State Auto Financial CORP
Form 10-K
March 02, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
ý Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2015 or
¨ Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission File Number 000-19289
STATE AUTO FINANCIAL CORPORATION
(Exact name of Registrant as specified in its charter)

Ohio	31-1324304
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
518 East Broad Street, Columbus, Ohio	43215-3976
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code:
(614) 464-5000

Securities registered pursuant to Section 12(b) of the Act: None
Securities registered pursuant to Section 12(g) of the Act:
Common Shares, without par value

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No ý
Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No ý
Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨
Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨		Accelerated filer ý
Non-accelerated filer ¨	(Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act).   Yes ¨   No ý

As of June 30, 2015, the last business day of the Registrant’s most recently completed second fiscal quarter, the aggregate market value (based on the closing sales price on that date) of the voting stock held by non-affiliates of the Registrant was $366,985,130.

On February 26, 2016, the Registrant had 41,442,395 Common Shares outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant’s Proxy Statement relating to the annual meeting of shareholders to be held May 6, 2016 (the “2016 Proxy Statement”), which will be filed within 120 days of December 31, 2015, are incorporated by reference into Part III of this Form 10-K.

Index to Annual Report on Form 10-K for the year ended December 31, 2015

IMPORTANT INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

All statements, other than statements of historical facts, included in this Annual Report on Form 10-K (this “Form 10-K”) of State Auto Financial Corporation (“State Auto Financial” or “STFC”) or incorporated herein by reference, including, without limitation, statements regarding State Auto Financial’s future financial position, business strategy, budgets, projected costs, goals and plans and objectives of management for future operations, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements generally can be identified by the use of forward-looking terminology such as “may,” “will,” “expect,” “intend,” “estimate,” “anticipate,” “project,” “believe” or “continue” or the negative thereof or variations thereon or similar terminology. Forward-looking statements speak only as the date the statements were made. Although State Auto Financial believes that the expectations reflected in forward-looking statements have a reasonable basis, it can give no assurance that these expectations will prove to be correct. Forward-looking statements are subject to risks and uncertainties that could cause actual events or results to differ materially from those expressed in or implied by the statements. For a discussion of the most significant risks and uncertainties that could cause State Auto Financial’s actual results to differ materially from those projected, see “Risk Factors” in Item 1A of this Form 10-K. Except to the limited extent required by applicable law, State Auto Financial undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

IMPORTANT DEFINED TERMS USED IN THIS FORM 10-K
Glossary of Terms for State Auto Financial Corporation and Its Subsidiaries and Affiliates

State Auto Financial or STFC	Refers to our holding company, State Auto Financial Corporation.
We, us, our or the Company	Refers to STFC and its consolidated subsidiaries, namely State Auto Property & Casualty Insurance Company ("State Auto P&C"), Milbank Insurance Company ("Milbank"), State Auto Insurance Company of Ohio ("SA Ohio"), and Stateco Financial Services, Inc. ("Stateco").
State Auto Mutual	Refers to State Automobile Mutual Insurance Company, which owns approximately 62.6% of STFC's outstanding common shares. State Auto Mutual also owns Risk Evaluation & Design, LLC ("RED"), which previously acted as a managing general underwriter exclusively for the benefit of our Pooled Companies.
STFC Pooled Companies	Refers to State Auto P&C, Milbank, and SA Ohio.
Mutual Pooled Companies	Refers to State Auto Mutual, and certain subsidiaries and affiliates of State Auto Mutual, namely, State Auto Insurance Company of Wisconsin ("SA Wisconsin"), Meridian Citizens Mutual Insurance Company ("Meridian Citizens Mutual"), Meridian Security Insurance Company ("Meridian Security"), Patrons Mutual Insurance Company of Connecticut ("Patrons Mutual"), Litchfield Mutual Fire Insurance Company ("Litchfield"), Rockhill Insurance Company ("RIC"), Plaza Insurance Company ("Plaza"), American Compensation Insurance Company ("American Compensation") and Bloomington Compensation Insurance Company ("Bloomington Compensation"). At the close of business on March 31, 2013, Litchfield was merged into Patrons Mutual. At the close of business on July 2, 2014, Meridian Citizens Mutual was merged into State Auto Mutual.
Pooled Companies or our Pooled Companies	Refers to the STFC Pooled Companies and the Mutual Pooled Companies.
Rockhill Insurance Group	Refers to Rockhill Holding Company, its insurance subsidiaries, namely RIC, Plaza, American Compensation and Bloomington Compensation, and its other non-insurance subsidiaries, including RTW, Inc. ("RTW"), a holding company that owns 100% of American Compensation and Bloomington Compensation.
Rockhill Insurers	Refers to RIC, Plaza, American Compensation and Bloomington Compensation.
State Auto Group	Refers to the Pooled Companies

Glossary of Selected Insurance and Accounting Terms

Accident year	The calendar year in which loss events occur, regardless of when the losses are actually reported, booked or paid.
Accounting standards codification or ASC	The Codification is the single source of authoritative nongovernmental GAAP developed by the Financial Accounting Standards Board (“FASB”).
Admitted insurer	An insurer licensed to transact insurance business within a state and subject to comprehensive policy rate, form and market conduct regulation by that state’s insurance regulatory authority.
American Institute of Certified Public Accountants or AICPA	The AICPA represents the certified public accounting profession nationally regarding rule-making and standard-setting, and serves as an advocate before legislative bodies, public interest groups and other professional organizations. The AICPA also monitors and enforces compliance with the profession’s technical and ethical standards.
Allocated loss adjustment expenses or ALAE	The costs that can be related to a specific claim, which may include attorney fees, external claims adjusters and investigation costs, among others.
Book value per share	Total common stockholders’ equity divided by the number of common shares outstanding.
Catastrophe loss	Loss and ALAE from catastrophes, where catastrophes are defined as a severe loss caused by various natural events, including hurricanes, hailstorms, tornadoes, windstorms, earthquakes, severe winter weather and fires. Our catastrophe losses are those designated by the Insurance Services Office (“ISO”) Property Claim Services (“PCS”). PCS defines a catastrophe as an event that causes $25.0 million or more in industry insured property losses and affects a significant number of property and casualty policyholders and insurers.
Combined ratio	The sum of the loss and LAE ratio and the expense ratio. A combined ratio under 100% generally indicates an underwriting profit. A combined ratio over 100% generally indicates an underwriting loss.
Debt to capital ratio	The ratio of notes payable to the sum of total stockholders’ equity and notes payable.
Deferred acquisition costs or DAC	Expenses that vary with, and are primarily related to, the production of new and renewal insurance business, and are deferred and amortized to achieve a matching of revenues and expenses when reported in financial statements prepared in accordance with GAAP.

Direct written premiums	The amounts charged by an insurer to insureds in exchange for coverages provided in accordance with the terms of an insurance contract. The amounts exclude the impact of all reinsurance premiums, either assumed or ceded.
Duration	A measure of the sensitivity of a financial asset’s price to interest rate movements.
Earned premiums or premiums earned	The portion of written premiums that applies to the expired portion of the policy term. Earned premiums are recognized as revenue under both SAP and GAAP.
Excess and surplus lines insurance	Specialized property and liability coverages written by non-admitted insurers. These coverages include exposures that do not fit within normal underwriting patterns, involve a degree of risk that is not commensurate with standard rates and/or policy forms, or are not written by admitted insurers because of general market conditions.
Expense ratio or underwriting expense ratio	For SAP, it is the ratio of (i) the sum of statutory underwriting and miscellaneous expenses incurred offset by miscellaneous income (collectively, “underwriting expenses”) to (ii) written premiums. For GAAP, it is the ratio of acquisition and operating expenses incurred to earned premiums.

Generally accepted accounting principles or GAAP	Accounting practices used in the United States of America determined by the FASB and American Institute of Certified Public Accountants (“AICPA”).
Incurred but not reported reserves or IBNR	Estimated losses and LAE that have been incurred but not yet reported to the insurer. This includes amounts for unreported claims, development on known cases, and re-opened claims.
Loss adjustment expenses or LAE	The expenses of settling claims, including legal and other fees, and the portion of general expenses allocated to claim settlement. LAE is comprised of ALAE and ULAE.
Loss and LAE ratio or loss ratio	For both SAP and GAAP, it is the ratio of incurred losses and LAE to earned premiums.
Loss reserves	Liabilities established by insurers and reinsurers to reflect the estimated cost of claims incurred that the insurer or reinsurer will ultimately be required to pay in respect of insurance or reinsurance it has written. Reserves are established for losses and for LAE, and consist of case reserves and IBNR reserves.
Managing general underwriter or MGU	An independent insurance professional firm that acts as an intermediary between the insurer and retail agents, much like a wholesaler. MGUs frequently have binding authority to issue insurance policies on behalf of an insurer that fit into the underwriting guidelines provided by that insurer. MGUs typically are compensated by an override commission on the insurance coverages sold by their sub-agents.
National Association of Insurance Commissioners or NAIC	An organization of the insurance commissioners or directors of all 50 states, the District of Columbia and the five U.S. territories organized to promote consistency of regulatory practices and statutory accounting standards throughout the United States.
Net premiums written to surplus ratio or leverage ratio	A SAP calculation which measures statutory surplus available to absorb losses. This ratio is calculated by dividing the net statutory premiums written for a rolling twelve month period by the ending statutory surplus for the period. For example, a ratio of 1.5 means that for every dollar of surplus, the insurer wrote $1.50 in premiums.
Net written premiums	Direct written premiums plus assumed reinsurance premiums less ceded reinsurance premiums.
Non-admitted insurer or surplus lines carrier	An insurer that is not required to be licensed in a state but is allowed to do business in that state subject to certain regulatory oversight by that state’s insurance regulatory authority. Non-admitted insurers are not subject to most of the rate and form regulations imposed on admitted insurers because they write specialized property and

	liability coverages, also known as excess and surplus lines insurance, which allows them the flexibility to change coverages offered and rates charged without time constraints and financial costs associated with the filing process. As such, these insurers offer an opportunity for coverage for specialized exposures that otherwise might not be insurable.
Retail agent or retail agency	An independent insurance professional who represents, and acts as an intermediary for, admitted insurers, generally recommending, marketing and selling insurance products and services to insurance consumers.
Return on average equity	The percent derived by dividing net income by average total stockholders' equity.
Risk-based capital or RBC	A measure adopted by the NAIC and state regulatory authorities for determining the minimum statutory capital and surplus requirements of insurers. Insurers having total adjusted capital less than that required by the RBC calculation will be subject to varying degrees of regulatory action depending on the level of capital inadequacy.
Standard insurance	Insurance which is typically written by admitted insurers. Our personal and business insurance segments are comprised of standard insurance.

Statutory accounting practices or SAP	The practices and procedures prescribed or permitted by state insurance regulatory authorities in the United States for recording transactions and preparing financial statements.
Statutory surplus	Under SAP, the amount remaining after all liabilities, including loss reserves, are subtracted from all admitted assets. Admitted assets are assets of an insurer prescribed or permitted by a state to be recognized on the balance sheet prepared in accordance with SAP.
Unallocated loss adjustment expenses or ULAE	The costs incurred in settling claims, such as in-house processing costs, which cannot be associated with a specific claim.
Underwriting gain or loss	Under SAP, earned premiums less loss and LAE and underwriting expenses.
Unearned premiums	The portion of written premiums that applies to the unexpired portion of the policy term. Unearned premiums are not recognized as revenues under both SAP and GAAP.
Wholesale broker	An independent insurance professional who offers specialized insurance products and serves as an intermediary between a retail agent and an insurer, while typically having no contact with the insured. A wholesale broker may represent both admitted and non-admitted insurers, and may offer both standard and excess and surplus lines insurance.

PART I

Item 1. Business

State Auto Financial is an Ohio domiciled property and casualty insurance holding company incorporated in 1990. We are engaged in writing personal, business and specialty insurance. State Auto Financial's principal subsidiaries are State Auto P&C, Milbank and SA Ohio, each of which is a property and casualty insurance company, and Stateco, which provides investment management services to affiliated insurance companies.

State Auto Mutual is an Ohio domiciled mutual property and casualty insurance company organized in 1921. It owns approximately 62.6% of State Auto Financial's outstanding common shares. State Auto Mutual's other subsidiaries and affiliates include SA Wisconsin, Meridian Security, Patrons Mutual and the Rockhill Insurers, each of which is a property and casualty insurance company. State Auto Mutual and its insurance subsidiaries and affiliates, along with State Auto Financial's insurance subsidiaries, pool their respective insurance business under the Pooling Arrangement, as further described below.

The State Auto Group markets its insurance products throughout the United States primarily through independent agencies, which include retail agencies and wholesale brokers. All of the property and casualty insurance companies in the State Auto Group are admitted insurers, except for RIC, which is a non-admitted insurer. The operations of the State Auto Group are headquartered in Columbus, Ohio.

Our Pooled Companies are rated A- (Excellent) by the A.M. Best Company ("A.M. Best").

FINANCIAL INFORMATION ABOUT SEGMENTS

Our reportable insurance segments are personal insurance, business insurance and specialty insurance (collectively the "insurance segments"). These insurance segments are aligned consistent with the reporting lines to our principal operating decision makers. Our Investment operations is also a reportable segment. See a detailed discussion regarding our segments at Item 7 of this Form 10-K "Management's Discussion and Analysis of Financial Condition and Results of Operations—Overview" and Note 15 to our consolidated financial statements included in Item 8 of this Form 10-K.

As a result of changes to our reporting structure that occurred during late 2015, effective December 31, 2015, the workers' compensation unit moved from the specialty insurance segment to the business insurance segment. Prior reporting periods have been restated to conform to the new presentation.

PERSONAL AND BUSINESS INSURANCE

Products offered in our personal and business insurance segments are marketed exclusively through retail agents, but the segments are managed separately from each other due to the differences in the types of customers they serve, products they provide or services they offer.

Products

Personal Insurance

In our personal insurance segment, we write standard insurance covering personal exposures to individuals. The primary coverages offered are personal auto, homeowners, and farm & ranch.

Business Insurance

In our business insurance segment, we write standard insurance covering small-to-medium sized commercial exposures. We offer a broad range of coverages which include commercial auto, commercial multi-peril, business owners, fire & allied, general liability, and workers' compensation.

Marketing

We market our personal and business insurance through approximately 2,500 retail agencies. We view our retail agents as our primary customers, because they are in a position to recommend either our insurance products or those of a competitor to their customers. We strongly support the independent agency system and believe its maintenance is essential to our present and future success. We continually develop programs and procedures to enhance our agency relationships, including the following: regular travel by senior management and regional office staff to meet with agents, in person, in their home states; training opportunities; and incentives related to profit and growth. In addition, we share the cost of approved advertising with selected agencies.

We actively help our agencies develop the professional sales skills of their staff. Our training programs include both product and sales training conducted in our corporate headquarters. Further, some of our training programs include disciplined follow-up and coaching for an extended time. In addition, from time to time we provide targeted training sessions in our agents' offices.

