State Auto Financial CORP
Form 10-K
March 03, 2015

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, 2014 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, 2014, 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 $361,818,623.

On February 27, 2015, the Registrant had 41,050,931 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 8, 2015 (the "2015 Proxy Statement"), which will be filed within 120 days of December 31, 2014, 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, 2014

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"), Stateco Financial Services, Inc. ("Stateco"). STFC's former subsidiary Farmers Casualty Insurance Company ("Farmers") was merged into State Auto P&C as of the close of business on December 31, 2012.
State Auto Mutual	Refers to State Automobile Mutual Insurance Company, which owns approximately 62.5% 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 Florida Insurance Company ("SA Florida"), State Auto Insurance Company of Wisconsin ("SA Wisconsin"), Meridian Citizens Mutual Insurance Company ("Meridian Citizens Mutual"), Meridian Security Insurance Company ("Meridian Security"), Beacon National Insurance Company ("Beacon National"), 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 December 31, 2012, SA Florida and Beacon National were merged into Meridian Security. 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.
Patrons Insurance Group or Patrons Group	Refers to Patrons Mutual and Litchfield.
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 and, through December 31, 2012, Beacon Lloyds Insurance Company, which was dissolved as of the close of business on December 31, 2012.

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 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.

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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 62.5% 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.

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 and homeowners.

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 and general liability.

Marketing

We market our personal and business insurance through approximately 2,600 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 staffs. Our training programs include both products and sales training conducted in our corporate headquarters. Further, our training programs include disciplined follow-up and coaching for an extended time. Other targeted training sessions are held in our regional headquarters from time to time, as well as in our agents' offices.

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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.

We have made continuing efforts to use technology to make it easier for our retail agents to do business with us. We offer internet-based (i) rating, (ii) policy application submission, (iii) execution of changes to policies for certain products and (iv) claims submission. In addition, we provide our agents with the opportunity to maintain policyholder records electronically, avoiding the expense of preparing and storing paper records. We believe that, since agents and their customers realize better service and efficiency through automation, they value their relationship with us. Automation can make it easier for an agent to do business with us, which attracts prospective agents and enhances existing agencies' relationships with us.

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, Programs and Workers' Compensation.

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 our Programs unit include commercial auto, general liability, and property.

Our Workers' Compensation unit serves the small-to-medium account and association business in select states with a focus on risks contained within four walls with limited off-premise exposure. A specialized rating structure is used to price risks based on size, class, complexity and loss experience. This unit has a dedicated internal claims team emphasizing managed care cost containment strategies including focusing on the injured employee's early return to work and cost-effective quality care.

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, 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. We supplement our field staff with independent adjusters and appraisers in areas in which there is not sufficient volume of claims to warrant staff adjusters.

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, if possible, by settling disputes regarding automobile physical damage, bodily injury and property insurance claims through arbitration or mediation when appropriate. In addition, selected agents have authority to settle small first party claims, which improves claims service.

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. We primarily utilize TPAs for our program business as individual programs typically have long-standing relationships with a TPA, although we also use TPAs for our non-program specialty insurance segment business, primarily to supplement our internal capacity. As with our internal claims adjusters, claim settlement authority is established for the 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 we retain for defending our insureds when appropriate.

Our Claims Express Centers allow us to improve claims efficiency and economy by concentrating the handling of smaller, less complex claims in a centralized environment. We provide claim service 24 hours a day, seven days a week, either through associates in our Claims Express Centers, which are located in Des Moines, Iowa and Columbus, Ohio, or for a few overnight hours, through a third party service provider.

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, 2014:

State	% of Total	
Ohio	10.2	%
Texas	9.2	
Kentucky	6.1	
Florida	5.3	
Indiana	4.3	
Minnesota	4.2	
Tennessee	4.0	
Connecticut	3.8	
Illinois	3.5	
California	3.4	
Pennsylvania	3.4	
Maryland	3.3	
Michigan	3.2	
South Carolina	3.0	
All others [(1)]	33.1	
Total	100.0	%

(1) No other single state accounted for 3.0% or more of the total direct written premiums written in 2014.

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, has a ten-year term and renews for an additional ten-year period unless terminated sooner in accordance with its terms. Effective January 1, 2015, this agreement was renewed for an additional ten years. 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, 2014, 2013 and 2012:

($ millions)	Year Ended December 31		
	2014	2013	2012
Beginning of Year:			
Loss and loss expenses payable	$959.9	$942.2	$907.1
Less: Reinsurance recoverable on losses and loss expenses payable	9.1	13.5	25.5
Net losses and loss expenses payable(1)	950.8	928.7	881.6
Provision for losses and loss expenses occurring:			
Current year	726.2	741.0	795.2
Prior years(2)	45.1	(21.2)	(16.9)
Total	771.3	719.8	778.3
Loss and loss expense payments for claims occurring during:			
Current year	373.2	355.0	397.2
Prior years	375.3	342.7	334.0
Total	748.5	697.7	731.2
End of Year:			
Net losses and loss expenses payable	973.6	950.8	928.7
Add: Reinsurance recoverable on losses and loss expenses payable	9.6	9.1	13.5
Losses and loss expenses payable(3)	$983.2	$959.9	$942.2

(1) Includes net amounts assumed from affiliates of $438.0 million, $435.1 million, and $376.8 million at beginning of year 2014, 2013, and 2012, 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 $494.3 million, $438.0 million, and $435.1 million at end of year 2014, 2013, and 2012, respectively.

The following table sets forth our development of loss reserves from 2004 through 2014. "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, 2014, we have paid 77.2% of the losses and LAE that had been incurred but not paid, as estimated at December 31, 2004.

