected, cast with respect to election of directors generally. Votes cast (i) include votes to withhold authority in each case, and (ii) exclude abstentions with respect to that director's election or, in the case where the number of nominees exceeds the number of directors to be elected, abstentions with respect to election of directors generally.

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

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

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

Class II Director Nominees

(Terms expiring in 2011)

Name of Director Nominees and Position(s) with Company	Age(1)	Principal Occupation(s) During the Past Five Years	A Director of the Company Since	Common Shares Owned Beneficially as of March 14, 2008(2)(3)(4)	% Of Class
David J. D Antoni(5) Director	63	Retired from Ashland, Inc. since 9/04; Senior Vice President and Group Operating Officer, Ashland, Inc., 3/99 to 9/04; President of APAC, Inc., a subsidiary of Ashland, Inc., 7/03 to 1/04; Senior Vice President of Ashland, Inc. and President, Ashland Chemical, a division of Ashland, Inc., 7/88 to 3/99. Ashland, Inc. is a chemical, energy and transportation construction company. Mr. D Antoni is also a director of OMNOVA Solutions Inc., a producer of decorative and functional surfaces, coatings and specialty chemicals, and Compass Minerals International, Inc., a producer and distributor of inorganic minerals.	1995	56,400	*
David R. Meuse Director	63	Principal of Stonehenge Financial Holdings, Inc., a provider of financial and advisory resources, 8/99 to present. Mr. Meuse is also a director of Diamond Hill Investment Group, Inc., a provider of investment management services and manager of mutual funds and private investment funds.	2006	35,000	*
S. Elaine Roberts Director	55	President and Chief Executive Officer of the Columbus Regional Airport Authority, a public port authority which oversees the operations of Port Columbus, Rickenbacker and Bolton Field airports in Franklin County, Ohio, 01/03 to present; Executive Director of Columbus Airport Authority, 12/00 to 01/03.	2002	8,400	*

Table of Contents

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

Class III Directors**(Terms expiring in 2009)**

Name of Director and Position(s) with Company	Age(1)	Principal Occupation(s) During the Past Five Years	A Director of the Company Since	Common Shares Owned Beneficially as of March 14, 2008(2)(3)(4)	% Of Class
Robert P. Restrepo, Jr.(6) Chairman, President and Chief Executive Officer	57	Chairman of the Board and Chief Executive Officer of the Company, State Auto Property & Casualty Insurance Company (State Auto P&C), Milbank Insurance Company (Milbank), State Auto National Insurance Company (State Auto National) and Farmers Casualty Insurance Company (Farmers Casualty), each a wholly owned subsidiary of the Company and of State Auto Mutual, 2/06 to present; President of the Company, State Auto P&C, Milbank, State Auto National, Farmers Casualty, and State Auto Mutual, 3/06 to present; Senior Vice President, Insurance Operations, Main Street American Group, a property and casualty insurance underwriting business, 4/05 to 2/06; President and Chief Executive Officer for two property and casualty insurance subsidiaries of Allmerica Financial Corporation (now known as Hanover Insurance Group), 1998 to 2003.	2006	39,040	*
Richard K. Smith(7) Director	63	Retired as Partner of KPMG, LLP, a public accounting firm, since 6/97; Partner of KPMG, LLP for more than five years prior to 6/97.	1999	18,400	*
Paul S. Williams Director	48	Managing Director with Major, Lindsey & Africa, LLC, an attorney search consulting firm, 5/05 to present; officer of Cardinal Health, Inc., a provider of products and services to healthcare providers and manufacturers, for more than five years prior to 4/05, last serving as that company's Executive Vice President, Chief Legal Officer and Secretary. Mr. Williams is also a director of Bob Evans Farms, Inc., a restaurant and food products company.	2003	4,525	*

Table of Contents**Class I Directors****(Terms expiring in 2010)**

Name of Director and Position(s) with Company	Age(1)	Principal Occupation(s) During the Past Five Years	A Director of the Company Since	Common Shares Owned Beneficially as of March 14, 2008(2)(3)(4)	% Of Class
Robert E. Baker Director	61	President of Puroast Coffee Inc., a maker of specialty coffee products, 10/04 to present; Vice President of Corporate Marketing for ConAgra Foods, Inc., one of North America's largest packaged food companies, 4/99 to 10/04.	2007	300	*
Thomas E. Markert Director	50	CEO, Ipsos Loyalty Worldwide, a division of Ipsos which provides research and consulting to help clients improve customer satisfaction and loyalty, 5/07 to present; Global Chief Marketing and Client Service Officer, AC Nielsen, a leading global provider of marketing research and information services company, 1/04 to 5/07; for more than five years prior thereto, Mr. Markert held various executive positions within AC Nielsen.	2007	0	*
Alexander B. Trevor Director	63	President of Nuvocom Incorporated, a provider of patent litigation support services, 10/96 to present.	2006	0	*

* Less than one (1%) percent.