We provide our retail agents with defined travel and cash incentives if they achieve certain sales and underwriting profit levels. Further, we recognize our very top agencies—measured by consistent profitability, achievement of written premium thresholds and growth—as Inner Circle Agencies. Inner Circle Agencies are rewarded with additional incentives.

SPECIALTY INSURANCE

In contrast to standard insurance markets which are characterized by regulated products, uniform coverages and more predictable exposures, specialty risks, due to the nature of the particular risk or activities of the insured, often do not lend themselves to the strict, uniform underwriting criteria of standard insurers and require unique underwriting solutions. As a result, competition in the specialty markets focuses on expertise, flexibility and customer service. Because the specialty markets generally involve higher perceived insurance risks than those characteristic in the standard markets, through our specialty insurance segment we offer commercial coverages that require specialized product underwriting, claims handling and/or risk management services. We offer our specialty products through a distribution channel of retail agents and wholesale brokers, including program administrators and other specialty sources. Our specialty insurance products are written through our admitted and non-admitted insurers. Our units within the specialty insurance segment are Excess & Surplus ("E&S") property, Excess & Surplus ("E&S") casualty and Programs.

Our E&S property unit markets and underwrites specialized property exposures, primarily in the Gulf, Southeast and West regions of the United States with a focus on catastrophe exposed risks. Individual risk catastrophe modeling, specialized underwriters, underwriting guidelines and specialized rating plans are leveraged. In addition, catastrophe portfolio exposure management is utilized to produce the optimal portfolio of risk. Coverages offered by this unit are property and general liability.

Our E&S casualty unit markets and underwrites commercial exposures that have unique insurance requirements. This includes difficult to place classes of commercial business, which may require customized rates and forms, along with customized insurance programs for specialty niche and homogeneous groups of exposures. Coverages offered by this unit may include commercial auto, healthcare, umbrella, property, and general liability.

Our Programs unit markets and distributes business through specialty program managers to whom we have outsourced underwriting and policy administration. Program business typically consists of homogenous risks that require specialized underwriting and claims expertise. Accordingly, our program managers have specialized underwriting expertise in the particular risks covered by the program. Coverages offered through this unit include commercial auto, general liability, and property.

INVESTMENT OPERATIONS

The primary objectives of our investment strategy are to maintain adequate liquidity and capital to meet our responsibilities to policyholders; grow surplus long term to support the growth of our company; provide a consistent level of income; and manage investment risk. Our investment portfolio is managed separately from that of State Auto Mutual and its subsidiaries and affiliates, and investment results are not shared through the Pooling Arrangement, as described below. Stateco performs investment management services for both us and State Auto Mutual and all subsidiaries and affiliates. Investment policies and guidelines are set for each company through the Investment Committee of its respective Board of Directors.

For additional discussion regarding our investments, including the market risks related to our investment portfolio, see Item 7 of this Form 10-K, "Management's Discussion and Analysis of Financial Condition and Results of Operations—Investment Operations Segment."

CLAIMS

Our claims division supports our insurance segments through emphasis on timely investigation of claims, settlement of meritorious claims for equitable amounts, maintenance of adequate case reserves for claims, sharing of relevant information, and control of external claims adjustment expenses. Achievement of these goals supports our marketing

efforts by providing agents and policyholders with prompt and effective service.
We employ a specialized claims model that is skills-based and focused on yielding a quality customer experience regardless of the type and severity of the claim. We staff field adjusters in locations where we have size, scale and density of claims whenever possible to control file quality and enhance customer service. In areas where there is not a sufficient volume of claims to warrant staff adjusters, we supplement our field staff with outside adjusters and appraisers who work under our direction.
Claim settlement authority levels are established for each adjuster, supervisor and manager based on their level of expertise. Our claims division is responsible for reviewing the claim, obtaining necessary documentation and establishing loss and expense reserves of certain claims. Generally, property or casualty claims estimated to reach $100,000 or above are sent to specialists for direct handling.
We minimize claim adjusting costs by settling as many claims as possible through our claims staff and, when appropriate, by settling disputes regarding automobile physical damage, bodily injury and property insurance claims through arbitration or mediation.
In addition to our internal claims adjusters, we utilize third party claims administrators (“TPAs”) to investigate, process and settle certain specialty insurance segment claims on our behalf As with our internal claims adjusters, claim settlement authority is established for adjusters, supervisors and managers within each TPA. Claims handling and reporting guidelines are established and provided to each TPA. Members of our internal claims staff perform periodic reviews of individual claim files produced by each TPA for compliance with such established claims handling and reporting guidelines.
We have in-house counsel offices to defend and resolve claims which are in litigation. These offices are strategically placed where we have size, scale and density of legal cases to warrant their existence. We also have a list of highly skilled panel counsel to defend our insureds, when appropriate.
POOLING ARRANGEMENT
Our Pooled Companies pool their respective insurance business in accordance with a quota share reinsurance agreement which we refer to as the “Pooling Arrangement.” In general, under the Pooling Arrangement, State Auto Mutual assumes premiums, losses and expenses from each of the remaining Pooled Companies and in turn cedes to each a specified portion of premiums, losses and expenses based on each of the Pooled Companies’ respective pooling percentages. The balance of the pooled premiums, losses and expenses are retained by State Auto Mutual.
See the detailed discussion of our Pooling Arrangement at Item 7 of this Form 10-K, “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Pooling Arrangement.”
GEOGRAPHIC DISTRIBUTION
The following table sets forth the geographic distribution of our direct written premiums for the year ended December 31, 2015:

State	% of Total	
Ohio	9.7	%
Texas	8.5	
Kentucky	6.0	
Florida	5.2	
Minnesota	4.1	
Indiana	3.9	
California	3.9	
Tennessee	3.9	
Connecticut	3.7	
Illinois	3.5	
Pennsylvania	3.4	
Maryland	3.3	
Georgia	3.2	
North Carolina	3.1	
South Carolina	3.1	
Michigan	3.0	

All others [1]	28.5	
Total	100.0	%

(1) No other single state accounted for 3.0% or more of the total direct written premiums written in 2015.

MANAGEMENT AGREEMENT

Through various management and cost sharing agreements, State Auto P&C provides employees to perform all organizational, operational and management functions for the State Auto Group, while State Auto Mutual provides certain operating facilities, including our corporate headquarters.

Our primary management agreement, which we refer to as the 2005 Management Agreement, renewed for an additional ten-year period on January 1, 2015. If the 2005 Management Agreement was terminated for any reason, we would have to relocate our facilities to continue our operations. See “Properties” included in Item 2 of this Form 10-K.

REINSURANCE

Members of the State Auto Group follow the customary industry practice of reinsuring a portion of their exposures and paying to the reinsurers a portion of the premiums received. Insurance is ceded principally to reduce net liability on individual risks or for individual loss occurrences, including catastrophic losses. Although reinsurance does not legally discharge the individual members of the State Auto Group from primary liability for the full amount of limits applicable under their policies, it does make the assuming reinsurer liable to the extent of the reinsurance ceded. See the detailed discussion of our reinsurance arrangements at Item 7 of this Form 10-K, “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Reinsurance Arrangements.” See “Regulation” in this Item 1 for a discussion of the Terrorism Acts.

LOSS RESERVES

We maintain reserves for the eventual payment of losses and LAE for both reported claims and IBNR. Loss reserves are management’s best estimate at a given point in time of what we expect to pay to settle all losses incurred as of the end of the accounting period, based on facts, circumstances and historical trends then known. During the loss settlement period, additional facts regarding individual claims may become known, and consequently, it often becomes necessary to revise our estimate of the liability. The results of our operations and financial condition could be impacted, perhaps significantly, in the future if our estimate of ultimate payments required to settle claims varies from the loss reserves currently recorded.

Loss reserves for reported losses are initially established on either a case-by-case or formula basis depending on the type and circumstances of the loss. The case-by-case reserve amounts are determined based on our reserving practices, which take into account the type of risk, the circumstances surrounding each claim and applicable policy provisions. The formula reserves are based on historical paid loss data for similar claims with provisions for changes caused by inflation. Loss reserves for IBNR claims are estimated based on many variables including historical and statistical information, changes in exposure units, inflation, legal developments, storm loss estimates and economic conditions. Case and formula basis loss reserves are reviewed on a regular basis. As new data becomes available, estimates are updated resulting in adjustments to loss reserves. Generally, reported losses initially reserved on a formula basis which have not settled after six months, are case reserved at that time. Although our management uses many resources to calculate loss reserves, there is no precise method for determining the ultimate liability. We do not discount loss reserves for financial statement purposes. For additional information regarding our loss reserves, see Item 7 of this Form 10-K, “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Loss and LAE.”

The following table sets forth our one-year development information on changes in the loss reserve for the years ended December 31, 2015, 2014 and 2013:

($ millions)	Year Ended December 31		
	2015	2014	2013
Beginning of Year:			
Loss and loss expenses payable	$983.2	$959.9	$942.2
Less: Reinsurance recoverable on losses and loss expenses payable	9.6	9.1	13.5
Net losses and loss expenses payable(1)	973.6	950.8	928.7
Provision for losses and loss expenses occurring:			
Current year	852.8	726.2	741.0
Prior years(2)	10.0	45.1	(21.2)
Total	862.8	771.3	719.8
Loss and loss expense payments for claims occurring during:			
Current year	421.5	373.2	355.0
Prior years	367.8	375.3	342.7
Total	789.3	748.5	697.7
End of Year:			
Net losses and loss expenses payable	1,047.1	973.6	950.8
Add: Reinsurance recoverable on losses and loss expenses payable	5.9	9.6	9.1
Losses and loss expenses payable(3)	$1,053.0	$983.2	$959.9

(1) Includes net amounts assumed from affiliates of $494.3 million, $438.0 million, and $435.1 million at beginning of year 2015, 2014, and 2013, respectively.

(2) This line item shows changes in the current calendar year in the provision for losses and loss expenses attributable to claims occurring in prior years. See discussion regarding the calendar year developments at Item 7 of this Form 10-K Management's Discussion and Analysis section at "Results of Operations—Loss and LAE Development."

(3) Includes net amounts assumed from affiliates of $532.4 million, $494.3 million, and $438.0 million at end of year 2015, 2014, and 2013, respectively.

The following table sets forth our development of loss reserves from 2005 through 2015. "Net liability for losses and loss expenses payable" sets forth the estimated liability for unpaid losses and LAE recorded at the balance sheet date, net of reinsurance recoverable, for each year shown. This liability represents the estimated amount of losses and LAE for claims incurred during the current year or incurred during prior years that are unpaid at the balance sheet date, including IBNR.

The upper section of the table shows the cumulative amounts paid with respect to the previously reported loss reserve as of the end of each succeeding year. For example, through December 31, 2015, we have paid 77.9% of the losses and LAE that had been incurred but not paid, as estimated at December 31, 2005.

The lower portion of the table shows the current estimate of the previously reported loss reserve based on experience as of the end of each succeeding year. The estimate is increased or decreased as more information becomes known about the claims incurred.

The amounts on the "cumulative redundancy (deficiency)" line represent the aggregate change in the estimates over all prior years. For example, the year end 2005 loss reserve has developed $115.2 million or 16.2% redundant through December 31, 2015. This $115.2 million amount has been included in operating results over the ten years and did not have a significant effect on income in any one year.

In evaluating the information in the table, it should be noted that each amount includes the effects of all changes in amounts for prior periods. For example, the amount of the redundancy or deficiency evaluated at December 31, 2007, on claims incurred in 2007 includes the cumulative redundancy or deficiency for years 2005, 2006 and 2007.

Conditions and trends that have affected the development of the liability in the past may not necessarily occur in the future. Accordingly, it may not be appropriate to extrapolate future redundancies or deficiencies based on this table.

We experienced a cumulative deficiency of $10.0 million and $45.1 million in 2015 and 2014, respectively. The $10.0 million cumulative deficiency in 2015 was primarily due to adverse development in lines of business with auto exposures due to higher than anticipated bodily injury severity from the latest two accident years. The $45.1 million cumulative deficiency in 2014 was due to RED reserve strengthening of $96.7 million, including the net cost of the adverse development cover (“ADC”) reinsurance agreement. The RED reserve strengthening was primarily related to the two largest terminated RED programs, the restaurant and commercial trucking programs. See “Management’s

Discussion and Analysis of Financial Condition and Results of Operations - Loss and LAE Development” and Note 4, “Losses and Loss Expenses Payable” to our consolidated financial statements included in Item 8 of this Form 10-K for further information.

On January 1, 2011, the Rockhill Insurers were added to the pool, and accordingly net assets equal to the increase in net liabilities were transferred to us from them. As of December 31, 2011, the overall participation percentage of the STFC Pooled Companies was reduced from 80% to 65%, and accordingly net assets equal to the decrease in net liabilities were transferred by us to the Mutual Pooled Companies. The amount of the assets transferred along with the reserve liabilities assumed/ceded in 2005, 2008, 2010 and 2011 has been netted against and has reduced/increased the cumulative amounts paid for years prior to 2005, 2008, 2010 and 2011, respectively.

($ millions)	Years Ended December 31							
	2005	2006	2007	2008	2009	2010	2011	201
Net liability for losses and loss expenses payable	$711.3	$661.0	$647.1	$770.0	$819.4	$874.2	$881.6	$92
Paid (cumulative) as of:								
One year later	34.9	%34.9	%31.7	%34.9	%35.5	%40.8	%37.9	%36.
Two years later	51.1	%50.5	%49.4	%53.2	%53.2	%58.2	%57.3	%59.
Three years later	60.9	%60.4	%62.6	%62.7	%63.5	%68.0	%70.5	%74.
Four years later	66.0	%67.8	%69.1	%68.5	%69.0	%74.2	%78.4	%
Five years later	70.3	%71.3	%73.7	%72.0	%72.0	%77.7	%	
Six years later	72.7	%74.3	%76.1	%74.0	%74.2	%		
Seven years later	74.9	%75.9	%77.8	%76.0	%			
Eight years later	76.0	%77.2	%79.8	%				
Nine years later	76.9	%78.7	%					
Ten years later	77.9	%						
Net liability re-estimate as of:								
One year later	89.9	%91.7	%95.8	%92.7	%92.1	%96.2	%98.1	%97.
Two years later	86.4	%90.5	%93.7	%89.5	%89.1	%94.0	%96.1	%103
Three years later	85.6	%88.8	%91.9	%87.9	%87.8	%92.4	%98.2	%103
Four years later	85.3	%87.4	%90.8	%87.1	%86.9	%92.0	%97.5	%
Five years later	84.7	%86.9	%90.2	%86.8	%86.0	%91.1	%	
Six years later	84.4	%86.7	%90.0	%86.3	%85.4	%		
Seven years later	84.2	%86.7	%89.5	%85.9	%			
Eight years later	84.2	%86.3	%89.4	%				
Nine years later	84.0	%86.2	%					
Ten years later	83.8	%						
Cumulative redundancy (deficiency)	$115.2	$91.3	$68.5	$108.3	$119.6	$77.9	$22.3	$(3
Cumulative redundancy (deficiency)	16.2	%13.8	%10.6	%14.1	%14.6	%8.9	%2.5	%(3.3
Gross* liability—end of year	$1,111.1	$1,032.7	$1,029.9	$1,198.6	$1,293.2	$1,391.4	$1,411.9	$1,
Reinsurance recoverable	$399.8	$371.7	$382.8	$428.6	$473.8	$517.2	$530.3	$50
Net liability—end of year	$711.3	$661.0	$647.1	$770.0	$819.4	$874.2	$881.6	$92
Gross liability re-estimated— latest	87.4	%89.1	%93.0	%89.0	%87.8	%94.3	%93.7	%99.
Reinsurance recoverable re-estimated—latest	93.7	%94.3	%98.9	%94.6	%92.0	%99.9	%87.6	%91.
Net liability re-estimated— latest	83.8	%86.2	%89.4	%85.9	%85.4	%91.1	%97.5	%103

* Gross liability includes: Direct and assumed losses and loss expenses payable.