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 2004 loss reserve has developed $104.9 million or 16.0% redundant through December 31, 2014. This $104.9 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, 2006, on claims incurred in 2006 includes the cumulative redundancy or deficiency for years 2004, 2005 and 2006. 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. While we have historically experienced cumulative redundancies, we experienced a cumulative deficiency of $45.1 million and $34.0 million for 2013 and 2012, respectively, primarily due to RED reserve strengthening within our specialty insurance segment. During 2014 and 2013, we strengthened RED reserves by $96.7 million, including the net cost of the ADC reinsurance agreement, and $21.3 million for 2013. 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.

In 2005, the MIGI Insurers were added to the pool and our share of their net liabilities and assets were transferred to us from them. In 2008, Beacon National, the Patrons Insurance Group, State Auto middle market business and voluntary assumed reinsurance from parties affiliated with State Auto Mutual were added to the pool, and accordingly net assets equal to the increase in net liabilities were transferred to us from them. In 2010, SA National and voluntary assumed reinsurance from third parties unaffiliated with the Pooled Companies that was assumed on or after January 1, 2009 by State Auto Mutual were added to the pool, and accordingly net assets equal to the increase in net liabilities were transferred to us from them. As of 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							
	2004	2005	2006	2007	2008	2009	2010	201
Net liability for losses and loss expenses payable	$655.9	$711.3	$661.0	$647.1	$770.0	$819.4	$874.2	$88
Paid (cumulative) as of:								
One year later	31.6	%34.9	%34.9	%31.7	%34.9	%35.5	%40.8	%37.
Two years later	48.4	%51.1	%50.5	%49.4	%53.2	%53.2	%58.2	%57.
Three years later	59.9	%60.9	%60.4	%62.6	%62.7	%63.5	%68.0	%70.
Four years later	66.1	%66.0	%67.8	%69.1	%68.5	%69.0	%74.2	%
Five years later	69.2	%70.3	%71.3	%73.7	%72.0	%72.0	%	
Six years later	72.3	%72.7	%74.3	%76.1	%74.0	%		
Seven years later	73.8	%74.9	%75.9	%77.8	%			
Eight years later	75.6	%76.0	%77.2	%				
Nine years later	76.5	%76.9	%					
Ten years later	77.2	%						
Net liability re-estimate as of:								
One year later	93.3	%89.9	%91.7	%95.8	%92.7	%92.1	%96.2	%98.
Two years later	87.6	%86.4	%90.5	%93.7	%89.5	%89.1	%94.0	%96.
Three years later	86.9	%85.6	%88.8	%91.9	%87.9	%87.8	%92.4	%98.
Four years later	86.2	%85.3	%87.4	%90.8	%87.1	%86.9	%92.0	%
Five years later	85.5	%84.7	%86.9	%90.2	%86.8	%86.0	%	
Six years later	85.2	%84.4	%86.7	%90.0	%86.3	%		
Seven years later	84.4	%84.2	%86.7	%89.5	%			
Eight years later	84.2	%84.2	%86.3	%				
Nine years later	84.2	%84.0	%					
Ten years later	84.0	%						
Cumulative redundancy (deficiency)	$104.9	$114.1	$90.4	$67.7	$105.7	$115.0	$69.9	$16
Cumulative redundancy (deficiency)	16.0	%16.0	%13.7	%10.5	%13.7	%14.0	%8.0	%1.8
Gross* liability—end of year	$1,006.4	$1,111.1	$1,032.7	$1,029.9	$1,198.6	$1,293.2	$1,391.4	$1,
Reinsurance recoverable	$350.5	$399.8	$371.7	$382.8	$428.6	$473.8	$517.2	$53
Net liability—end of year	$655.9	$711.3	$661.0	$647.1	$770.0	$819.4	$874.2	$88
Gross liability re-estimated— latest	87.8	%87.5	%89.2	%93.0	%89.3	%88.3	%95.3	%94.
Reinsurance recoverable re-estimated—latest	94.8	%93.7	%94.4	%98.8	%94.8	%92.2	%101.0	%88.
Net liability re-estimated— latest	84.0	%84.0	%86.3	%89.5	%86.3	%86.0	%92.0	%98.

* 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										
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Reinsurance recoverable	$350.5	$399.8	$371.7	$382.8	$428.6	$473.8	$517.2	$530.3	$507.1	$521.9	$488.9
Amount netted against assumed from State Auto Mutual	$324.6	$382.4	$358.2	$371.6	$407.4	$453.0	$498.4	$504.8	$493.6	$512.8	$479.3
	$25.9	$17.4	$13.5	$11.2	$21.2	$20.8	$18.8	$25.5	$13.5	$9.1	$9.6

Net reinsurance recoverable

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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. We will file an ORSA Summary Report, supported by internal risk management materials, with state regulators later in 2015 and annually thereafter.