- (1) Ages shown are as of the date of the Annual Meeting.
- (2) Except as indicated in the notes to this table, the persons named in the table have sole voting and investment power with respect to all Common Shares shown as beneficially owned by the named person. With respect to stock options, this table includes only stock options for Common Shares which are currently exercisable or exercisable within 60 days of March 14, 2008.
- (3) The amounts reported include Common Shares attributable to options granted under the Company's Equity Incentive Compensation Plan for Mr. Restrepo (27,671) and Common Shares attributable to options granted under both the Company's 1991 Directors Stock Option Plan and 2000 Directors Stock Option Plan for Messrs. D'Antoni (15,400), Smith (10,400), Williams (4,200) and Ms. Roberts (7,400).
- (4) The amounts reported for Messrs. 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.
- (5) Includes 12,000 Common Shares owned by Mr. D'Antoni's spouse, as to which he disclaims beneficial ownership.
- (6) Includes 10,500 Common Shares received by Mr. Restrepo pursuant to the terms of a restricted share agreement entered into in connection with his employment by the Company. All of these Common Shares are subject to a risk of forfeiture if Mr. Restrepo's employment is terminated for any reason prior to March 2, 2009 (or if he violates any provision of the restricted share agreement prior to that date). These

Table of Contents

Common Shares are also subject to restrictions on transfer until March 2, 2009. See Compensation Discussion and Analysis Contractual Arrangements with Named Executive Officers Robert P. Restrepo, Jr. for additional information concerning these restricted Common Shares.

(7) Includes 5,000 Common Shares owned by Mr. Smith's spouse, as to which he disclaims beneficial ownership.

Beneficial Ownership Information for Named Executive Officers and Executive Group

In addition to the Common Shares owned beneficially by Mr. Restrepo, as set forth above, our Named Executive Officers or NEOs (those persons listed in the Summary Compensation Table on page 38 of this Proxy Statement) beneficially owned the number of Common Shares set forth below as of March 14, 2008:

Named Executive Officer	Common Shares Beneficially Owned(1)	Stock Options(2)	Total Beneficial Ownership of Common Shares	Percent of Class
Steven E. English	2,196	16,505	18,701	*
Mark A. Blackburn(3)	33,568	87,696	121,264	*
Steven R. Hazelbaker	4,986	23,872	28,858	*
Lorraine M. Siegworth	517	3,591	4,108	*

As of March 14, 2008, our directors and executive officers as a group (18 persons) beneficially owned 597,519 (1.5%) Common Shares, which included options for 328,355 Common Shares and 10,500 restricted Common Shares which have been issued to Mr. Restrepo subject to a risk of forfeiture. See Compensation of Executive Officers Contractual Arrangements Robert P. Restrepo, Jr. for additional information concerning these restricted Common Shares.

* Less than one (1%) percent.

- (1) These persons and/or their spouses have sole voting and investment power with respect to all Common Shares beneficially owned by them.
- (2) 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 14, 2008.
- (3) 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 death, 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. See Compensation Discussion and Analysis Contractual Arrangements with Named Executive Officers Mark A. Blackburn for additional information concerning these restricted Common Shares.

Table of Contents

PROPOSAL TWO: APPROVAL OF AMENDMENT TO EMPLOYEE STOCK PURCHASE PLAN

Proposal

At the Annual Meeting, shareholders will be asked to consider and vote upon a proposal to approve an amendment to the State Auto Financial Corporation 1991 Employee Stock Purchase and Dividend Reinvestment Plan and Trust, or Employee Stock Purchase Plan, to (1) permit employees employed by an entity acquired by the Company or a related entity to participate in the Employee Stock Purchase Plan in anticipation of becoming an employee of the Company and (2) change the applicable enrollment and subscription periods under the Employee Stock Purchase Plan to align such periods with the calendar year and provide employees of acquired entities an earlier opportunity to participate in the Employee Stock Purchase Plan. The Board of Directors approved the amendment on November 9, 2007. At the Annual Meeting, unless otherwise indicated, proxies will be voted to approve the amendment to the Employee Stock Purchase Plan.

Reason for Amendment

The Company and its affiliates have acquired and/or affiliated with various entities over the past several years. In that regard, the Company desires to extend certain benefits to the individuals of those entities as they become employees of the Company, including the ability to participate in the Employee Stock Purchase Plan. Due to certain transition processes and tax considerations, employees of acquired entities typically become employees of the Company as of the first day of a calendar year. The current terms of the Employee Stock Purchase Plan preclude employees new as of January 1 from participating in the Employee Stock Purchase Plan until the subscription period beginning on June first of that year. In order to provide employees of acquired and/or affiliated entities an opportunity to participate in the Employee Stock Purchase Plan upon becoming an employee of the Company and in order to align the Employee Stock Purchase Plan's subscription periods with the calendar year, the Company desires to revise the applicable enrollment and subscription periods under the Employee Stock Purchase Plan.