As the Pooling Arrangement provides for the right of offset, we have reported losses and loss expenses payable ceded to State Auto Mutual as assets only in situations when net amounts ceded to State Auto Mutual exceed that assumed. The following table provides a reconciliation of the reinsurance recoverable to the amount reported in our consolidated financial statements at each balance sheet date:

($ millions)	December 31										
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Reinsurance recoverable	$399.8	$371.7	$382.8	$428.6	$473.8	$517.2	$530.3	$507.1	$521.9	$488.9	$520.6
Amount netted against assumed from State Auto Mutual	$382.4	$358.2	$371.6	$407.4	$453.0	$498.4	$504.8	$493.6	$512.8	$479.3	$514.7
Net reinsurance recoverable	$17.4	$13.5	$11.2	$21.2	$20.8	$18.8	$25.5	$13.5	$9.1	$9.6	$5.9

12

COMPETITION

The property and casualty insurance industry is highly competitive. We compete with numerous insurance companies, with varying size and financial resources. We compete in the personal and business insurance markets based on the following factors: price; product offerings and innovation; underwriting criteria; quality of service to insureds, relationships with our retail agents and wholesale brokers; prompt and fair claims handling and settlement; financial stability; and technology, making us a preferred business partner. In addition, because most of our retail agents and wholesale brokers represent more than one insurer, we face competition within each agency and broker.

REGULATION

Most states, including all the domiciliary states of the State Auto Group, have enacted legislation that regulates insurance holding company systems. Each insurance company in our holding company system is required to register with the insurance supervisory agency of its state of domicile and furnish information concerning the operations of companies within our holding company system that may materially affect the operations, management or financial condition of the insurers within the system. Pursuant to these laws, the respective insurance departments may examine any members of the State Auto Group, at any time, require disclosure of material transactions involving insurer members of our holding company system, and require prior notice and an opportunity to disapprove of certain "extraordinary" transactions, including, but not limited to, extraordinary dividends to shareholders. Pursuant to these laws, all transactions within our holding company system affecting any insurance subsidiary within the State Auto Group must be fair and equitable. In addition, approval of the applicable state insurance commissioner is required prior to the consummation of transactions affecting the control of an insurer. The insurance laws of all the domiciliary states of the State Auto Group provide that no person may acquire direct or indirect control of a domestic insurer without obtaining the prior written approval of the state insurance commissioner for such acquisition.

In addition to being regulated by the insurance department of its state of domicile, each of our insurance companies is subject to supervision and regulation in the states in which we transact business. Such supervision and regulation relate to numerous aspects of an insurance company's business operations and financial condition. The primary purpose of such supervision and regulation is to ensure financial stability of insurance companies for the protection of policyholders. The laws of the various states establish insurance departments with broad regulatory powers relative to granting and revoking licenses to transact business, regulating trade practices, licensing agents, approving policy forms, setting reserve requirements, determining the form and content of required statutory financial statements, prescribing the types and amount of investments permitted and requiring minimum levels of statutory capital and surplus. Although premium rate regulation varies among states and lines of insurance, such regulations generally require approval of the regulatory authority prior to any changes in rates. In addition, all of the states in which the State Auto Group transacts business have enacted laws which restrict these companies' underwriting discretion. Examples of these laws include restrictions on policy terminations, restrictions on agency terminations and laws requiring companies to accept any applicant for automobile insurance. These laws may adversely affect the ability of the insurers in the State Auto Group to earn a profit on their underwriting operations.

The Risk Management and Own Risk Solvency Assessment Model Act ("ORSA"), adopted by the NAIC in 2012, requires insurers to incorporate a comprehensive enterprise risk management framework within company operations. Overall, ORSA is an internal assessment of the risks associated with an insurer's business and the sufficiency of capital resources to support those risks. Each insurer's ORSA process will be unique, reflecting its business, strategy and approach to enterprise risk management. In 2015, the State Auto Group filed its ORSA Summary Report, supported by internal risk management materials, with the Ohio Department of Insurance, our lead state regulator.

We are required to file detailed annual reports with the supervisory agencies in each of the states in which we do business, and our business and accounts are subject to examination by such agencies at any time.

There can be no assurance that such regulatory requirements will not become more stringent in the future and have an adverse effect on the operations of the State Auto Group.

Dividends. Our insurance subsidiaries generally are restricted by the insurance laws of our respective states of domicile as to the amount of dividends we may pay without the prior approval of our respective state regulatory authorities. Generally, the maximum dividend that may be paid by an insurance subsidiary during any year without prior regulatory approval is limited to the greater of a stated percentage of that subsidiary's statutory surplus as of a certain date, or adjusted net income of the subsidiary for the preceding year. Under current law, $81.4 million is available in 2016 for payment as a dividend from our insurance subsidiaries to STFC without prior approval from our respective domiciliary state insurance departments. STFC received dividends of $15.0 million and $20.0 million in 2015 and 2014, respectively, from its insurance subsidiaries. Additional information regarding dividend restrictions can be found in this Item 7 and in Note 11 to our consolidated financial statements included in Item 8 of this Form 10-K.

Rates and Related Regulation. Except as discussed below, we are not aware of the adoption of any material adverse legislation or regulation in any state in which we conducted business during 2015 which would materially impact our business.

Many states in which we operate have passed or are considering legislation restricting or banning the use of credit scoring in the rating and risk selection process. Some states are also becoming active in questioning the use of catastrophe modeling in the pricing and underwriting areas. Regulation risk is realized when states do not approve or limit the amount of rate a company can charge which may result in writing under-priced business. See “Risk Factors - Regulations” in Item 1A of this Form 10-K.

In an attempt to make capital and surplus requirements more accurately reflect the underwriting risk of different lines of insurance, as well as investment risks that attend insurers' operations, the NAIC annually tests insurers' risk-based capital requirements. As of December 31, 2015, each of the Pooled Companies had adequate levels of capital as defined by the NAIC with its respective risk-based capital requirements.

The property and casualty insurance industry is also affected by court decisions. In general, premium rates are actuarially determined to enable an insurance company to generate an underwriting profit. These rates contemplate a certain level of risk. The courts may modify, in a number of ways, the level of risk which insurers had expected to assume, including eliminating exclusions, expanding the terms of the contract, multiplying limits of coverage, creating rights for policyholders not intended to be included in the contract and interpreting applicable statutes expansively to create obligations on insurers not originally considered when the statute was passed. Courts have also undone legal reforms passed by legislatures, which reforms were intended to reduce a litigant's rights of action or amounts recoverable and so reduce the costs borne by the insurance mechanism. These court decisions can adversely affect an insurer's profitability. They also create pressure on rates charged for coverages adversely affected, and this can cause a legislative response resulting in rate suppression that can unfavorably impact an insurer.

The Terrorism Risk Insurance Act of 2002 and its successors, the Terrorism Risk Insurance Extension Act of 2005 and the Terrorism Risk Insurance Program Reauthorization Act of 2007 (collectively, the "Terrorism Acts"), has been extended until 2020. Under the Terrorism Acts, commercial property and casualty insurers like State Auto Group, in exchange for making terrorism insurance available, may be entitled to be reimbursed by the Federal Government for a portion of their aggregate losses. As required by the Terrorism Acts, we offer policyholders in specific lines of commercial insurance the option to elect terrorism coverage. In order for a loss to be covered under the Terrorism Acts, the loss must meet the aggregate industry loss minimum and must be the result of an act of terrorism as certified by the Secretary of the Treasury. For 2015, the aggregate industry loss minimum was $100.0 million and will increase by $20.0 million annually beginning in 2016 to $200.0 million in 2020. The Terrorism Acts require insurance carriers to retain 15% of any claims from a certified terrorist event in excess of the federally mandated deductible in 2015 subject to an annual industry-wide cap of $100.0 billion. This retention will increase, beginning on January 1, 2016, by 1% each calendar year until it reaches 20% in 2020. The federally mandated deductible represents 20% of direct earned premium for the covered lines of business of the prior year. Policyholders may choose to reject terrorism coverage (terrorism coverage is mandatory for workers' compensation). If the policyholder rejects coverage for certified acts of terrorism, we will cover only such acts of terrorism that are not certified acts under the Terrorism Acts and continue to apply policy exclusions that may limit any coverage from loss due to nuclear, biological or chemical agents. Our current commercial property reinsurance excludes certified acts of foreign terrorism and loss due to nuclear, biological or chemical agents. Beginning in 2016, insurers participating in the Terrorism Acts will be required to provide information regarding insurance coverage for terrorism losses, including; (i) lines of business with exposure to such losses; (ii) premiums earned on such coverage; (iii) geographical location of exposures; (iv) pricing of such coverage; (v) the take-up rate for such coverage; and (vi) the amount of private reinsurance for acts of terrorism purchased. See "Risk Factors-Terrorism" in Item 1A of this Form 10-K.

The Federal Insurance Office ("FIO") was established in 2010 by the enactment of the Dodd-Frank Act. The FIO is a separate office within the United States Department of Treasury. The primary objective of the FIO is to monitor all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the United States financial system. The FIO also coordinates and develops federal policy on prudential aspects of international insurance matters, including representing the United States in the International Association of Insurance Supervisors, assists in negotiating certain international agreements, monitors access to affordable insurance by traditionally underserved communities and consumers, minorities, and low- and moderate-income persons, and assists in the administration of the terrorism risk insurance program; however, the FIO has no authority as a regulator or supervisor of insurance companies.

EMPLOYEES

As of February 26, 2016, we had approximately 2,065 employees. Our employees are not covered by any collective bargaining agreement. We consider the relationship with our employees to be good.

AVAILABLE INFORMATION

Our website address is www.StateAuto.com. Through this website (found by clicking the “Investors” link, then the “All SEC Filings” link), we make available, free of charge, our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, proxy and information statements and all amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the “Exchange Act”), as soon as reasonably practicable after we electronically file such material with the Securities and Exchange Commission (the “SEC”). Also available on our website is information pertaining to our corporate governance, including the charters of each of our standing committees of our Board of Directors, our corporate governance guidelines, our employees’ code of business conduct and our directors’ ethical principles.

Any of the materials we file with the SEC may also be read and copied at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. Information on the operation of the SEC's Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains a website that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at www.sec.gov.

Executive Officers of the Registrant

Name of Executive Officer and Position(s) with Company	Age[1]	Principal Occupation(s) During the Past Five Years	An Executive Officer of the Company Since[2]
Michael E. LaRocco, Chairman, President and Chief Executive Officer	59	President and Chief Executive Officer of STFC and State Auto Mutual, 5/15 to present; Chairman of the Board of STFC, 1/16 to present; chief executive officer of Business Insurance Direct LLC, 10/11 to 4/15; chief executive officer of AssureStart Insurance Agency LLC, 1/13 to 7/14; chief executive officer of Fireman's Fund Insurance Company, 3/08 to 7/11.	2015
Steven E. English, Senior Vice President and Chief Financial Officer	55	Senior Vice President of STFC and State Auto Mutual, 8/13 to present; Vice President of STFC and State Auto Mutual, 5/06 to 7/13; Chief Financial Officer of STFC and State Auto Mutual, 12/06 to present.	2006
Melissa A. Centers, Senior Vice President, Secretary and General Counsel	44	Senior Vice President, Secretary and General Counsel of STFC, 11/15 to present; General Counsel and Secretary of State Auto Mutual, 11/15 to present; Assistant Secretary of STFC and State Auto Mutual, 11/12 to 11/15; Associate General Counsel of STFC and State Auto Mutual, 3/12 to 11/15; Assistant General Counsel of STFC and State Auto Mutual, 6/10 to 3/12.	2015
Jessica E. (Buss) Clark, Senior Vice President, Director of Specialty Lines and Middle Markets	44	Senior Vice President, Director of Specialty Lines and Middle Markets of STFC and State Auto Mutual, 8/15 to present; Senior Vice President, Specialty Lines, of STFC and State Auto Mutual, 8/13 to 7/15; Vice President, Specialty Lines of STFC and State Auto Mutual, 1/11 to 7/13; Chief Operating Officer of Rockhill Insurance Company, 11/08 to 1/11.	2011
Kim B. Garland, Senior Vice President, Standard Lines	50	Senior Vice President of Standard Lines of STFC and State Auto Mutual, 8/15 to present; chief product officer of American Insurance Group, Inc.'s ("AIG") consumer division, 1/13 to 12/14; chief underwriting officer of AIG's global consumer insurance division, 12/12 to 1/13; president and chief executive officer of United Guaranty Corporation ("UGC"), an affiliate of AIG, 2/12 to 12/12; chief operating officer of UGC, 6/09 to 12/12.	2015
John M. Petrucci, Senior Vice President, Service and Administration	57	Senior Vice President, Service and Administration, 9/15 to present; Vice President and Director of Sales of STFC and State Auto Mutual, 3/00 to 9/15.	2015
Cynthia A. Powell, Senior Vice President and Chief Audit Executive	55	Senior Vice President of STFC and State Auto Mutual, 8/13 to present; Chief Audit Executive of STFC and State Auto Mutual, 9/15 to present; Chief Risk Officer of STFC and State Auto Mutual,	2000

		6/12 to 9/15; Vice President of State Auto Mutual, 3/00 to 7/13; Vice President of STFC, 5/00 to 7/13; Chief Accounting Officer and Treasurer of STFC and State Auto Mutual, 6/06 to 6/12.	
Paul M. Stachura, Senior Vice President and Chief Claims and Risk Engineering Officer	58	Senior Vice President and Chief Claims Officer of STFC and State Auto Mutual, 9/15 to present; chief claims officer, of QBE Holdings, Inc., 5/13 to 9/15; chief claims and risk services officer of Fireman's Fund Insurance Company, 5/05 to 4/13.	2015
Gregory A. Tacchetti, Senior Vice President and Chief Information and Strategy Officer	47	Senior Vice President and Chief Information and Strategy Officer of STFC and State Auto Mutual, 8/15 to present; chief executive officer of AssureStart Insurance Agency LLC, 7/14 to 12/14; chief operating officer of AssureStart Insurance Agency LLC, 10/11 to 6/14; senior vice president and chief administrative officer of Fireman's Fund Insurance Company, 2008 to 10/11.	2015
Scott A. Jones, Vice President and Chief Investment Officer	51	Vice President and Investment Officer of STFC and State Auto Mutual, 3/12 to present; Assistant Vice President of STFC and State Auto Mutual, 8/09 to 3/12.	2012
Matthew S. Mrozek, Vice President and Chief Actuarial Officer	47	Vice President and Chief Actuarial Officer of STFC and State Auto Mutual, 3/09 to present.	2015
Matthew R. Pollak, Vice President, Chief Accounting Officer and Treasurer	50	Vice President, Chief Accounting Officer and Treasurer of STFC and State Auto Mutual, 4/13 to present; vice president, corporate finance and accounting of American Safety Insurance Holdings, Ltd. 2/10 to 4/13.	2013

(1) Age as of March 2, 2016.