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, $77.8 million is available in 2015 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 $20.0 million and $10.0 million in 2014 and 2013, 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 2014 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, 2014, 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.
On January 12, 2015, 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"), was 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 is $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 27, 2015, we had approximately 2,274 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)
Robert P. Restrepo, Jr., Chairman, President and Chief Executive Officer	64	Chairman of the Board and Chief Executive Officer of STFC and State Auto Mutual, 2/06 to present; President of STFC and State Auto Mutual, 3/06 to present.	2006
Steven E. English, Senior Vice President and Chief Financial Officer	54	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
Joel E. Brown, Senior Vice President, Standard Lines	57	Senior Vice President, Standard Lines, of STFC and State Auto Mutual, 8/13 to present; Vice President, Standard Lines of STFC and State Auto Mutual, 1/11 to 7/13; Vice President, Personal Lines, and Regional Vice President of STFC and State Auto Mutual, 1/01 to 1/11.	2011
Jessica E. Buss, Senior Vice President, Specialty Lines	43	Senior Vice President, Specialty Lines, of STFC and State Auto Mutual, 8/13 to present; 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
Clyde H. Fitch, Jr., Senior Vice President and Chief Sales Officer	64	Senior Vice President and Chief Sales Officer of STFC and State Auto Mutual, 11/07 to present.	2007
Stephen P. Hunckler, Senior Vice President and Chief Claims Officer	56	Senior Vice President of STFC and State Auto Mutual, 8/13 to present; Chief Claims Officer of STFC and State Auto Mutual, 8/09 to present; Vice President of STFC and State Auto Mutual, 8/09 to 7/13, Chief Claims Officer of Balboa Insurance Group 8/06 to 8/09.	2011
Cynthia A. Powell, Senior Vice President and Chief Risk Officer	54	Senior Vice President of STFC and State Auto Mutual, 8/13 to present; Chief Risk Officer of STFC and State Auto Mutual, 6/12 to present; 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.	2000
Lyle D. Rhodebeck, Senior Vice President, Director of Operations	57	Senior Vice President of STFC and State Auto Mutual, 8/13 to present; Vice President, Director of Operational Effectiveness, 01/08 to present.	2008
Lorraine M. Siegworth, Senior Vice President and Chief Strategy & Organization Effectiveness Officer	47	Senior Vice President of STFC and State Auto Mutual, 8/13 to present; Chief Strategy & Organization Effectiveness Officer of STFC and State Auto Mutual, 11/06 to present; Vice President of STFC and State Auto Mutual, 11/06 to 7/13.	2006
James A. Yano,	63	Senior Vice President of STFC and State Auto Mutual, 8/13 to present; Secretary and General	2007

Senior Vice President, Secretary and General Counsel		Counsel of STFC and State Auto Mutual, 4/07 to present; Vice President of STFC and State Auto Mutual, 4/07 to 7/13	
Scott A. Jones, Vice President and Chief Investment Officer	50	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; Portfolio Manager of STFC and State Auto Mutual for more than five years prior to 8/09.	2012
Matthew R. Pollak, Vice President, Chief Accounting Officer and Treasurer	49	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; Senior Vice President and E&S Segment Chief Financial Officer of Argo Group International Holdings, Ltd. 6/05 to 2/10.	2013

(1) Age as of March 3, 2015.

(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 2014 and 2013 results reflected decreases in weather-related catastrophe losses when compared to 2012; however, there can be no assurance that a favorable trend will continue in future years. In 2012, the largest catastrophe or series of catastrophes affecting STFC's results of operations were as follows: in 2012, losses related to wind and hail activity from a tornado in March, wind and hail activity in Louisville, Kentucky, and St. Louis, Missouri, in April, and wind activity from a storm in the Midwest and Mid-Atlantic states in June resulted in approximately $50.5 million in pre-tax losses.

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 formulae 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;
- 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 negative outlook. The State Auto Group’s current financial strength rating from Moody’s is A3 with an under review for downgrade outlook and from Standard & Poor’s is BBB+ with a negative 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 negative outlook. The State Auto Group's current credit rating from Standard & Poor's BB+ with a negative 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. In the fourth quarter of 2012, the Board of Directors of State Auto Financial reduced the amount of dividends paid on our common shares from $0.15 per share to $0.10 per share; 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. We implemented a new claims system for most lines of business during 2013. This initiative involved a significant commitment of resources. This new system is intended to add functionality and increase our claims efficiency with improved file quality. However, there can be no certainty that all such intended benefits will be fully realized.

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.

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.

System implementations are complex processes requiring extensive planning and coordination among multiple stakeholder groups. During 2013, we began planning a multi-year business and technology transition to consolidate all of our policy administration and billing systems. The transition is not expected to be complete for several years. For this initiative, we are partnering with a third party which specializes in providing core system software to the insurance industry. 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 2015 and beyond.

If we experience difficulties with outsourcing, or other third party relationships, our ability to conduct business might be negatively impacted.
During 2014, we transitioned the support and maintenance of information technology legacy systems to a third party vendor. This decision was designed to advance our application and support capabilities, while delivering an improved customer experience. However, there can be no assurance that these desired objectives will be achieved. If the third party provider fails to perform as expected, we may experience operational difficulties, service problems or increased costs.
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.
CYBER-SECURITY THREATS
Our highly automated and networked organization is subject to cyber-terrorism and a variety of other cyber-security 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. Cyber-attacks 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. Cyber-attacks 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.
We rely on services and products provided by many vendors. 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.

As described in more detail elsewhere in this Form 10-K, the State Auto Group entered into a one-year property aggregate excess catastrophe reinsurance agreement, effective January 1, 2015, with a syndicate of reinsurers covering property business underwritten by our personal insurance and business insurance segments. This reinsurance agreement excludes property risks underwritten by our specialty insurance segment. This reinsurance agreement replaces the homeowner quota share reinsurance agreement that had been in place for the prior three years. Under that quota share reinsurance agreement, which expired in accordance with its terms on December 31, 2014, we had ceded to reinsurers 75% of our homeowner business during the term of the agreement.

The one-year property aggregate excess catastrophe reinsurance agreement provides reinsurance coverage to the State Auto Group of $75.0 million during 2015 for the ISO's PCS numbered catastrophes and certain other weather-related events after the State Auto Group's retention of $165.0 million. Individual occurrences are not subject to an occurrence deductible, but are subject to a maximum amount of $55.0 million consistent with the Group's retention under the existing property catastrophe excess of loss reinsurance agreement.