Description of the Employee Stock Purchase Plan

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

Purpose

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

Eligibility

All employees of the Company or its parent or subsidiary corporations are eligible to participate in the Employee Stock Purchase Plan. As of March 14, 2008, there were 1,029 employees participating in the Employee Stock Purchase Plan, which represents approximately 47% of the Company's work force.

If the proposed amendment is approved by shareholders, then, in addition to the employees described in the preceding paragraph, eligible employees will also include an individual who is employed by an entity acquired by the Company or its parent or a subsidiary corporation in anticipation of and conditioned on, becoming an

Table of Contents

employee of the Company or its parent or a subsidiary corporation as of the commencement date of an applicable subscription period. Such designation as an eligible employee is solely for the purpose of the individual's eligibility to enroll in the Employee Stock Purchase Plan during an applicable enrollment period prior to the applicable subscription period. In the event an individual is not an employee of the Company or its parent or a subsidiary corporation as of the commencement of a subscription period, the individual shall not be an eligible employee or become a participant in the Employee Stock Purchase Plan.

Stock Purchases; Purchase Price; Reinvestment of Cash Dividends

Employees who desire to participate in the Employee Stock Purchase Plan may do so by making an election to participate during one of two annual enrollment periods. Currently, the enrollment periods are May 1 through May 14 and November 1 through November 14. If the proposed amendment is approved by shareholders, then the two annual enrollment periods will be changed to June 1 through June 14 and December 1 through December 14.

Participating employees may elect to contribute, by payroll deduction, from one percent to six percent of their base pay toward the purchase of Common Shares. Amounts accumulated in the plan account of each participating employee through the last pay period during a subscription period will be credited to the purchase of Common Shares from the Company. Unless withdrawn by the participant, Common Shares purchased under the plan will be held for the participant by the Employee Stock Purchase Plan's agent, currently National City Bank.

The purchase price for Common Shares purchased under the plan is the lesser of 85% of the fair market value of the Common Shares on the last trading day before the subscription period or on the last trading day of the subscription period.

Currently, the two annual subscription periods are June 1 through November 30 and December 1 through May 31. If the proposed amendment is approved by shareholders, then the two annual subscription periods will be changed to January 1 through June 30 and July 1 through December 31.

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

Federal Income Tax Information

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

If a participant disposes of Common Shares purchased under the employee stock purchase feature of the Employee Stock Purchase Plan within two years after the last trading day preceding the subscription period in which such Common Shares were purchased (the "Grant Date"), the participant must include in ordinary income, as compensation, an amount equal to the excess of the fair market value of the Common Shares on the purchase date over the purchase price paid for such Shares under the Employee Stock Purchase Plan. The employer company will be allowed a deduction in an amount equal to the amount included in the participant's income as compensation. If the participant does not dispose of the Common Shares purchased under the employee stock purchase feature of the Employee Stock Purchase Plan until after the expiration of the two-year holding period described above or if the participant dies while holding the Common Shares acquired under the employee stock purchase feature of the Employee Stock Purchase Plan, the participant must include in income, as compensation,

Table of Contents

in the taxable year in which disposition or death occurs, an amount equal to the lesser of (i) the excess of the fair market value of the Common Shares at the time of their disposition or death over the purchase price paid for the Common Shares under the plan, or (ii) 15% of the fair market value of the Common Shares on the Grant Date. The basis of the participant in the Common Shares purchased under the employee stock purchase feature of the Employee Stock Purchase Plan will equal the amount paid for the Common Shares plus the amount, if any, included in the participant's income as compensation. Any compensation resulting from the disposition of the Common Shares will be includable in the income of the participant in the participant's taxable year in which the disposition of the Common Shares occurs. The participant's holding period for the Common Shares purchased under the employee stock purchase feature of the plan will commence on the Grant Date. Any gain in excess of the basis will be treated as long-term capital gain if the participant's holding period for the Common Shares is more than one year.