(2) Each of the foregoing officers has been designated by our Board of Directors as an executive officer for purposes of Section 16 of the Exchange Act.

Item 1A. Risk Factors

Statements contained in this Form 10-K may be "forward-looking" within the meaning of Section 21E of the Exchange Act. Such forward-looking statements are subject to certain risks and uncertainties that could cause our operating results to differ materially from those projected. The following factors, among others, in some cases have affected, and in the future could affect, our actual financial performance. If any risks or uncertainties discussed below develop into actual events, then such events could have a material adverse effect on our business, reputation, liquidity, capital resources, financial position or results of operations. In that case, the market price of our stock could decline materially.

In the discussion below, we have organized risks according to categories of risk factors; however, many of the risks may have correlations and ramifications in more than one category. For example, the timely availability of sufficient, reliable data and information is included in Underwriting and Pricing, yet may also affect a number of risk factor categories. The categories, therefore, should be viewed as a starting point for understanding the significant risks we face, not as a limitation on the potential impact of risks.

The risk factors might affect, alter, or change actions we take in developing or executing our strategies, including, but not limited to capital management. We employ a number of risk management approaches to reduce our exposure to risk, all of which have inherent limitations. The failure of our risk management actions could have material adverse effects on our business, reputation, liquidity, capital resources, financial position or results of operations.

The following list of risk factors is not exhaustive and others may exist or develop. This information should be carefully considered together with the other information included in this report and in other reports and materials we file with the SEC, as well as news releases and other information we publicly disseminate from time to time.

RESERVES

If our estimated liability for losses and loss expenses is incorrect, our loss reserves may be inadequate to cover our ultimate liability for losses and loss expenses and may have to be increased.

We establish loss reserves based on actuarial estimates of the amount to be paid in the future to settle all claims incurred as of the end of the accounting period. We maintain loss reserves to cover our estimated ultimate unpaid liability for losses and loss expenses with respect to reported and unreported claims incurred as of the end of each accounting period. Loss reserves do not represent an exact calculation of the liability, but instead represent estimates, generally using actuarial projection techniques at a given accounting date. Our loss reserve estimates are expectations of what the ultimate settlement and administration of claims will cost based on our assessment of facts and circumstances then known, historical settlement patterns, estimates of trends in claims severity and frequency, legal theories of liability and other factors. Variables in the loss reserve estimation process can be affected by both internal and external events, such as changes in claims handling procedures, trends in loss costs, economic inflation, legal developments and legislative changes. Many of these items are not directly quantifiable, particularly on a prospective basis. Additionally, there may be a significant reporting lag, or changes in the report lag, between the occurrence of an insured event and the time a claim is actually reported to us. We refine loss reserve estimates in a regular, ongoing process as historical loss experience develops and additional claims are reported and settled. We record adjustments to loss reserves in the results of operations for the periods in which the estimates are changed. In establishing loss reserves, we take into account estimated recoveries for reinsurance, salvage and subrogation.

Because estimating loss reserves is an inherently uncertain process, currently established loss reserves may not be adequate. If we conclude the estimates are incorrect and our loss reserves are inadequate, we are obligated to increase them. An increase in loss reserves results in an increase in losses, reducing our net income for the period in which the deficiency is identified. Accordingly, an increase in loss reserves could have a material adverse effect on our results of operations, liquidity and financial condition.

CATASTROPHE LOSSES AND GEOGRAPHIC CONCENTRATIONS

The occurrence of catastrophic events could cause volatility in our results of operations and could materially reduce our level of profitability and adversely affect our liquidity and financial position.

Our insurance operations expose us to claims arising out of catastrophic events. We have experienced, and will in the future experience, catastrophe losses that may cause substantial volatility in our financial results for any fiscal quarter or year and could materially reduce our level of profitability or harm our financial condition, which in turn could adversely affect our ability to write new business. Catastrophes can be caused by various natural events, including hurricanes, hailstorms, tornadoes, windstorms, earthquakes, severe winter weather, fires and man-made events, none of which are within our control. Catastrophe losses can vary widely and could significantly impact our results. The frequency and severity of catastrophes are inherently unpredictable. Additionally, catastrophe losses incurred by residual markets or pooling mechanisms (such as wind pools) in certain states could trigger assessments to us. Such assessments could be material and may not be recoupable, depending on the applicable state mechanism.

The magnitude of loss from a catastrophe is a function of the severity of the event and the total amount of insured exposure in the affected area. Accordingly, we can sustain significant losses from less severe catastrophes, such as localized windstorms, when they affect areas where our insured exposure is concentrated. Although catastrophes can cause losses in a variety of our property and casualty lines, most of our catastrophe claims in the past have related to homeowners, allied lines, commercial property and commercial multi-peril coverages. The geographic distribution of our business subjects us to catastrophe exposure from severe thunderstorms, tornadoes and hail, as well as earthquakes and hurricanes affecting the United States. Our 2015, 2014 and 2013 results reflected decreases in weather-related catastrophe losses compared to the years prior to 2013; however, there can be no assurance that a favorable trend will continue in future years.

Increases in the value and geographic concentration of insured properties and the effects of inflation could increase the severity of claims from catastrophic events in the future. In addition, states have from time to time passed legislation that limits the ability of insurers to manage catastrophe risk, such as legislation prohibiting insurers from withdrawing from catastrophe-prone areas or refusing to enforce policy provisions such as hurricane deductibles. Although we attempt to reduce the impact of catastrophes on our business by controlling concentrations of exposures in catastrophe prone areas and through the purchase of reinsurance, such reinsurance may prove inadequate if a major catastrophic loss exceeds the reinsurance limit, or we incur a number of smaller catastrophes that, individually, fall below the reinsurance retention level.

Along with others in the industry, we utilize catastrophe models developed by third party vendors to help assess and manage our exposure to catastrophe losses. Such models assume various conditions and probability scenarios and use historical information about catastrophic events, along with detailed information about our business. While we use modeling information in connection with our pricing and risk management activities, there are limitations with respect to the models' usefulness in predicting losses in any reporting period. Such limitations are evidenced by the occurrence of significant variations in estimates between models and modelers; material increases or decreases in model results due to changes and refinements of the underlying data elements and assumptions; and differences observed between the results of actual event conditions and modeled expectations. Climate change, to the extent it affects changes in weather patterns, could impact the frequency or severity of weather events. Some industry commentators have expressed concerns that hydraulic fracturing or "fracking," a process which involves drilling deep underground wells and injecting water, chemicals and sand into the rock formations in order to extract oil and gas, may cause seismic activity which, among other things, may affect the frequency of earthquakes. We view fracking as a potential emerging risk facing the industry.

Our ongoing catastrophe management efforts could negatively impact growth to the extent constraints on property exposures are deemed necessary in certain territories. In addition, due to the potential impact on cross-selling opportunities, new business growth in auto or other lines of business could be negatively affected.

A severe catastrophic event, pandemic or terrorist attack somewhere in the world may not result in material insurance losses to us. However, our investment portfolio, reinsurers or the general economy could be negatively affected, resulting in a material adverse effect on our business, liquidity, capital resources, financial position or results of operations.

UNDERWRITING AND PRICING

Our financial results depend primarily on our ability to underwrite risks effectively and to charge adequate rates to policyholders.

Our financial condition, cash flows and results of operations depend on our ability to underwrite and set rates adequately for a full spectrum of risks, across a number of lines of insurance. Rate adequacy is necessary to generate sufficient premium to pay losses, loss adjustment expenses and underwriting expenses and to earn a profit.

Our ability to underwrite and set rates effectively is subject to a number of risks and uncertainties, including, without limitation:

- the timely availability of sufficient, reliable data;
- our ability to conduct a complete and accurate analysis of available data;

- our ability to timely recognize changes in trends and to project both the severity and frequency of losses with reasonable accuracy;
- uncertainties which are generally inherent in estimates and assumptions;

- our ability to project changes in certain operating expense levels with reasonable accuracy;
- the development, selection and application of appropriate rating formula or other pricing methodologies;
- our use of predictive modeling or other underwriting tools to assist with correctly and consistently achieving the intended results in underwriting and pricing;
- our ability to establish and consistently follow company underwriting guidelines;
- our ability to innovate with new product and/or pricing strategies, and the success of those innovations on implementation;
- our ability to secure regulatory approval of premium rates on an adequate and timely basis and effectively implement such rate changes;
- our ability to accurately predict consumer behavior, such as policyholder retention;
- our ability to properly classify our new and renewal business;
- unanticipated court decisions, legislation or regulatory action;
- unanticipated changes or execution problems in our claim settlement practices, including our ability to recognize and respond to fraudulent or inflated claims;
- changing driving patterns for auto exposures; changing weather patterns (including those which may be related to climate change) for property exposures;
- technological innovations in automobiles, such as accident avoidance systems and advances leading to autonomous cars;
- changes in the medical sector of the economy; including healthcare reform cost shifting and other factors;
- unanticipated changes in auto repair costs, auto parts prices and used car prices;
- impact of inflation and other factors, such as demand surge on cost of construction materials, labor and other expenditures;
- our ability to monitor and manage property concentration in catastrophe prone areas, such as hurricane, earthquake and wind/hail regions; and
- the general state of the economy in the states in which we operate.

Such risks may result in our rates being based on inadequate or inaccurate data or inappropriate assumptions or methodologies, and may cause our estimates of future changes in the frequency or severity of claims to be incorrect. As a result, we could underprice risks, which would negatively affect our margins, or we could overprice risks, which could reduce our competitiveness. In either event, our operating results, financial condition and cash flows could be materially adversely affected.

CREDIT AND FINANCIAL STRENGTH RATINGS

A downgrade in our financial strength ratings may negatively affect our business and reputation and a downgrade in our credit rating could negatively affect the cost and availability of debt financing.

Insurance companies are subject to financial strength ratings produced by external rating agencies. Higher ratings generally indicate financial stability and a strong ability to pay claims. Ratings are assigned by rating agencies to insurers based upon factors that they believe are relevant to policyholders and creditors. Ratings are important to maintaining public confidence in our Company and in our ability to market our products. A downgrade in our financial strength ratings could, among other things, negatively affect our ability to sell certain insurance products, our relationships with agents and our ability to compete.

Although other agencies cover the property and casualty industry, we believe our ability to write business is most influenced by our rating from A.M. Best. According to A.M. Best, its ratings are designed to assess an insurer’s financial strength and ability to meet ongoing obligations to policyholders. The State Auto Group’s current financial strength rating from A.M. Best is A- (Excellent) with a stable outlook.

Generally, credit ratings affect the cost, type and availability of debt financing. Higher rated securities receive more favorable pricing and terms relative to lower rated securities at the time of issue. The State Auto Group's current credit rating from A.M. Best is bbb- with a stable outlook.

Depending on future results and developments, we may not be able to maintain our current ratings.

DIVIDENDS

There can be no assurance that we will continue to pay cash dividends consistent with current or past levels.

We have a history of consistently paying cash dividends to our shareholders; however, the future payment of cash dividends will depend upon a variety of factors, such as our results of operations, financial condition and cash requirements, as well as the ability of our insurance subsidiaries to make distributions to STFC. State insurance laws restrict the payment of dividends by insurance companies to their shareholders. In addition, competitive pressures generally require insurance companies to maintain insurance financial strength ratings. Such restrictions and other requirements and factors may affect the ability of our insurance subsidiaries to make dividend payments to STFC. Limits on the ability of our insurance subsidiaries to pay dividends could adversely affect STFC's liquidity, including STFC's ability to pay cash dividends to shareholders.

TECHNOLOGY AND TELECOMMUNICATION SYSTEMS

Our business success and profitability depend, in part, on effective information technology and telecommunication systems. If we are unable to keep pace with the rapidly developing technological advancements in the insurance industry, our ability to compete effectively could be impaired.

We depend in large part on our technology and telecommunication systems for conducting business and processing claims. Our business success is dependent on maintaining the effectiveness of existing technology and telecommunication systems and on their continued development and enhancement to support our business processes and strategic initiatives in a cost effective manner.

If we are unable to effectively execute our top initiatives and projects, we may not meet organizational objectives due to cost overruns, missed project milestones, defects and/or failing to deliver the desired business value.

An ongoing challenge during system development and enhancement is the effective and efficient utilization of our current technology in view of a constantly changing technological landscape. There can be no assurance that the development of current technology for future use will not result in our being competitively disadvantaged, especially with those carriers that have greater resources. If we are unable to keep pace with the advancements being made in technology, our ability to compete with other insurance companies who have advanced technological capabilities will be negatively affected. Further, if we are unable to effectively execute and update or replace our key legacy technology and telecommunication systems as they become obsolete or as emerging technology renders them competitively inefficient, our competitive position and/or cost structure could be adversely affected.

System implementations are complex processes requiring extensive planning and coordination among multiple stakeholder groups. During 2015, we accelerated our business and technology plan to consolidate our policy administration and billing systems. We have partnered with a third party specializing in providing core system software to the insurance industry and we plan on introducing the new technology to our agents beginning in the third quarter of 2016. Initially, the technology will only be available for personal lines new business in a limited number of states, with additional states being added in subsequent quarters. Additionally, we plan on introducing the technology for certain small commercial product offerings beginning in the fourth quarter of 2016, again in a limited number of states, with additional states being added in subsequent quarters. The new technology platform is intended to provide us with quicker speed to market, improve ease of doing business for our policyholders, agents and brokers, lower our costs for maintenance and product introductions and provide greater operational efficiency. However, even with our best planning and efforts and the involvement of third party expertise, there can be no assurance that the expected benefits will be realized upon implementation or that the transition will be completed within the planned time frame or budget. Such risks are also present in other key initiatives and projects planned for 2016 and beyond.

If we experience difficulties with outsourcing, or other third party relationships, our ability to conduct business might be negatively impacted.

From time to time we may outsource certain other business, information technology or administrative functions, or otherwise rely on certain third parties for the performance of such functions, for efficiency and cost saving purposes.

If we fail to develop and implement our sourcing strategies or our third party providers fail to perform as expected, we may experience operational difficulties, increased costs, and a loss of business that may have a material adverse effect on our results of operations or financial condition.