As described in more detail elsewhere in this Form 10-K, the State Auto Group entered into an ADC reinsurance agreement to protect against adverse development of loss and ALAE reserves for the terminated RED restaurant program. The ADC reinsurance agreement provides the State Auto Group with $40.0 million of adverse development cover in excess of the carried reserves for the terminated RED restaurant program at December 31, 2014.

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, particularly business insurance, 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 overall cyclicality 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 businesses are characterized by an automated underwriting cycle 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.

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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 agents 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 agents 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 agents 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. In February 2013, the Department of Housing and Urban Development finalized a federal regulation introducing disparate impact criteria to the sale of homeowners insurance. Such regulation may have a negative effect on our underwriting and pricing of homeowners insurance, as it puts in jeopardy the use of longstanding, sound actuarial factors. We are continuing to monitor the impact of this legislation.

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. In December 2013, the Federal Insurance Office issued a report on regulatory modernization. The report concluded that the regulatory debate at present is not whether insurance regulation should be state-based or regulated by the federal government, but, whether there are areas in which the federal government's involvement in regulation under the state-based approach would be beneficial. The report recommended 18 areas for short-term insurance regulation improvement, centering around capital adequacy, reform of insurer resolution practices and marketplace regulation, and nine areas of direct federal government involvement in regulation. Industry response to the report has been mixed. It is uncertain what regulatory changes may ultimately result from the report and what impact such changes may have on the industry and to us.

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. Such situations may, to some degree, threaten the sanctity of the insurance contract.

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 2014, 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, 2014, State Auto Mutual owned approximately 62.5% 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. Many of our competitors have well-established national reputations and brands supported by extensive media advertising. Many 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, 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.

VOLATILITY OF OUR COMMON STOCK

The price of our common stock could be volatile.

The trading price of our common stock may fluctuate substantially due to a variety of factors, some of which may not be related to our operating performance and are beyond our control. Such factors include, but are not limited to, the following: volatility and variations in our actual or anticipated operating results or changes in the expectations of financial market analysts; investor perceptions of our Company and/or the property and casualty industry; the number of shares outstanding, trading volume, market conditions in the insurance industry and any significant volatility in the market; and major catastrophic events.

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. Our Company 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

The following describes a pending class action legal proceeding in which we are a party:

In April 2013, a putative class action lawsuit (Schumacher vs. State Automobile Mutual Insurance Company, et al.) was filed against State Auto Mutual, State Auto Financial and State Auto P&C in Federal District Court in Ohio. Plaintiffs claim that in connection with the homeowners policies of various State Auto companies, the coverage limits and premiums were improperly increased as a result of an insurance to value ("ITV") program and Plaintiffs allege that they purchased coverage in excess of that which was necessary to insure them in the event of loss. Plaintiffs' claims include breach of good faith and fair dealing, negligent misrepresentation and fraud, violation of the Ohio Deceptive Trade Practices Act, and fraudulent inducement. Plaintiffs sought compensatory and punitive damages to be determined by the court, as well as class certification. On February 2, 2015, the Court struck the class allegations, and on February 13, 2015, the Court stayed the proceedings to allow the parties to engage in settlement discussions.

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

Item 4. Mine Safety Disclosures

Not applicable.

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 27, 2015, there were 1,258 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:

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

2013	High	Low	Dividend
First Quarter	$17.99	$14.10	$0.10
Second Quarter	19.77	15.48	0.10
Third Quarter	23.10	17.56	0.10
Fourth Quarter	22.61	18.65	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, 2009, 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.

	12/31/2009	12/31/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014
STFC	100.00	97.67	79.44	90.68	131.73	140.38
NASDAQ Index	100.00	118.15	117.22	137.90	193.29	221.96
NASDAQ Ins. Index	100.00	118.13	124.81	145.69	191.08	211.24

Item 6. Selected Consolidated Financial Data

(dollars and shares in millions, except per share data)	Year ended December 31				
	2014	2013	2012	2011*	2010*
Statement of Income Data — GAAP Basis:					
Earned premiums	$1,074.1	1,055.0	1,042.1	1,428.8	1,257.2
Net investment income	$74.7	72.8	75.4	85.4	80.8
Total revenues	$1,172.7	1,153.0	1,150.1	1,553.7	1,355.1
Net income (loss)	$107.4	60.8	10.7	(160.7)	24.4
Earned premium growth	1.8 %	1.2	(27.1)	13.6	6.9
Return on average invested assets[1]	3.5 %	3.4	3.5	3.6	3.6
Balance Sheet Data — GAAP Basis:					
Total investments	$2,357.9	2,251.3	2,268.4	2,229.9	2,307.1
Total assets	$2,766.9	2,496.4	2,477.8	2,764.4	2,701.4
Total notes payable	$100.8	100.8	115.9	116.4	116.8
Total stockholders' equity	$872.9	785.0	737.2	723.8	831.2
Common shares outstanding	40.9	40.7	40.5	40.3	40.1
Return on average equity	13.0 %	8.0	1.5	(20.7)	2.9
Debt to capital ratio	10.4 %	11.4	13.6	13.9	12.3
Per Common Share Data — GAAP Basis:					
Basic EPS	$2.63	1.50	0.26	(4.00)	0.61
Diluted EPS	$2.60	1.49	0.26	(4.00)	0.61
Cash dividends per share	$0.40	0.40	0.55	0.60	0.60
Book value per share	$21.32	19.27	18.22	17.95	20.71
Common Share Price:					
High	$25.43	23.10	16.91	18.35	20.38
Low	$18.35	14.10	12.21	10.09	13.40
Close at December 31	$22.22	21.24	14.94	13.59	17.42
Close price to book value per share	1.04	1.10	0.82	0.76	0.84
GAAP Ratios:					
Loss and LAE ratio	71.8 %	68.2	74.7	82.6	70.8
Expense ratio	33.7 %	33.6	33.2	33.9	33.8
Combined ratio	105.5 %	101.8	107.9	116.5	104.6
Statutory Ratios:					
Loss and LAE ratio	71.6 %	68.5	74.8	82.4	70.3
Expense ratio	34.4 %	34.5	33.6	33.9	32.9
Combined ratio	106.0 %	103.0	108.4	116.3	103.2
Net premiums written to surplus	1.5	1.4	1.7	2.1	1.7

(1) Invested assets include investments and cash equivalents.