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

2007 Information Pertaining to Named Executive Officers and Other Groups

The following table sets forth, with respect to each of the persons named in the Summary Compensation Table and certain groups of employees, certain information about Common Shares purchased under the Employee Stock Purchase Plan during 2007:

Name	Number of Common Shares Purchased	Average Per Share Purchase Price \$(1)	Net Value of Common Shares Realized \$(2)
Robert P. Restrepo, Jr. Chairman, President and Chief Executive Officer	855	23.698	3,574
Steven E. English Vice President and Chief Financial Officer	608	24.999	2,671
Mark A. Blackburn Executive Vice President and Chief Operating Officer	1,036	24.999	4,559
Steven R. Hazelbaker Vice President	478	24.999	2,101
Lorraine M. Siegworth Vice President	502	24.999	2,207
All executive officers as a group (10 persons)	5,261	24.709	22,882
All participants, other than executive officers, as a group (973 persons)	86,524	24.909	380,579

Edgar Filing: State Auto Financial CORP - Form DEF 14A

- (1) Represents 85% of the average fair market value of the Common Shares on both purchase dates in 2007, except for Mr. Restrepo who participated in only one subscription period in 2007. All of the other NEOs participated in both subscription periods in 2007.
- (2) Represents the net value of the Common Shares on the purchase date determined by subtracting the net purchase price from the fair market value of the Common Shares on the purchase date of each subscription period that ended in 2007 and multiplying that amount by the number of shares purchased for each subscription period.

Table of Contents

Reasons for Shareholder Approval

The Company's shareholders are being asked to approve the amendment to the Employee Stock Purchase Plan because shareholder approval is required under the terms of the Employee Stock Purchase Plan.

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

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

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 2008. 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 2008 is appropriate because of the firm's reputation, qualifications and experience.

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

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE FOR RATIFICATION OF THE SELECTION OF ERNST & YOUNG LLP AS THE COMPANY'S INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR 2008.

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 six Board meetings during the fiscal year ended December 31, 2007. Seven of our incumbent directors attended 100% of the Board meetings and the meetings of all committees on which they served. Our other two directors attended over 88% 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, Director Ethical Principles, Employee Code of Business Conduct and Code of Ethics for Senior Financial Officers, are available on our website at www.stfc.com under Corporate Governance (<http://www.stfc.com/corp.gov/index.htm>).

The Audit Committee is charged with several responsibilities, including: (1) appointment, compensation, retention and oversight of the work performed by our independent auditors; (2) reviewing our accounting functions, operations and management; (3) considering the adequacy and effectiveness of our internal controls and internal auditing methods and procedures; (4) meeting and consulting with our independent auditors and with our financial and accounting personnel concerning the foregoing matters; (5) reviewing with our independent auditors the scope of their audit and the results of their examination of our financial statements; (6) participating in the process of administering our Employee Code of Business Conduct and our Director Ethical Principles set forth in our Corporate Governance Guidelines; (7) establishing procedures for receipt, retention and treatment of compliance regarding accounting, internal accounting controls or auditing matters, including procedures for the confidential, anonymous submission by employees of concerns regarding accounting or auditing matters; and (8) approving in advance any other work performed by our independent auditors that they are permitted by law to perform for us. Present members of the Audit Committee are Chairperson Richard K. Smith, David J. D. Antoni, 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 nine meetings during 2007.

The Compensation Committee is charged with several responsibilities, including: (1) administering our Amended and Restated Equity Incentive Compensation Plan, our 1991 Stock Option Plan, our Leadership Bonus Plan, our Long-term Incentive Plan, and our Outside Directors Restricted Share Unit Plan; (2) evaluating and approving the compensation, fringe benefits and perquisites provided to our executive officers and adopting compensation policies applicable to our officers; and (3) evaluating the compensation provided to the members of the Board and its committees. 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 seven meetings during 2007.

As further discussed in Compensation Discussion and Analysis, 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, beginning in March 2008, a director of State Auto Mutual who is a member of State Auto Mutual's Nominating and Governance Committee began attending the meetings of our Compensation Committee as a non-voting member. This State Auto Mutual director, Roger P. Sugarman, is

Table of Contents

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 and is compensated by State Auto Mutual for attending our Compensation Committee meetings.

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 Director 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 2007. 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 2007.

The standing Independent Committee principally serves to review inter-company transactions between or among us and our subsidiaries, on the one hand, and State Auto Mutual and its subsidiaries, on the other. The Independent Committee also helps determine which entity, our Company or State Auto Mutual, is best suited to take advantage of transactional opportunities presented by a third party. The members of the standing Independent Committee are Chairperson S. Elaine Roberts, Robert E. Baker, Thomas E. Markert, Richard K. Smith and Alexander B. Trevor. The Independent Committee, which only meets as needed, met three times in 2007.

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 2007 meeting with assistance from Towers Perrin, the compensation consultant directly engaged by the Compensation Committee. At the November meeting, Towers Perrin reviewed 2006 market data and 2007 Fortune 500 data on director compensation. Towers Perrin concluded that, based on this data, outside directors' compensation 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 2008.

Our outside directors received the following compensation in 2007:

Name	Fees Earned or		Total (\$)
	Paid in Cash (\$)	Stock Awards \$(1)	
David J. D. Antoni	68,000	36,820	104,820
Robert E. Baker(2)	51,000	36,820	87,820
Paul W. Huesman(3)	23,500	0	23,500