VENDOR MANAGEMENT

Loss of key vendor relationships or failure of a vendor to perform as anticipated or to protect personal information of our customers, claimants or employees could negatively affect our operations.

We rely on services and products provided by various vendors. In the event that one or more of our vendors becomes unable to continue to provide products or services as anticipated, we may suffer operational impairment and financial loss. If one or more of our vendors fail to protect personal information of our customers, claimants or employees, we may incur operational impairments, or could be exposed to litigation, compliance costs or reputation damage.

CYBERSECURITY THREATS

Our highly automated and networked organization is subject to cyberterrorism and a variety of other cybersecurity threats. These threats come in a variety of forms, such as viruses and malicious software. Such threats can be difficult to prevent or detect, and if experienced, could interrupt or damage our operations, harm our reputation or have a material adverse effect on our operations.

Our technology and telecommunications systems are highly integrated and connected with other networks. Cyberattacks involving these systems could be carried out remotely and from multiple sources and could interrupt, damage or otherwise adversely affect the operations of these critical systems. Cyberattacks could result in the modification or theft of data, the distribution of false information or the denial of service to users. We obtain, utilize and maintain data concerning individuals and organizations with which we have a business relationship. Threats to data security can emerge from a variety of sources and change in rapid fashion, resulting in the ongoing need to expend resources to secure our data in accordance with customer expectations and statutory and regulatory requirements.

We could be subject to liability if confidential customer information is misappropriated from our technology systems. Despite the implementation of security measures, these systems may be vulnerable to physical break-ins, computer viruses, programming errors, attacks by third parties or similar disruptive problems. Any well-publicized compromise of security could deter people from entering into transactions that involve transmitting confidential information to our systems, which could have a material adverse effect on our business and reputation.

While we take commercially reasonable measures to keep our systems and data secure, it is not possible to defend against every risk posed by cybercrime. Increasing sophistication of cyber criminals and terrorists make keeping up with new threats difficult and could result in a breach. Patching and other measures to protect existing systems and servers could be inadequate, especially on systems that are being retired. Controls employed by our U.S., off-shore and cloud vendors could prove inadequate. In the event that one or more of our vendors fails to protect personal information of our customers, claimants or employees, we may incur operational impairments, or could be exposed to litigation, compliance costs or reputational damage.

While we have not experienced material cyber incidents to date, the occurrence and effects of cyber incidents may remain undetected for an extended period. We maintain cyber liability insurance coverage to offset certain potential losses, subject to policy limits, such as liability to others, costs of related crisis management, data extortion, applicable forensics and certain regulatory defense costs, fines and penalties.

BUSINESS CONTINUITY

Our business depends on the uninterrupted operation of our facilities, systems and business functions, including our information technology, telecommunications and other business systems. Our business continuity and disaster recovery plans may not sufficiently address all contingencies.

Our business is highly dependent upon our ability to execute, in an efficient and uninterrupted fashion, necessary business functions, such as Internet support and 24-hour claims contact centers, processing new and renewal business, receiving and processing payment receipts and processing and paying claims. A shut-down of or inability to access one or more of our facilities, power outages, a major failure of the Internet, a pandemic, or a failure of one or more of our information technology, telecommunications or other systems could significantly impair our ability to perform such functions on a timely basis. In addition, because our information technology and telecommunications systems interface with and depend on third party systems, we could experience service denials if demand for such service exceeds capacity, or if our system or a third party system fails or experiences an interruption. If sustained or repeated, such a business interruption, systems failure or service denial could result in a deterioration of our ability to write and process new and renewal business, provide customer service, receive premium payments, pay claims in a timely manner or perform other necessary corporate functions. This could result in a materially adverse effect on our business results and liquidity and may cause reputational damage.

We have established a business continuity plan that is designed to continue our core business operations in the event that normal business operations cannot be performed due to a catastrophic event. While we continue to test and assess our business continuity plan to meet the needs of our core business operations and address multiple business interruption events, there is no assurance that we will be able to perform our core business operations upon the occurrence of such an event, which may result in a material adverse effect on our reputation, financial position and results of operations.

REINSURANCE

Reinsurance may not be available, collectible or adequate to protect us against losses, or may cause us to constrain the amount of business we underwrite in certain lines of business and locations.

We use reinsurance to help manage our exposure to insurance risks and to manage our capital. There can be no assurance that our use of reinsurance effectively meets our strategic business objectives. The availability, policy conditions and cost of reinsurance are subject to prevailing market conditions, which can affect our business volume and profitability. Although the reinsurer is liable to us to the extent of the ceded reinsurance, we remain liable as the direct insurer on all risks reinsured. Ceded reinsurance arrangements do not eliminate our obligation to pay claims. As a result, we are subject to counterparty risk with respect to our ability to recover amounts due from reinsurers. Reinsurance may not be adequate to protect us against losses and may not be available to us in the future at commercially reasonable rates. In addition, the magnitude of losses in the reinsurance industry resulting from catastrophes may adversely affect the financial strength of certain reinsurers, which may result in our inability to collect or recover reinsurance. Reinsurers also may reserve their right to dispute coverage with respect to specific claims. With respect to catastrophic or other loss, if we experience difficulty collecting from reinsurers or obtaining additional reinsurance in the future, we will bear a greater portion of the total financial responsibility for such loss, which could materially reduce our profitability or harm our liquidity and financial condition.

CYCLICAL NATURE OF THE INDUSTRY

The property and casualty insurance industry is cyclical, which may cause fluctuations in our operating results.

The property and casualty insurance industry has been historically characterized by periods of intense price competition due to excess underwriting capacity, as well as periods of shortages of underwriting capacity that result in higher prices and more restrictive contract and/or coverage terms. The periods of intense price competition may adversely affect our operating results, and the cyclical nature of the industry may cause fluctuations in our operating results. While we may adjust prices during periods of intense competition, it remains our strategy to allow for acceptable profit levels and to decline coverage in situations where pricing or risk would not result in acceptable expected returns. Accordingly, our commercial and specialty lines of business tend to contract during periods of severe competition and price declines and expand when market pricing allows an acceptable return. This can cause volatility in our premium revenues. Our specialty insurance segment markets and underwrites commercial exposures through wholesale brokers, program administrators and other specialty sources. The reaction of these distribution channels to price competition may result in the movement of business and volatility of premium revenues.

The personal lines products are influenced by a collection of loss cost trends. Driving patterns, inflation in the cost of auto repairs and medical care and increasing litigation of liability claims are some of the more important factors that affect loss cost trends. Inflation in the cost of building materials and labor costs and demand caused by weather-related catastrophic events affect personal lines homeowners loss cost trends. We may be unable to increase premiums at the same pace as coverage costs increase. Accordingly, profit margins initially decline in periods of increasing loss costs.

ECONOMIC CONDITIONS

Economic conditions may adversely affect our business.

The current challenging national and global economy, as well as negative economic conditions in the future, may adversely impact our business and results of operations. While the volatility of the economic climate makes it difficult for us to predict the overall impact of economic conditions on our business and results of operations, our business may be impacted in a variety of ways.

Economic conditions affect consumer behavior. For example, a decrease in gas prices may result in consumers driving more miles, leading to a possible increase in auto claim frequency. Negative economic conditions may cause consumers and businesses to decrease their spending, which may impact the demand for insurance products. For example, declining automotive sales and weaknesses in the housing market generally impact the purchase of our personal auto and homeowners insurance products by consumers and business insurance products by businesses involved in these industries. High levels of unemployment have a tendency to cause the number of workers' compensation claims to increase, as laid-off and unemployed workers may seek workers' compensation benefits to replace their lost healthcare benefits. Similarly, uninsured and underinsured motorist claims may rise. Vacated homes and business properties pose increased insurance industry risk.

Volatility and weakness in the financial and capital markets may negatively impact the value of our investment portfolio. Economic strains on states and municipalities could result in downgrades or defaults of certain municipal obligations.

We may be adversely affected by business difficulties, bankruptcies and impairments of other parties with whom we do business, such as independent agents, key vendors and suppliers, reinsurers or banks, which increases our credit risk and other counterparty risks. Bankruptcies among our current business insurance customers can negatively affect our retention. Reductions in new business start-ups may negatively affect the number of future potential business insurance customers.

In response to economic conditions, the United States federal government and other governmental and regulatory bodies have taken action and may take additional actions to address such conditions. There can be no assurance as to what impact such actions or future actions will have on the financial markets, economic conditions or our Company. In addition, government spending and monetary policies or other factors may cause the rate of inflation to increase in the future. Inflation can have a significant negative impact on property and casualty insurers because premium rates are established before the amount of losses and loss expenses are known. When establishing rates, we attempt to anticipate increases from inflation subject to the limitations of modeling economic variables. Premium rates may prove to be inadequate due to low trend assumptions arising from the use of historical data. Even when general inflation is relatively modest, price inflation on the goods and services purchased by insurance companies in settling claims can steadily increase. Reserves may develop adversely and become inadequate. Retentions and deductibles may be exhausted more quickly. Interest rate increases in an inflationary environment could cause the values of our fixed income investments to decline.

Adverse capital and credit market conditions may negatively affect our ability to meet unexpected liquidity needs or to obtain credit on acceptable terms.

In the event that we need access to additional capital to pay our operating expenses, make payments on our indebtedness, pay for capital expenditures or fund acquisitions, our ability to obtain such capital may be constrained and the cost of any such capital may be significant. Our ability to obtain additional financing will depend on numerous factors, such as market conditions, the general availability of credit, the overall availability of credit to our industry, our credit ratings and credit capacity, as well as lenders' perception of our long- or short-term financial prospects. Our access to funds may also be constrained if regulatory authorities or rating agencies take negative actions. If certain factors were to occur, our internal sources of liquidity may prove to be insufficient and we may not be able to successfully obtain additional financing on satisfactory terms.

DISTRIBUTION SYSTEM

Our retail agents, who are part of the independent agency distribution channel, are our sole distribution method for our personal and business insurance segments. Our exclusive use of such distribution may constrain our ability to grow at a comparable pace to our competitors that utilize multiple distribution channels. In addition, consumers may prefer to purchase insurance products through other means, such as the internet, rather than through agents.

We market our insurance products in our personal and business insurance segments exclusively through independent, non-exclusive insurance agents and brokers, whereas some of our competitors sell their insurance products through direct marketing techniques, the internet or "captive" insurance agents who sell products exclusively for one insurance company. Throughout its history, the State Auto Group has supported the independent agency system as our distribution channel. However, we recognize that although the number of distribution locations has expanded and the size of many agencies has grown, the number of individual independent agencies in the industry has dramatically shrunk over the past decade due to agency purchases, consolidations, bankruptcies and agent retirements. We also recognize that it will be progressively more difficult to expand the number of independent agencies representing us. If we are unsuccessful in maintaining and increasing our agency representation, our sales and results of operations could be adversely affected.

The retail agents that market and sell our products also sell products of our competitors. These agents may recommend our competitors' products over our products or may stop selling our products altogether. When price competition is intense, our premium production may be negatively impacted by the fact our independent agent distribution force has products to sell from other carriers that may be more willing to lower prices to grow top line sales. Consequently, we must remain focused on attracting and partnering with agents to market and sell our products. We compete for productive agents primarily on the basis of our financial position, support services, ease of doing business, compensation and product features. Although we make efforts to ensure we have strong relationships with our retail agents, we may not be successful and our sales and results of operations could be adversely affected.

In addition, consumers are increasingly using the internet and other alternative channels to purchase insurance products. While our website provides a significant amount of information about our insurance products, consumers cannot purchase insurance through our website. Instead, consumers must contact one of our independent agents to purchase our insurance products or make changes to their policies. This single distribution system may place us at a disadvantage with consumers who prefer to purchase insurance products online or through other alternative distribution channels.

Because our specialty insurance segment business is dependent upon wholesale brokers, managing general underwriters and retail agents, we are exposed to certain risks arising out of these distribution channels that could cause our results to be adversely affected.

We market and distribute our specialty insurance segment products through wholesale agents and managing general underwriters to whom we have granted quoting and binding authority and who, in turn, sell our insurance products to insureds through retail insurance brokers. While we have established and provided these wholesale agents and managing general underwriters with pre-established underwriting guidelines, if they fail to comply with our underwriting guidelines and the terms of their appointment, we could be bound on a particular risk or number of risks that were not anticipated when we developed the insurance products. Such actions could adversely affect our results of operations.

Additionally, in any given period we may derive a significant portion of our business from a limited number of agents and brokers and the loss of any of these relationships could have a significant impact on our ability to market our products and services. Likewise, in certain jurisdictions, when the insured remits premium payments to our agent or broker in full, our premiums are considered to have been paid in full, notwithstanding that we may or may not have actually received the premiums from the agent or broker. Consequently, we assume a degree of credit risk associated with certain agents and brokers with whom we transact business.

REGULATION

Our business is heavily regulated, and changes in regulation may reduce our profitability and limit our growth.

We are subject to extensive regulation in the states in which we conduct business. This regulation is generally designed to protect the interests of policyholders, as opposed to shareholders and other investors, and relates to authorization for lines of business, capital and surplus requirements, investment limitations, underwriting limitations, transactions with affiliates, dividend limitations (see "Regulation-Dividends" in Item 1), changes in control, premium rates and a variety of other financial and non-financial components of an insurance company's business. The NAIC and state insurance regulators are constantly examining laws and regulations, generally focusing on modifications to holding company regulations, interpreting existing laws and developing new laws.

From time to time, some states in which we conduct business have considered or enacted laws that may alter or increase state authority to regulate insurance companies and insurance holding companies. In other situations, states in which we conduct business have considered or enacted laws that impact the competitive environment and marketplace for property and casualty insurance.

Nearly all states require licensed insurers to participate in guaranty funds through assessments covering a portion of insurance claims against impaired or insolvent insurers. An increase in the magnitude of impaired companies could result in an increase in our share of such assessments. Residual market or pooling arrangements exist in many states to provide certain types of insurance coverage to those that are otherwise unable to find private insurers willing to insure them. Licensed insurers voluntarily writing such coverage are required to participate in these residual markets or pooling mechanisms. Such participation exposes us to possible assessments, some of which could be material to our results of operations. The potential availability of recoupments or premium rate increases, if applicable, may not offset such assessments in the financial statements nor do so in the same fiscal periods.

From time to time, many of the states in which we operate consider legislation restricting or banning the use of credit scoring in rating and/or risk selection in personal lines of business. Similarly, several states have considered restricting insurers' rights to use loss history information maintained in various databases by insurance support organizations. These tools help us price our products more fairly and enhance our ability to compete for business that we believe will be profitable. Such regulations would limit our ability, as well as the ability of all other insurance carriers operating in any affected jurisdiction, to take advantage of these tools.

Currently the federal government does not directly regulate the insurance business. However, in recent years the state insurance regulatory framework has come under increased federal scrutiny. Congress and some federal agencies from time to time investigate the current condition of insurance regulation in the United States to determine whether to impose federal regulation or to allow an optional federal charter, similar to banks. In addition, changes in federal legislation and administrative policies in several areas, including changes in the Gramm-Leach-Bliley Act, financial services regulation and federal taxation, or repeal of McCarran-Ferguson Act (which largely exempts the insurance industry from the federal antitrust laws), could significantly impact the insurance industry and us.