* Reflects changes in Pooling Arrangement, effective December 31, 2011, January 1, 2011 and 2010.

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 2014 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

Our 2014 results reflect a number of the actions we took in the fourth quarter of 2014 to address certain issues that impacted our financial performance in recent years and overshadowed improvement in our overall underwriting performance. We replaced the HO QS Arrangement (defined and described below) with a one year property aggregate excess catastrophe reinsurance agreement and entered into an adverse development cover ("ADC") reinsurance agreement to provide protection against adverse development related to the terminated RED restaurant program business in run-off. We believe the ADC reinsurance agreement, combined with the actions taken to strengthen our RED reserves during 2014, reduces the likelihood of RED underwriting results materially impacting our future results. In addition, our cumulative profitability since 2011, among other factors, led management to conclude that the valuation allowance against our net deferred tax assets was no longer necessary. As a result, the valuation allowance was reversed, resulting in increases to both GAAP equity and statutory surplus. Finally, our 2014 results benefited from below average catastrophe losses and price increases across all lines and segments.

Replacement of HO QS Arrangement

The HO QS Arrangement, which was put in place in 2011, provided capital support and additional catastrophe protection over the past three years, over which time we undertook a number of actions aimed at improving the financial performance of our homeowners line. See the "Personal Insurance Segment" discussion included in this Item 7 for further information. Since 2011, the financial performance of our homeowners line improved due to the actions we undertook as well as improved weather. We evaluated various reinsurance structures to replace the expired HO QS Arrangement, ultimately entering into a one-year property aggregate excess catastrophe reinsurance agreement effective January 1, 2015. Because we believe our homeowners line is positioned to generate adequate margins to absorb weather volatility, we are not willing to cede those margins to reinsurers as we would under a quota share arrangement. The one-year property aggregate excess catastrophe reinsurance agreement provides protection against significant downside earnings risk resulting from the occurrence of multiple catastrophe events such as those that materially impacted our 2011 results.

RED Reserve Strengthening and ADC

For 2014, we strengthened loss and ALAE reserves related to the terminated RED program business in run-off by a total of $96.7 million, which included the net cost of the ADC reinsurance agreement. The majority of the reserve strengthening related to the two largest terminated RED programs, the restaurant and commercial trucking programs. In addition, the State Auto Group entered into the ADC reinsurance agreement to protect against adverse development of loss and ALAE reserves for the restaurant program. The ADC reinsurance agreement provides the State Auto Group with $40.0 million of adverse development cover in excess of the restaurant program's carried reserves at December 31, 2014.

Net Deferred Tax Assets Valuation Allowance

Since the second quarter of 2011, STFC has carried a valuation allowance against its net deferred tax assets. At December 31, 2013, the was $82.6 million. Management periodically evaluates STFC's deferred tax assets to determine if they are realizable based upon available evidence, both positive and negative. When evaluating the ability to realize STFC's deferred tax assets at December 31, 2014, we focused on STFC's recent profitability, including (i) three-year cumulative pre-tax income of $98.7 million; (ii) three consecutive years of pre-tax income; and (iii) expected future profitability. We also considered the following factors, all of which were determined to have contributed to STFC's profitability since 2011 and which we believe will contribute to future profitability: (i) the improved financial performance of our homeowners line since 2011, (ii) the expiration of the HO QS Arrangement under which we ceded a certain portion of our homeowners underwriting profits to the participating reinsurers, (iii) the actions we took (including reserve strengthening and entering into an ADC reinsurance agreement protecting against the risk of further adverse development for one of the programs) with respect to the terminated RED program business, which significantly reduced our reported financial results since 2011, (iv) increased pricing, which has contributed to improved underwriting margins, and (v) profitable growth within our specialty insurance segment, excluding the terminated RED program business. As a result of our evaluation of all of the above factors, we determined positive evidence outweighed negative evidence and concluded that the valuation allowance was no longer necessary. Accordingly, the valuation allowance as of the beginning of 2014 was reversed, resulting in an income tax benefit of $82.6 million. Management's assessment of expected future profitability was based on management's opinion that 2014 and 2013 pre-tax operating profitability is a strong indicator of future profitability, along with the anticipated benefits from the expiration of the HO QS Arrangement and from the actions taken with respect to RED.

Personal Insurance

Remediation efforts in our homeowners line of business have resulted in improved loss and LAE ratios, higher policy premiums and fewer retail agency relationships. While these efforts resulted in declines in new business for both our homeowners and personal auto lines, renewal retention for those lines has remained stable. We are working to stabilize production and promote new business growth in these lines through the introduction of new marketing initiatives targeting our "prime of life" consumer base, but we do not anticipate these efforts to result in meaningful direct written premium growth until 2016.

Although our results were favorably impacted by fewer and less severe catastrophe events during the year, our goal is to achieve strong underwriting profitability through disciplined underwriting, responsive and adequate pricing and superior performance levels in our claim organization.

Business Insurance

Our 2014 business insurance net written premiums increased 3.8% when compared to 2013 as a result of focusing our underwriting efforts on larger risks with higher average premiums. This segment's 2014 net loss and ALAE and expense ratios remained the same when compared to 2013. Business insurance underwriting results for the first half of 2014 were impacted by a combination of harsh weather and an increased frequency in large fire losses, primarily related to our Business Owner's Policy ("BOP") product. In response, we identified several classes of business and larger premium accounts that disproportionately impacted our underwriting performance, stopped writing certain classes of business, and reduced the marketing of our BOP product to accounts with premium greater than $25,000.

Specialty Insurance

We have experienced steady premium growth and solid underwriting performance in our specialty insurance segment, excluding the impact of the terminated RED program business. Our E&S property and E&S casualty units have both produced strong and consistent underwriting performance. Our E&S property unit has benefited from disciplined underwriting and fewer than normal catastrophe events, particularly in Florida where the majority of this business is written. Our E&S casualty unit benefited from organic growth as a result of the additions of underwriters in more geographic locations and the 2014 acquisition of Partners General Insurance Agency, a managing general underwriter, by our parent State Auto Mutual. This acquisition should continue to provide growth opportunities in 2015.

In our workers' compensation unit, we focus on a two-pronged "barbell" strategy, with approximately one-half of the our underwriting efforts focused on the "debit mod" market, targeting accounts with premiums in excess of $100,000, and the other half focused on "four wall" classes of business with premiums less than $25,000. This strategy continues to produce strong underwriting performance and we continue to see opportunities to expand into new states and to broaden our distribution network.

Going forward, we believe that our Program business should generate improved underwriting results given our small-to-medium account and association business focus in select states, strong underwriting and claim controls, and rigorous pricing discipline.

Claims

We have completed the transformation of our claim operations by redesigning business processes, restructuring the organization, reducing reliance on third-party vendors, and implementing a new technology platform. We believe that we are now positioned to capitalize on these investments by using analytics to improve our fraud detection, improve our first notice of loss handling, and identify opportunities to improve customer service and speed.

Operations

At the end of 2014, we completed a new sourcing arrangement with a third party that assumed responsibility for maintaining all legacy system applications. This arrangement will allow our IT associates to focus on higher priority strategic initiatives to replace all of our legacy policy administration and billing systems with a new Guidewire platform. The initiatives will take several years to complete and will begin in 2015 with the development and installation of new agent portals designed to improve customer service, enhance productivity and should improve the efficiency with which we quote, bind, issue and service our policies.

Moving forward

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 by growing book value and surplus through our strong underwriting performance.

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. Except as otherwise noted, there were no changes to the participants or to their participation percentages during 2014.

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(1)	34.5	
SA Wisconsin	0.0	
Meridian Security	0.0	
Patrons Mutual(2)	0.5	
RIC	0.0	
Plaza	0.0	
American Compensation	0.0	
Bloomington Compensation	0.0	
Total State Auto Mutual Pooled Companies	35.0	%

(1) Includes the pooling participation percentage of Meridian Citizens Mutual which was merged into State Auto Mutual as of the close of business on July 2, 2014. Meridian Citizen Mutual's pooling participation percentage was 0.5% from January 1, 2011 to July 2, 2014.

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, 2014, 2013 and 2012:

($ millions, except per share data)	2014	2013	2012
GAAP Basis:			
Total revenues	$ 1,172.7	$ 1,153.0	$ 1,150.1
Net income	$ 107.4	$ 60.8	$ 10.7
Stockholders' equity	$ 872.9	$ 785.0	$ 737.2
Book value per share	$ 21.32	$ 19.27	$ 18.22
Return on average equity	13.0 %	8.0 %	1.5 %
Debt to capital ratio	10.4 %	11.4 %	13.6 %
Cat loss and ALAE ratio	3.0 %	3.4 %	6.4 %
Non-cat loss and LAE ratio	68.8 %	64.8 %	68.3 %
Loss and LAE ratio	71.8 %	68.2 %	74.7 %
Expense ratio	33.7 %	33.6 %	33.2 %
Combined ratio	105.5 %	101.8 %	107.9 %
Premiums written growth	12.4 %	0.6 %	(17.8)%
Investment yield	3.5 %	3.4 %	3.5 %
SAP Basis:			
Cat loss and ALAE points	3.0 %	3.4 %	6.4 %
Non-cat loss and ALAE	62.1 %	58.6 %	61.7 %
ULAE	6.5 %	6.5 %	6.7 %
Loss and LAE ratio	71.6 %	68.5 %	74.8 %
Expense ratio	34.4 %	34.5 %	33.6 %
Combined ratio	106.0 %	103.0 %	108.4 %
Net premiums written to surplus	1.5	1.4	1.7

Our 2014 net income was $107.4 million compared to 2013 and 2012 net income of $60.8 million and $10.7 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 2014 results as compared to 2013 and 2012:

- Earned premiums in 2014 were $1,074.1 million compared to $1,055.0 million and $1,042.1 million in 2013 and 2012, respectively. Earned premium growth in 2014 was driven by higher average new business premium, increased renewal pricing, and the addition of new distribution relationships.
- The 2014 catastrophe loss ratio was 3.0% compared to 3.4% and 6.4% for 2013 and 2012, respectively. The improvement was primarily the result of fewer and less severe catastrophe events during 2014.
- The SAP non-catastrophe loss and ALAE ratio for 2014 was 62.1% compared to 58.6% and 61.7% for 2013 and 2012, respectively. The ratios 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, $21.3 million in 2013 and $30.5 million in 2012. In addition, the HO QS Arrangement increased our SAP non-catastrophe loss and ALAE ratio 3.4 points in 2014, 2.8 points in 2013 and 2.3 points in 2012.
- Our 2014 net income was favorably impacted by the recognition of $19.0 million of profit commission from the HO QS Arrangement. The HO QS Arrangement reduced our GAAP expense ratio by 0.9 points in 2014 and increased our GAAP expense ratios by 0.6 points in 2013 and 2012, respectively.