The Federal Insurance Office was established in 2010 by the enactment of the Dodd-Frank Act. The Federal Insurance Office is a separate office within the United States Department of Treasury. The primary objective of the Federal Insurance Office is to monitor all aspects of the insurance industry. The Federal Insurance Office also coordinates and develops federal policy on international insurance matters, including representing the United States in the International Association of Insurance Supervisors, assists in negotiating certain international agreements, monitors access to affordable insurance by traditionally underserved communities and consumers, minorities, and low- and moderate-income persons, and assists in the administration of the terrorism risk insurance program. However, the Federal Insurance Office lacks regulatory authority, and it is not clear how this federal office will coordinate and interact with the NAIC or state insurance regulators.

Although we do not write health insurance, rules affecting health care services can affect insurance we write, including workers' compensation, commercial and personal automobile and liability insurance. The enactment of the Patient Protection and Affordable Care Act of 2010 (the "Healthcare Act") and additional health care reform legislation may have an impact on various aspects of our business. In addition, we may be impacted as a business enterprise by potential tax issues and changes in employee benefits. We will continue to monitor and assess the impact of health care legislation or regulations, or changing interpretations, at the federal or state levels.

We cannot predict with certainty the effect any enacted, proposed or future state or federal regulation or NAIC initiatives may have on the conduct of our business. Furthermore, there can be no assurance that the regulatory requirements applicable to our business will not become more stringent in the future or result in materially higher costs than current requirements. For example, concerns over climate change may prompt federal, state or local laws intended to protect the environment. Changes in the regulation of our business may reduce our profitability, limit our growth or otherwise adversely affect our operations.

We could be adversely affected if our controls designed to assure compliance with guidelines, policies, and legal and regulatory standards, including financial and regulatory reporting, are ineffective. Our business is dependent on our ability to regularly engage in a large number of insurance underwriting, claim processing, personnel and human

resources, and investment activities, many of which are complex. These activities often are subject to internal guidelines and policies, as well as legal and regulatory requirements. No matter how well designed and executed, control systems provide only reasonable assurance that the system objectives will be met. If our controls are not effective, it could lead to financial loss, unexpected risk exposures or damage to our reputation.
Tax legislation initiatives or challenges to our tax positions could adversely affect our results of operations and financial condition.

We are subject to the tax laws and regulations of the United States federal, state and local governments. Tax legislative initiatives by these governmental bodies, including actions by departments of insurance, taxing authorities and other state and local agencies, to change the current tax structure or to increase taxes, assessments and other revenue-generating fees may increase the cost of doing business in those jurisdictions.

From time to time, various legislative initiatives may be proposed that could adversely affect our tax positions. There can be no assurance that our effective tax rate or tax payments will not be adversely affected by these initiatives. In addition, United States federal, state and local tax laws and regulations are extremely complex and subject to varying interpretations. There can be no assurance that our tax positions will not be challenged by relevant tax authorities or that we would be successful in any such challenge.

CLAIM AND COVERAGE DEVELOPMENTS
Developing claim and coverage issues in our industry are uncertain and may adversely affect our insurance operations.
As industry practices and legislative, judicial and regulatory conditions change, unexpected and unintended issues related to claims and coverage may develop. These issues could have an adverse effect on our business by either extending coverage beyond our underwriting intent or by increasing the frequency or severity of claims. The premiums we charge for our insurance products are based upon certain risk expectations. When legislative, judicial or regulatory authorities expand the burden of risk beyond our expectations, the premiums we previously charged or collected may no longer be sufficient to cover the risk, and we do not have the ability to retroactively modify premium amounts. Furthermore, our reserve estimates do not take into consideration a major retroactive expansion of coverage through legislative or regulatory actions or judicial interpretations.
In particular, court decisions have had, and are expected to continue to have, significant impact on the property and casualty insurance industry. Court decisions may increase the level of risk which insurers are expected to assume in a number of ways, such as by eliminating exclusions, increasing limits of coverage, creating rights in claimants not intended by the insurer and interpreting applicable statutes expansively to create obligations on insurers not originally considered when the statute was passed. In some cases, court decisions have been applied retroactively. Court decisions have also negated legal reforms passed by state legislatures.
We have seen instances of political pressure exerted to force or persuade insurers to provide extra-contractual coverage, such as foregoing the use of deductibles.
There is also a growing trend of plaintiffs targeting property and casualty insurers, including us, in putative class action litigation relating to claim-handling and other practices, particularly with respect to the handling of personal lines auto and homeowners claims.
There are concerns that the focus on climate change and global warming could affect court decisions or result in litigation, including potential matters arising from federal, state or local laws intended to protect the environment. Other environmental concerns could also create or affect potential liability exposures.
Many of these issues are beyond our control. The effects of these and other unforeseen claims and coverage issues are extremely hard to predict and could materially harm our business and results of operations.
LITIGATION
We may suffer losses from litigation, which could materially and adversely affect our operating results or cash flows and financial condition.
As is typical in our industry, we face risks associated with litigation of various types, including disputes relating to insurance claims under our policies, as well as other general commercial and corporate litigation. Litigation is subject to inherent uncertainties and in the event of an unfavorable outcome in one or more litigation matters, the ultimate liability may be in excess of amounts currently reserved and may be material to our operating results or cash flows for a particular quarter or annual period and to our financial condition.
TERRORISM
Terrorist attacks, and the threat of terrorist attacks, and ensuing events could have an adverse effect on us.
Terrorism, both within the United States and abroad, and military and other actions and heightened security measures in response to these types of threats, may cause loss of life, property damage, reduced economic activity, and additional disruptions to commerce. Terrorist attacks could cause losses from insurance claims related to the property and casualty insurance operations of the State Auto Group, as well as a decrease in our stockholders’ equity, net income and/or revenue.
The Terrorism Acts require the federal government and the insurance industry to share the risk of insured losses on future acts of terrorism that are certified by the U.S. Secretary of the Treasury. We are required to participate in the Terrorism Acts as a result of our commercial insurance business. In addition, under the Terrorism Acts, terrorism coverage is mandatory for all primary workers’ compensation policies. Insureds with non-workers’ compensation commercial policies, however, have the option to accept or decline our terrorism coverage. In 2015, over 90% of our commercial lines non-workers’ compensation policyholders purchased terrorism coverage. Although the Terrorism Acts mitigate our exposure to a large-scale terrorist attack, our deductible is substantial and losses could have a material adverse effect on our results of operations, financial condition and liquidity.

In addition, some of the assets in our investment portfolio may be adversely affected by declines in the equity markets and economic activity caused by the continued threat of terrorism, ongoing military and other actions and heightened security measures. We cannot predict at this time the extent to which industry sectors in which we maintain investments may suffer losses as a result of potentially decreased commercial and economic activity, or how any such decrease might impact the ability of companies within the affected industry sectors to pay interest or principal on their securities, or how the value of any underlying collateral might be affected.

Furthermore, our reinsurers could experience significant losses as a result of terrorist attacks, potentially jeopardizing their ability to pay losses ceded to them and reducing the availability of reinsurance. Our current commercial property reinsurance excludes certified acts of foreign terrorism and loss due to nuclear, biological or chemical agents.

INVESTMENTS

The performance of our investment portfolios is subject to various investment risks, such as market, credit, concentration, liquidity, and interest rate risks. Such risks could result in material adverse effects to our results of operations, cash flows and financial position.

Like other property and casualty insurance companies, we depend on income from our investment portfolio for a portion of our revenues and earnings and are therefore subject to market risk, credit risk, concentration risk, liquidity risk and the risk that we will incur losses due to adverse changes in equity, interest, commodity or foreign currency exchange rates and prices. Our primary market risk exposures are to changes in interest rates and equity prices. Continuation of the current low interest rate environment puts downward pressure on investment income. Future increases in interest rates could cause the values of our fixed income portfolios to decline, with the magnitude of the decline depending on the duration of our portfolio. Individual securities in our fixed income portfolio are subject to credit risk and default. Downgrades in the credit ratings of fixed maturities can have a significant negative effect on the market valuation of such securities. For example, budget strains on certain states and local governments could negatively affect the credit quality and ratings of their issued securities.

Our fixed income portfolio includes certain securities with call features permitting them to be redeemed by the issuers prior to stated maturity. Reinvestment risk exists with such securities as it may not be possible to reinvest the proceeds from the called securities at equivalent yields.

If the fixed income or equity portfolios, or both, were to be impaired by market, sector or issuer-specific conditions to a substantial degree, our liquidity, financial position and financial results could be materially adversely affected. Under these circumstances, our income from these investments could be materially reduced, and declines in the value of certain securities could further reduce our reported earnings and capital levels. A decrease in value of our investment portfolio could also put our insurance subsidiaries at risk of failing to satisfy regulatory minimum capital requirements. If we were not at that time able to supplement our subsidiaries' capital from STFC or by issuing debt or equity securities on acceptable terms, our business could be materially adversely affected. Also, a decline in market rates of fixed income securities or a decline in the fair value of equity securities could cause the investments in our pension plans to decrease, resulting in additional expense and increasing required contributions to the pension plan.

In addition, our investments are subject to risks inherent in the nation's and world's capital markets. The functioning of those markets, the values of the investments held by us and our ability to liquidate investments on favorable terms or short notice may be adversely affected if those markets are disrupted or otherwise affected by local, national or international events, such as power outages, system failures, wars or terrorist attacks or by recessions or depressions, a significant change in inflation expectations, a significant devaluation of governmental or private sector credit, currencies or financial markets and other factors or events.

Changes in tax laws impacting marginal tax rates and/or the preferred tax treatment of municipal obligations under current law, could adversely affect the market value of municipal obligations. Since a significant portion of our investment portfolio is invested in tax-exempt municipal obligations, any such changes in tax law could adversely affect the value of the investment portfolio. Additionally, any such changes in tax law could reduce the difference between tax-exempt interest rates and taxable rates.

EMPLOYEES

Our ability to attract, develop and retain talented employees, managers and executives, and to maintain appropriate staffing levels, is critical to our success, as is our ability to effectively plan for the succession and transition of key executives and subject matter experts.

Our success depends on our ability to attract, train, develop and retain talented, ethical, diverse employees, including executives and other key managers in a specialized industry. The loss of certain key officers and employees or the failure to attract and develop talented new executives and managers could have a materially adverse effect on our business. Effective succession planning is important to assure the timely, competent replacement of retiring or transitioning senior executives and other departing management talent and subject matter experts.

Talent management is a key consideration in our specialty insurance segment, which requires specialized product underwriting, claims handling and risk management services and involves distribution through channels other than our retail agents. Other business units also focus on specialized technical or analytical skills.

Our success also depends on our ability to maintain and improve the effectiveness of our staff. Our ability to do so may be impaired as a result of a variety of internal and external factors which affect employees and the employment marketplace, as well as our ability to recognize and respond to changing trends and other circumstances that affect our employees. In addition, we must forecast the changing business environments (for multiple business units and in many geographic markets) with reasonable accuracy and adjust hiring programs and/or employment levels accordingly. Our failure to recognize the need for such adjustments, or the failure or inability to react appropriately on a timely basis, could lead either to over-staffing (which would adversely affect our cost structure) or under-staffing (impairing our ability to execute and effectively service our business) in one or more business units or locations. In either event, our financial results could be materially adversely affected.

CONTROL BY OUR PARENT COMPANY

State Auto Mutual owns a significant interest in us and may exercise its control in a manner detrimental to your interests.

As of December 31, 2015, State Auto Mutual owned approximately 62.6% of the voting power of our Company. Therefore, State Auto Mutual has the power to direct our affairs and is able to determine the outcome of substantially all matters required to be submitted to shareholders for approval, including the election of all our directors. State Auto Mutual could exercise its control over us in a manner detrimental to the interests of other STFC shareholders.

COMPETITION

Our industry is highly competitive, which could adversely affect our sales and profitability.

The property and casualty insurance business is highly competitive, and we compete with a large number of other insurers. Some of our competitors have well-established national reputations and brands supported by extensive media advertising. Some

of our competitors have substantially greater financial, technical and operating resources and market share than us. We may not be able to effectively compete, which could adversely affect our sales and profitability. We believe that competition in our lines of business is based primarily on price, service, commission structure, product features, technology, use of telematics, financial strength ratings, producer relationships, reputation and name or brand recognition. Market developments such as usage-based auto insurance or new entrants into the insurance marketplace could potentially result in reduced market share or adverse selection. The growth in mobile communications and the prominence of social media as a source of information for consumers are recent examples of significant developments in the marketplace which may adversely affect our competitive position. Social media, for example, could be potentially utilized in a manner which negatively affects our reputation with current or prospective policyholders and agents.

Our competitors sell through various distribution channels, including independent agents, captive agents and directly to the consumer. We compete not only for personal and business insurance customers, but also for independent agents and brokers to market and sell our products. Our specialty insurance segment faces competitors attempting to sell their products through the distribution system of wholesale brokers, program administrators and other specialty sources. Some of our competitors offer a broader array of products, have more competitive pricing or have higher claims paying ability ratings. In addition, other financial institutions are now able to offer services similar to our own as a result of the Gramm-Leach-Bliley Act.

The increased transparency that arises from information available from the use of tools such as comparative rater software, could work to our disadvantage. The competitive environment for certain lines of business, such as personal auto insurance, puts pressure on achieving sustainable profit margins. We may have difficulty differentiating our products or becoming among the lowest cost providers. Expense efficiencies are important to maintaining and increasing our growth and profitability. If we are unable to efficiently execute and realize future expense efficiencies, it could affect our ability to establish competitive pricing and could have a negative effect on new business growth and retention of existing policyholders.

CHANGES IN ACCOUNTING STANDARDS

Changes in accounting standards issued by the FASB or other standard-setting bodies may adversely affect our results of operations and financial condition.

Our financial statements are prepared in accordance with GAAP, FASB, AICPA and other accounting standard-setting bodies may periodically issue changes to, interpretations of or guidance with respect to GAAP. The adoption of such guidance may have an adverse effect on our results of operations and financial position. See Note 1 to our consolidated financial statements included in Item 8 of this Form 10-K regarding adoption of recent accounting pronouncements.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We share our operating facilities with State Auto Mutual pursuant to the terms of the 2005 Management Agreement. Our corporate headquarters are located in Columbus, Ohio, in buildings owned by State Auto Mutual that contain approximately 280,000 square feet of office space. We and State Auto Mutual also own and lease other office facilities in numerous locations throughout the State Auto Group’s geographical areas of operation.

Item 3. Legal Proceedings

We are involved in lawsuits in the ordinary course of our business arising out of or otherwise related to our insurance policies. Additionally, from time to time we may be involved in lawsuits, including class actions, in the ordinary course of business but not arising out of or otherwise related to our insurance policies. These lawsuits are in various stages of development. We generally will contest these matters vigorously but may pursue settlement if appropriate. Based on currently available information, we do not believe it is reasonably possible that any such lawsuit or related lawsuits will be material to our results of operations or have a material adverse effect on our consolidated financial position or cash flows.