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 "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 "Critical Accounting Policies – Pension and Postretirement Benefit Obligations 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, 2013 and 2012, (ii) exclude the one-time impact of the unearned premium transfer associated with the termination of the HO QS Arrangement at December 31, 2014, (iii) exclude the impact of the unearned premium transfer associated with the termination of the umbrella quota share reinsurance agreement for the year ended December 31, 2012, and (iv) exclude the impact of the terminated RED program business, which is in run-off. 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, 2013 and 2012, and (b) perform a meaningful comparison of our results of operations for the years ended December 31, 2014, 2013 and 2012. We have also included Reconciliation Tables 1-9 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 year ended December 31, 2014, the Company recognized $19.0 million of profit commission, 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, 2013 and 2012.

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 %

Reconciliation Table 3

($ millions)	GAAP HO QS Arrangement Cession - Overall Results		
December 31, 2012	As Reported	HO QS Cession	Pro Forma without HO QS Cession
Net written premiums	$ 1,055.3	$ 172.3	$ 1,227.6
Earned premiums	1,042.1	166.2	1,208.3
Losses and LAE incurred:			
Cat loss and ALAE	67.1	49.5	116.6
Non-cat loss and LAE	711.2	74.5	785.7
Total Loss and LAE incurred	778.3	124.0	902.3
Acquisition and operating expenses	345.9	48.2	394.1
Net underwriting loss	$ (82.1)	$ (6.0)	$ (88.1)
Cat loss and ALAE ratio	6.4 %	29.8 %	9.6 %
Non-cat loss and LAE ratio	68.3 %	44.8 %	65.0 %
Total Loss and LAE ratio	74.7 %	74.6 %	74.6 %
Expense ratio	33.2 %	29.0 %	32.6 %
Combined ratio	107.9 %	103.6 %	107.2 %

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 and 2012.

Reconciliation Table 4

($ 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	666.9	66.8	733.7
Total Loss and ALAE	699.2	85.8	785.0
ULAE	69.4	—	69.4
Total Loss and LAE incurred	768.6	85.8	854.4
Underwriting expenses	411.3	43.2	454.5
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	62.1 %	38.1 %	58.7 %
Total loss and ALAE ratio	65.1 %	48.9 %	62.8 %
ULAE ratio	6.5 %	— %	5.6 %
Total loss and LAE ratio	71.6 %	48.9 %	68.4 %
Expense ratio	34.4 %	51.9 %	35.6 %
Combined ratio	106.0 %	100.8 %	104.0 %

Reconciliation Table 5

($ 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 %

Reconciliation Table 6

($ millions)	SAP HO QS Arrangement Cession—Overall Results		
December 31, 2012	As Reported	HO QS Cession	Pro Forma without HO QS Cession
Net written premiums	$ 1,055.3	$ 172.3	$ 1,227.6
Earned premiums	1,042.1	166.2	1,208.3
Losses and LAE incurred:			
Cat loss and ALAE	67.1	49.5	116.6
Non-cat loss and ALAE	643.0	74.5	717.5
Total Loss and ALAE	710.1	124.0	834.1
ULAE	68.9	—	68.9
Total Loss and LAE incurred	779.0	124.0	903.0
Underwriting expenses	355.1	50.0	405.1
Net underwriting loss	$ (92.0)	$ (7.8)	$ (99.8)
Cat loss and ALAE ratio	6.4 %	29.8 %	9.6 %
Non-cat loss and ALAE ratio	61.7 %	44.8 %	59.4 %
Total loss and ALAE ratio	68.1 %	74.6 %	69.0 %
ULAE ratio	6.7 %	— %	5.7 %
Total loss and LAE ratio	74.8 %	74.6 %	74.7 %
Expense ratio	33.6 %	29.0 %	33.0 %
Combined ratio	108.4 %	103.6 %	107.7 %

See additional pro forma reconciliation tables for the HO QS Arrangement cession on our homeowners line of business at Reconciliation Tables 7-9.

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, 2014, 2013 and 2012:

($ millions)	2014							
	Personal	% Ratio	Business	% Ratio	Specialty	% Ratio	Total[3]	% Ratio
Written premiums[1]	$532.1		$389.2		$272.9		$1,194.2	
Earned premiums	451.4		381.8		240.9		1,074.1	
Cat loss and ALAE	13.9	3.1	16.5	4.3	1.9	0.8	32.3	3.0
Non-cat loss and ALAE	260.9	57.8	196.7	51.5	209.3	86.9	666.9	62.1
ULAE	43.5	9.6	18.1	4.7	7.8	3.3	69.4	6.5
Underwriting expenses[2]	144.8	27.2	159.0	40.9	107.5	39.4	411.3	34.4
SAP underwriting loss and SAP combined ratio	$(11.7)	97.7	$(8.5)	101.4	$(85.6)	130.4	$(105.8)	106.0

($ millions)	2013							
	Personal	% Ratio	Business	% Ratio	Specialty	% Ratio	Total[3]	% Ratio
Written premiums	$465.4		$374.8		$221.9		$1,062.1	
Earned premiums	464.0		364.2		226.8		1,055.0	
Cat loss and ALAE	14.0	3.0	20.9	5.7	1.4	0.6	36.3	3.4
Non-cat loss and ALAE	285.8	61.6	181.9	50.0	150.0	66.2	617.7	58.6
ULAE	42.4	9.1	19.0	5.2	7.3	3.2	68.7	6.5
Underwriting expenses	134.4	28.9	152.6	40.7	79.3	35.7	366.3	34.5
SAP underwriting loss and SAP combined ratio	$(12.6)	102.6	$(10.2)	101.6	$(11.2)	105.7	$(34.0)	103.0