Item 4. Mine Safety Disclosures

Not applicable.

27

PART II

Item 5. Market for the Registrant's Common Equity, Related Shareholder Matters, and Issuer Purchases of Equity Securities

Market Information; Holders of Record

Our common shares are traded on the NASDAQ Global Select Market under the symbol STFC. As of February 26, 2016, there were 1,241 shareholders of record of our common shares.

Market Price Ranges and Dividends Declared on Common Shares

Initial Public Offering—June 28, 1991 – $2.25[1] The following table sets forth information with respect to the high and low sale prices of our common shares for each quarterly period for the past two years as reported by NASDAQ, along with the amount of cash dividends declared by us with respect to our common shares for each quarterly period for the past two years:

2015	High	Low	Dividend
First Quarter	$24.80	$20.36	$0.10
Second Quarter	25.70	20.63	0.10
Third Quarter	27.37	21.55	0.10
Fourth Quarter	25.69	20.01	0.10

2014	High	Low	Dividend
First Quarter	$22.85	$18.35	$0.10
Second Quarter	23.62	20.01	0.10
Third Quarter	25.43	20.30	0.10
Fourth Quarter	24.00	19.36	0.10

(1) Adjusted for stock splits.

See Item 7 of this Form 10-K, "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Regulatory Considerations," for information regarding regulatory restrictions on the payment of dividends to State Auto Financial by its insurance subsidiaries.

Performance Graph

The line graph below compares the total return on $100.00 invested on December 31, 2010, in STFC's shares, the CRSP Total Return Index for the NASDAQ Stock Market ("NASDAQ Index"), and the CRSP Total Return Index for NASDAQ insurance stocks ("NASDAQ Ins. Index"), with dividends reinvested.

	12/31/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015
STFC	100.00	81.33	92.85	134.87	143.73	151.97
NASDAQ Index	100.00	99.21	116.71	163.60	187.86	201.21
NASDAQ Ins. Index	100.00	105.65	123.33	161.75	178.82	194.41

Item 6. Selected Consolidated Financial Data

(dollars and shares in millions, except per share data)	Year ended December 31				
	2015	2014	2013	2012	2011*
Statement of Income Data — GAAP Basis:					
Earned premiums	$1,270.5	1,074.1	1,055.0	1,042.1	1,428.8
Net investment income	$71.7	74.7	72.8	75.4	85.4
Total revenues	$1,368.6	1,172.7	1,153.0	1,150.1	1,553.7
Net income (loss)	$51.2	107.4	60.8	10.7	(160.7)
Earned premium growth	18.3 %	1.8	1.2	(27.1)	13.6
Return on average invested assets[(1)]	3.1 %	3.5	3.4	3.5	3.6
Balance Sheet Data — GAAP Basis:					
Total investments	$2,471.7	2,357.9	2,251.3	2,268.4	2,229.9
Total assets	$2,828.5	2,766.9	2,496.4	2,477.8	2,764.4
Total notes payable	$100.8	100.8	100.8	115.9	116.4
Total stockholders' equity	$884.6	872.9	785.0	737.2	723.8
Common shares outstanding	41.3	40.9	40.7	40.5	40.3
Return on average equity	5.8 %	13.0	8.0	1.5	(20.7)
Debt to capital ratio	10.2 %	10.4	11.4	13.6	13.9
Per Common Share Data — GAAP Basis:					
Basic EPS	$1.25	2.63	1.50	0.26	(4.00)
Diluted EPS	$1.23	2.60	1.49	0.26	(4.00)
Cash dividends per share	$0.40	0.40	0.40	0.55	0.60
Book value per share	$21.40	21.32	19.27	18.22	17.95
Common Share Price:					
High	$27.37	25.43	23.10	16.91	18.35
Low	$20.01	18.35	14.10	12.21	10.09
Close at December 31	$20.59	22.22	21.24	14.94	13.59
Close price to book value per share	0.96	1.04	1.10	0.82	0.76
GAAP Ratios:					
Loss and LAE ratio	67.9 %	71.8	68.2	74.7	82.6
Expense ratio	33.6 %	33.7	33.6	33.2	33.9
Combined ratio	101.5 %	105.5	101.8	107.9	116.5
Statutory Ratios:					
Loss and LAE ratio	68.0 %	72.1	68.5	74.8	82.4
Expense ratio	33.9 %	33.9	34.5	33.6	33.9
Combined ratio	101.9 %	106.0	103.0	108.4	116.3
Net premiums written to surplus	1.6	1.5	1.4	1.7	2.1

(1) Invested assets include investments and cash equivalents.

* Reflects changes in Pooling Arrangement, effective December 31, 2011 and January 1, 2011.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Capitalized terms used in this Item 7 and not otherwise defined have the meanings ascribed to such terms under the caption "Important Defined Terms Used in this Form 10-K" which immediately precedes Part I of this Form 10-K. This discussion should be read in conjunction with the consolidated financial statements and notes thereto included in Item 8 of this Form 10-K and the narrative description of our business contained in Item 1 of this Form 10-K.

OVERVIEW

State Auto Financial is a property and casualty insurance holding company. Our insurance subsidiaries are part of the State Auto Group and Pooling Arrangement described below. The State Auto Group markets its insurance products throughout the United States primarily through independent agencies, which include retail agencies and brokers. Our

Pooled Companies are rated A- (Excellent) by A.M. Best.

State Auto Financial's principal subsidiaries are State Auto P&C, Milbank and SA Ohio, each of which is a property and casualty insurance company, and Stateco, which provides investment management services to affiliated insurance companies.

Our reportable insurance segments are personal insurance, business insurance and specialty insurance. These insurance segments are aligned with the reporting lines to our principal operating decision makers. Investment operations is also a reportable segment. See "Personal and Business Insurance" and "Specialty Insurance" in Item 1 of this Form 10-K for more information about our insurance segments.

We evaluate the performance of our insurance segments using industry financial measurements determined under SAP and certain measures determined under GAAP. We evaluate our investment operations segment based on investment returns of assets managed. Financial information about our segments for 2015 is set forth in this Item 7 and in Note 15 to our consolidated financial statements included in Item 8 of this Form 10-K.

EXECUTIVE SUMMARY

While our 2015 results did not meet our expectations, including our growth objectives, progress was made by our new management team in understanding our issues and implementing initiatives to address them.

Insurance Operations

Since 2012, a number of issues have significantly impacted our underwriting results. These issues include declining policy counts and premium for our homeowners and personal auto products, deteriorating personal and commercial auto results and adverse development within our programs unit. We have identified the primary causes of these issues and have begun taking corrective action. The actions we have taken include the realignment of associates within the personal and business insurance segments, enhancements to our underwriting and pricing models, improved pricing segmentation and identification and mitigation of underwriting leakage. While much work is still to be done, management believes these actions are the right steps to return these product lines to profitable growth.

Personal insurance segment - Our homeowners line of business was profitable in 2015, but we continued to experience declines in both premiums and policy counts. We saw a slight increase in new business in the second half of 2015 and we expect this trend to continue as we execute our plans to grow profitably in this line. Personal auto results deteriorated in 2015 when compared to 2014. We have identified the primary contributors to these poor results and believe the corrective actions we are taking will drive improved personal auto underwriting results.

Other personal lines, which include our farm & ranch products, experienced profitable growth in 2015. We introduced new front end quoting technology for our farm and ranch products during the fourth quarter of 2015 and experienced a significant increased quote volume as a result. We expect quote volume for these products to increase further in 2016.

Business insurance segment - Our workers' compensation line grew profitably in 2015 and we expect that trend to continue in 2016. Our commercial auto results were below expectations in 2015 and deteriorated when compared to 2014. As with our personal auto business, we have identified the primary causes of the poor underwriting results and believe the corrective actions we are taking will drive improved underwriting performance in this line in 2016.

Specialty insurance segment - Our E&S casualty unit grew profitably in 2015 and we will continue to look for opportunities to further grow this business, both organically and through acquisitions. Our programs unit also experienced growth in 2015 due to increased production from new programs; however, the unit generated an underwriting loss due primarily to programs with commercial auto exposures. We have identified the issues driving the results and are taking corrective actions to address them.

Claims

Under new leadership, our claims unit was reorganized, with our claims associates being assigned to specific products in order to better align their claims handling expertise with the exposures driving the losses for their assigned products. For example, we have created specific claims teams for our personal and commercial auto products. We have implemented changes to our claims handling practices to reduce claims leakage, including reducing the number of vendors we utilize in order to increase our pricing leverage.

Technology

During 2015, we accelerated our previously disclosed transition plan for a new technology platform for certain products within our personal and business insurance segments. The new platform is expected to enable us to offer new products utilizing a new rating plan. In addition, the platform incorporates advanced data analytics, which should provide our agents with the ability to submit, rate, quote, bind, issue and bill policies through an automated and integrated platform. We plan to introduce the new

30

technology platform in five states during the third quarter of 2016 for personal auto, homeowners and umbrella and in late 2016 for certain small commercial policies, including business owners and small commercial auto. We plan to expand this platform to our remaining states throughout 2016 and 2017. We believe the difference between our current quote and issuance system and the new system will be dramatic and will deliver a greatly improved experience for both our agents and policyholders. The new system is expected to be the foundational element of our long-term technology strategy.

Culture

Among the most significant changes in 2015 was a shift in our culture. While our core strengths of integrity and our relationships with our agents, brokers and policyholders will not change, we recognize that, in order to succeed, we must be nimble, responsive, creative, passionate and driven. To achieve a cultural change, management is emphasizing candor, transparency and respect, along with replacing rules, processes, committees and guidelines that only add to bureaucracy with an open and collaborative approach that focuses on making a decision and moving forward. Additionally, management is encouraging creativity, responsiveness and passion by implementing a coaching approach that delivers regular, ongoing, two-way feedback.

Moving forward

Despite our disappointing results, we believe we made significant progress in 2015 in laying the foundation for improved results in 2016 and beyond. Through a combination of retention, promotion and recruitment, we are confident our new leadership team has the skills to meet emerging challenges in the rapidly changing property and casualty marketplace. Management's objective is to achieve profitability and growth for each of our products, and our progress will be evaluated going forward based on this objective. We remain a company focused on the property and casualty insurance business, committed to distributing our products through independent agents and brokers, and positioned to enhance the security and financial interests of our policyholders and shareholders.

POOLING ARRANGEMENT

The STFC Pooled Companies and the Mutual Pooled Companies participate in a quota share reinsurance pooling arrangement referred to as the "Pooling Arrangement." Under the Pooling Arrangement, State Auto Mutual assumes premiums, losses and expenses from each of the Pooled Companies and in turn cedes to each of the Pooled Companies a specified portion of premiums, losses and expenses based on each of the Pooled Companies' respective pooling percentages. State Auto Mutual then retains the balance of the pooled business.

The following table sets forth the participants and their participation percentages in the Pooling Arrangement. There were no changes to the participants or to their participation percentages during 2015.

STFC Pooled Companies:		
State Auto P&C	51.0	%
Milbank	14.0	
SA Ohio	0.0	
Total STFC Pooled Companies	65.0	
State Auto Mutual Pooled Companies:		
State Auto Mutual	34.5	
SA Wisconsin	0.0	
Meridian Security	0.0	
Patrons Mutual	0.5	
RIC	0.0	
Plaza	0.0	
American Compensation	0.0	
Bloomington Compensation	0.0	
Total State Auto Mutual Pooled Companies	35.0	%

We anticipate that the STFC Pooled Companies will maintain a 65% participation percentage in the Pooling Arrangement for the foreseeable future. However, under applicable governance procedures, if the Pooling Arrangement were to be amended, management would make recommendations to the Independent Committees of the Board of Directors of both State Auto Mutual and STFC. The Independent Committees review and evaluate such factors as they deem relevant and recommend any appropriate pooling change to the Board of Directors of both State Auto Mutual and STFC subject to regulatory approval by each participant's respective domiciliary insurance department. The Pooling Arrangement is terminable by any of our Pooled Companies at any time by any party by giving twelve months' notice to the other parties and their respective domiciliary insurance departments. None of our Pooled Companies currently intends to terminate the Pooling Arrangement.

Under the terms of the Pooling Arrangement, all subject premiums, incurred losses, loss expenses and other underwriting expenses are prorated among our Pooled Companies on the basis of their participation in the pool. By spreading the underwriting risk, the Pooling Arrangement is designed to produce more uniform and stable underwriting results for each of our Pooled Companies than any one company would experience individually. This has the effect of providing each of our Pooled Companies with a similar mix of pooled property and casualty insurance business on a net basis.

RESULTS OF OPERATIONS

Summary

The following table sets forth certain key performance indicators we use to monitor our operations for the years ended December 31, 2015, 2014 and 2013:

($ millions, except per share data)	2015		2014		2013	
GAAP Basis:						
Total revenues	$ 1,368.6		$ 1,172.7		$ 1,153.0	
Income before federal income taxes	$ 67.3		$ 26.8		$ 61.3	
Net income	$ 51.2		$ 107.4		$ 60.8	
Stockholders’ equity	$ 884.6		$ 872.9		$ 785.0	
Book value per share	$ 21.40		$ 21.32		$ 19.27	
Return on average equity	5.8	%	13.0	%	8.0	%
Debt to capital ratio	10.2	%	10.4	%	11.4	%
Cat loss and ALAE ratio	4.0	%	3.0	%	3.4	%
Non-cat loss and LAE ratio	63.9	%	68.8	%	64.8	%
Loss and LAE ratio	67.9	%	71.8	%	68.2	%
Expense ratio	33.6	%	33.7	%	33.6	%
Combined ratio	101.5	%	105.5	%	101.8	%
Premiums written growth	6.6	%	12.4	%	0.6	%
Investment yield	3.1	%	3.5	%	3.4	%
SAP Basis:						
Cat loss and ALAE points	4.0	%	3.0	%	3.4	%
Non-cat loss and ALAE	57.7	%	62.6	%	58.6	%
ULAE	6.3	%	6.5	%	6.5	%
Loss and LAE ratio	68.0	%	72.1	%	68.5	%
Expense ratio	33.9	%	33.9	%	34.5	%
Combined ratio	101.9	%	106.0	%	103.0	%
Net premiums written to surplus	1.6		1.5		1.4	

Our 2015 net income was $51.2 million compared to 2014 and 2013 net income of $107.4 million and $60.8 million, respectively. Our 2014 net income included a non-cash income tax benefit of $82.6 million related to the reversal of a valuation allowance against our net deferred tax assets.

The following highlights significant factors that impacted 2015 results as compared to 2014 and 2013:

- Earned premiums in 2015 were $1,270.5 million compared to $1,074.1 million and $1,055.0 million in 2014 and 2013, respectively. Earned premium growth in 2015 was due to (i) the termination of the HO QS Arrangement (as defined below) and (ii) new business growth in workers’ compensation and the specialty insurance segment.
- The SAP non-catastrophe loss and ALAE ratio for 2015 was 57.7% compared to 62.6% and 58.6% for 2014 and 2013, respectively. The 2015 loss ratio improved when compared to the 2014 and 2013 ratios, which were impacted by strengthening RED reserves within the specialty insurance segment by $96.7 million, which included the net cost of the ADC reinsurance agreement, in 2014 and $21.3 million in 2013. In addition, the HO QS Arrangement increased our SAP non-catastrophe loss and ALAE ratio 3.4 points in 2014 and 2.8 points in 2013. The 2015 SAP non-catastrophe loss and ALAE ratio was impacted by higher than expected severity in lines of business with auto exposures.

Insurance Segments

We measure our top-line growth for our insurance segments based on net written premiums, which provide us with an indication of how well we are doing in terms of revenue growth before it is actually earned. Our policies provide a fixed amount of coverage for a stated period of time, often referred to as the "policy term." As such, our written premiums are recognized as earned ratably over the policy term. The unearned portion of written premiums, called unearned premiums, is reflected on our balance sheet as a liability and represents our obligation to provide coverage for the unexpired term of the policies.

Insurance industry regulators require our insurance subsidiaries to report their financial condition and results of operations using SAP. We use SAP financial results, along with industry standard financial measures determined on a SAP basis and certain measures determined on a GAAP basis, to internally monitor the performance of our insurance segments and reward our employees.

One of the more significant differences between GAAP and SAP is that SAP requires all underwriting expenses to be expensed immediately and not deferred over the same period that the premium is earned. In converting SAP underwriting results to GAAP underwriting results, acquisition costs are deferred and amortized over the periods the related written premiums are earned. For a discussion of deferred acquisition costs, see the "Critical Accounting Policies—Deferred Acquisition Costs" section included in this Item 7.

The accounting for pension benefits also contributes to the difference between our GAAP loss and expense ratios and our SAP loss and expense ratios. At January 1, 2013, we adopted new SAP pension guidance, which required the recognition of service costs for non-vested participants. In accordance with GAAP, service costs related to non-vested participants were recognized over a two year vesting period ending December 31, 2014. See the "Critical Accounting Policies – Pension and Postretirement Benefit Obligations" section included in this Item 7.

Accounting for retroactive reinsurance agreements also contributes to the difference between our GAAP and SAP loss and LAE ratios and expense ratios. In accordance with SAP, the amount paid for a retroactive reinsurance agreement is recognized as other underwriting expense. Under GAAP, the amount recoverable for a retroactive reinsurance agreement is recorded as a reduction to loss and loss expenses up to the amount paid for the reinsurance contract. Recoverable amounts in excess of the amount paid for retroactive reinsurance coverage are deferred and amortized over the claim settlement period of the agreement. The statutory loss and ALAE, and underwriting expenses within this Form 10-K have been adjusted to reflect the impact of a retroactive reinsurance agreement. Accordingly, for the year ended December 31, 2015 we recognized a benefit of $5.9 million, reflected as a reduction in SAP loss and ALAE. For the year ended December 31, 2014 we recognized an expense of $5.9 million, reflected as an increase in SAP loss and ALAE. See the "Reinsurance Arrangements - Other Reinsurance Arrangements" section included in this Item 7.

All references to financial measures or components thereof in this discussion are calculated on a GAAP basis, unless otherwise noted.

Use of Non-GAAP Financial Measures

In the following discussion of the results of our insurance segments, we sometimes refer to GAAP financial measures in the context of "as reported" and to non-GAAP financial measures in the context of "pro forma." These pro forma, or non-GAAP financial measures, may (i) exclude the impact of the HO QS Arrangement cession for the years ended December 31, 2014 and 2013, and (ii) exclude the one-time impact of the unearned premium transfer associated with the termination of the HO QS Arrangement at December 31, 2014. We believe the use of these non-GAAP financial measures will enable investors to (a) better understand the impact of the reinsurance arrangement cession on our reported results for the years ended December 31, 2014 and 2013, and (b) perform a meaningful comparison of our results of operations for the years ended December 31, 2015, 2014 and 2013. We have also included Reconciliation Tables 1-8 and Tables 1-6 for readers to better understand the use and calculation of these non-GAAP financial measures.

Homeowners Quota Share Arrangement

To reduce risk and volatility, while at the same time providing us with additional catastrophe reinsurance protection, the State Auto Group entered into a quota share reinsurance agreement on December 31, 2011 with a syndicate of unaffiliated reinsurers covering its homeowners line of business (the "HO QS Arrangement"). Under the HO QS

Arrangement, the State Auto Group ceded to the reinsurers 75% of its homeowners business under policies in force at December 31, 2011 and new and renewal policies thereafter issued during the term of the agreement. The HO QS Arrangement expired on December 31, 2014. Upon expiration, the Company recognized $89.5 million of unearned premium returned from the reinsurers. In accordance with the terms of the HO QS Arrangement, the participating reinsurers' margin was capped at 9.0%, with any excess returned to the State Auto Group in the form of a profit commission. For the years ended December 31, 2015 and 2014, the Company recognized profit commission of $4.2 million and $19.0 million, respectively, which is reflected as a reduction in acquisition and operating expenses on our consolidated statements of income.

See “Liquidity and Capital Resources – Reinsurance Arrangements” included in this Item 7 for a more detailed discussion of the HO QS Arrangement.
The following tables set forth, on a GAAP and pro forma basis, certain of our key performance indicators before and after the impact of the HO QS Arrangement cession for the years ended December 31, 2014 and 2013.

Reconciliation Table 1

($ millions)	GAAP HO QS Arrangement Cession - Overall Results		
December 31, 2014	As Reported	HO QS Cession	Pro Forma without HO QS Cession
Net written premiums	$ 1,194.2	$ 83.3	$ 1,277.5
Earned premiums	1,074.1	175.6	1,249.7
Losses and LAE incurred:			
Cat loss and ALAE	32.3	19.0	51.3
Non-cat loss and LAE	739.0	66.8	805.8
Total Loss and LAE incurred	771.3	85.8	857.1
Acquisition and operating expenses	361.9	70.0	431.9
Net underwriting (loss) income	$ (59.1)	$ 19.8	$ (39.3)
Cat loss and ALAE ratio	3.0 %	10.8 %	4.1 %
Non-cat loss and LAE ratio	68.8 %	38.1 %	64.5 %
Total Loss and LAE ratio	71.8 %	48.9 %	68.6 %
Expense ratio	33.7 %	39.8 %	34.6 %
Combined ratio	105.5 %	88.7 %	103.2 %

Reconciliation Table 2

($ millions)	GAAP HO QS Arrangement Cession - Overall Results		
December 31, 2013	As Reported	HO QS Cession	Pro Forma without HO QS Cession
Net written premiums	$ 1,062.1	$ 176.9	$ 1,239.0
Earned premiums	1,055.0	177.0	1,232.0
Losses and LAE incurred:			
Cat loss and ALAE	36.3	22.7	59.0
Non-cat loss and LAE	683.5	70.0	753.5
Total Loss and LAE incurred	719.8	92.7	812.5
Acquisition and operating expenses	354.8	51.4	406.2
Net underwriting (loss) income	$ (19.6)	$ 32.9	$ 13.3
Cat loss and ALAE ratio	3.4 %	12.9 %	4.8 %
Non-cat loss and LAE ratio	64.8 %	39.5 %	61.2 %
Total Loss and LAE ratio	68.2 %	52.4 %	66.0 %
Expense ratio	33.6 %	29.0 %	33.0 %
Combined ratio	101.8 %	81.4 %	99.0 %

The following tables set forth, on a SAP and pro forma basis, certain of our key performance indicators before and after the impact of the HO QS Arrangement cession for the years ended December 31, 2014 and 2013.

Reconciliation Table 3

($ millions)	SAP HO QS Arrangement Cession—Overall Results		
December 31, 2014	As Reported	HO QS Cession	Pro Forma without HO QS Cession
Net written premiums	$ 1,194.2	$ 83.3	$ 1,277.5
Earned premiums	1,074.1	175.6	1,249.7
Losses and LAE incurred:			
Cat loss and ALAE	32.3	19.0	51.3
Non-cat loss and ALAE	672.8	66.8	739.6
Total Loss and ALAE	705.1	85.8	790.9
ULAE	69.4	—	69.4
Total Loss and LAE incurred	774.5	85.8	860.3
Underwriting expenses	405.4	43.2	448.6
Net underwriting (loss) income	$ (105.8)	$ 46.6	$ (59.2)
Cat loss and ALAE ratio	3.0 %	10.8 %	4.1 %
Non-cat loss and ALAE ratio	62.6 %	38.1 %	59.2 %
Total loss and ALAE ratio	65.6 %	48.9 %	63.3 %
ULAE ratio	6.5 %	— %	5.6 %
Total loss and LAE ratio	72.1 %	48.9 %	68.9 %
Expense ratio	33.9 %	51.9 %	35.1 %
Combined ratio	106.0 %	100.8 %	104.0 %

Reconciliation Table 4

($ millions)	SAP HO QS Arrangement Cession—Overall Results		
December 31, 2013	As Reported	HO QS Cession	Pro Forma without HO QS Cession
Net written premiums	$ 1,062.1	$ 176.9	$ 1,239.0
Earned premiums	1,055.0	177.0	1,232.0
Losses and LAE incurred:			
Cat loss and ALAE	36.3	22.7	59.0
Non-cat loss and ALAE	617.7	70.0	687.7
Total Loss and ALAE	654.0	92.7	746.7
ULAE	68.7	—	68.7
Total Loss and LAE incurred	722.7	92.7	815.4
Underwriting expenses	366.3	51.3	417.6
Net underwriting (loss) income	$ (34.0)	$ 33.0	$ (1.0)
Cat loss and ALAE ratio	3.4 %	12.9 %	4.8 %
Non-cat loss and ALAE ratio	58.6 %	39.5 %	55.8 %
Total loss and ALAE ratio	62.0 %	52.4 %	60.6 %
ULAE ratio	6.5 %	— %	5.6 %
Total loss and LAE ratio	68.5 %	52.4 %	66.2 %

Expense ratio	34.5	%	29.0	%	33.7	%
Combined ratio	103.0	%	81.4	%	99.9	%

See additional pro forma reconciliation tables for the HO QS Arrangement cession on our homeowners line of business at Reconciliation Tables 5-8.

Summary of Key Indicators of Insurance Segment Results

The following table sets forth certain key performance indicators for our insurance segments for the years ended December 31, 2015, 2014 and 2013:

($ millions)	2015							
	Personal	% Ratio	Business	% Ratio	Specialty	% Ratio	Total	% Ratio
Written premiums	$583.0		$479.5		$211.0		$1,273.5	
Earned premiums	591.8		476.0		202.7		1,270.5	
Cat loss and ALAE	35.1	5.9	15.7	3.3	0.3	0.2	51.1	4.0
Non-cat loss and ALAE	323.3	54.7	288.3	60.6	121.1	59.7	732.7	57.7
ULAE	45.2	7.6	27.3	5.7	8.0	4.0	80.5	6.3
Underwriting expenses	170.7	29.3	181.4	37.8	79.2	37.5	431.3	33.9
SAP underwriting gain (loss) and SAP combined ratio	$17.5	97.5	$(36.7)	107.4	$(5.9)	101.4	$(25.1)	101.9

($ millions)	2014							
	Personal	% Ratio	Business	% Ratio	Specialty	% Ratio	Total(3)	% Ratio
Written premiums(1)	$532.1		$473.1		$189.0		$1,194.2	
Earned premiums	451.4		459.9		162.8		1,074.1	
Cat loss and ALAE	13.9	3.1	16.5	3.6	1.9	1.1	32.3	3.0
Non-cat loss and ALAE	260.9	57.8	242.6	52.8	169.3	104.0	672.8	62.6
ULAE	43.5	9.6	20.9	4.5	5.0	3.1	69.4	6.5
Underwriting expenses(2)	144.8	27.2	184.5	39.0	76.1	39.9	405.4	33.9
SAP underwriting loss and SAP combined ratio	$(11.7)	97.7	$(4.6)	99.9	$(89.5)	148.1	$(105.8)	106.0

($ millions)	2013							
	Personal	% Ratio	Business	% Ratio	Specialty	% Ratio	Total(3)	% Ratio
Written premiums	$465.4		$446.8		$149.9		$1,062.1	
Earned premiums	464.0		433.5		157.5		1,055.0	
Cat loss and ALAE	14.0	3.0	20.9	4.8	1.4	0.9	36.3	3.4
Non-cat loss and ALAE	285.8	61.6	220.3	50.8	111.6	70.8	617.7	58.6
ULAE	42.4	9.1	21.1	4.9	5.2	3.3	68.7	6.5
Underwriting expenses	134.4	28.9	173.9	38.9	58.0	38.7	366.3	34.5
SAP underwriting loss and SAP combined ratio	$(12.6)	102.6	$(2.7)	99.4	$(18.7)	113.7 %	$(34.0)	103.0

(1) Includes $89.5 million of unearned premiums received by the STFC Pooled Companies on December 31, 2014 related to the expiration of the HO QS Arrangement.

(2) Includes ceding commissions returned to reinsurers upon expiration of the HO QS Arrangement of $26.0 million and recognition of $19.0 of profit commission.

(3)

See Reconciliation Tables 3 and 4 for the impact of the HO QS Arrangement cession on our SAP underwriting results.

Personal Insurance Segment

The following table sets forth the net written premiums by major product line of business for our personal insurance segment for the years ended December 31, 2015, 2014 and 2013.

Table 1

($ millions)	2015	2014	2013
Net Written Premiums			
Personal auto	$334.4	$354.4	$377.2
Homeowners[1]	215.8	146.4	58.8
Other personal	32.8	31.3	29.4
Total personal	$583.0	$532.1	$465.4

[1] December 31, 2014 net written premiums include $89.5 million of unearned premiums received by the STFC Pooled Companies on December 31, 2014 related to the expiration of the HO QS Arrangement.

The following table sets forth the SAP loss and ALAE ratios by major product line of business for our personal insurance segment with the catastrophe and non-catastrophe impact shown separately for the years ended December 31, 2015, 2014 and 2013:

Table 2

($ millions)

Statutory Loss and LAE Ratios	Earned Premium	Cat Loss & ALAE	Non-Cat Loss & ALAE	Statutory Loss & LAE	Cat loss Ratio	Non-Cat Loss & ALAE Ratio	Total Loss and LAE Ratio
2015							
Personal auto	$339.1	$4.6	$236.0	$240.6	1.3	69.7	71.0
Homeowners	220.5	28.9	76.1	105.0	13.1	34.5	47.6
Other personal	32.2	1.6	11.2	12.8	5.0	34.7	39.7
Total personal	$591.8	$35.1	$323.3	$358.4	5.9	54.7	60.6
ULAE	—	—	—	45.2	—	—	7.6
Total Loss and LAE	$591.8	$35.1	$323.3	$403.6	5.9	54.7	68.2
2014							