($ millions)	2012							
	Personal	% Ratio	Business	% Ratio	Specialty	% Ratio	Total[3]	% Ratio
Written premiums	$469.5		$349.4		$236.4		$1,055.3	
Earned premiums	469.8		327.2		245.1		1,042.1	
Cat loss and ALAE	26.9	5.7	37.8	11.5	2.4	1.0	67.1	6.4
Non-cat loss and ALAE	276.7	58.9	165.7	50.7	200.6	81.8	643.0	61.7
ULAE	41.2	8.8	19.0	5.8	8.7	3.5	68.9	6.7
Underwriting expenses	126.6	27.0	147.0	42.1	81.5	34.4	355.1	33.6
SAP underwriting loss and SAP combined ratio	$(1.6)	100.4	$(42.3)	110.1	$(48.1)	120.7	$(92.0)	108.4

(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 4, 5 and 6 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, 2014, 2013 and 2012.

Table 1

($ millions)	2014	2013	2012
Net Written Premiums			
Personal auto	$354.4	$377.2	$383.6
Homeowners[1]	146.4	58.8	56.5
Other personal	31.3	29.4	29.4
Total personal	$532.1	$465.4	$469.5

[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, 2014, 2013 and 2012:

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
2014							
Personal auto	$362.6	$7.0	$228.6	$235.6	1.9	63.1	65.0
Homeowners	58.8	5.5	21.3	26.8	9.4	36.1	45.5
Other personal	30.0	1.4	11.0	12.4	4.5	36.9	41.4
Total personal	$451.4	$13.9	$260.9	$274.8	3.1	57.8	60.9
ULAE	—	—	—	43.5	—	—	9.6
Total Loss and LAE	$451.4	$13.9	$260.9	$318.3	3.1	57.8	70.5
2013							
Personal auto	$378.4	$4.6	$253.0	$257.6	1.2	66.9	68.1
Homeowners	56.1	6.8	20.9	27.7	12.2	37.4	49.6
Other personal	29.5	2.6	11.9	14.5	8.6	40.5	49.1
Total personal	$464.0	$14.0	$285.8	$299.8	3.0	61.6	64.6
ULAE	—	—	—	42.4	—	—	9.1
Total Loss and LAE	$464.0	$14.0	$285.8	$342.2	3.0	61.6	73.7
2012							
Personal auto	$382.0	$10.7	$242.5	$253.2	2.8	63.4	66.2
Homeowners	59.7	8.5	23.2	31.7	14.3	38.9	53.2
Other personal	28.1	7.7	11.0	18.7	27.4	39.3	66.7
Total personal	$469.8	$26.9	$276.7	$303.6	5.7	58.9	64.6
ULAE	—	—	—	41.2	—	—	8.8
Total Loss and LAE	$469.8	$26.9	$276.7	$344.8	5.7	58.9	73.4

The personal insurance segment's net written premiums increased 14.3% compared to the same 2013 period (Table 1). Net written premiums for the year ended December 31, 2014 reflect the expiration of the HO QS Arrangement, effective December 31, 2014, which resulted in a return of $89.5 million of unearned premium previously ceded under the agreement. Excluding the impact of the homeowners cession and the expiration of the HO QS Arrangement, pro forma net written premiums decreased 4.2%[(1)] , primarily due to a decline in the personal auto net written premiums of 6.0% compared to the same 2013 period (Table 1). The decline in personal auto net written premiums was primarily the result of continued efforts to improve personal auto profitability, as well as the continued remediation of our homeowners line of business that included, among other things, pricing and agency management actions.

(1) For the years ended December 31, 2014 and 2013, respectively, the following table sets forth the reconciliation of as reported net written premiums to pro forma net written premiums that exclude the impact of the return of unearned premium associated with the termination of the HO QS Arrangement:

($ millions)	2014	2013	% Change
Net written premiums:			
Personal insurance segment	$532.1	$465.4	14.3
Homeowners cession	172.8	176.9	(2.3)
Return of ceded premium	(89.5)	—	—
Pro forma net written premiums	$615.4	$642.3	(4.2)

We continue to utilize the following additional strategies to improve our homeowners results:

- CustomFit[SM] homeowners: Since 2011, we have rolled out CustomFit, our by-peril rating approach, in all states except North Carolina (which has regulatory restrictions).
- Insurance to value: We continue to focus on insurance to value so that our insureds maintain an amount of coverage sufficient to replace their home and contents in the case of a total loss. Proper insurance to value ensures that our premiums are commensurate with our loss exposure. During 2013, we integrated our insurance to value review with our underwriting workflow. We deployed a model that allows us to identify homeowner risks that have a high probability of having insurance to value gaps. This model allows us to optimize our insurance to value reports, which has led to additional cost savings.
- Wind and hail deductibles: We continue to analyze each state's wind and hail deductible, and all peril deductibles, at each annual rate review, making adjustments where necessary. We have implemented mandatory wind and hail deductibles in all targeted catastrophe prone states.

These actions have led to a reduction in companion automobile policies as a high percentage of our auto and homeowners policies are cross-sold. In an effort to attract new personal auto business, we introduced a new "Start-up Discount" in 2014 that recognizes longevity with the insured's previous carrier. The Start-up Discount was introduced in 18 states as of December 31, 2014, and we plan to introduce it in the remaining states by the end of 2015.

The personal insurance segment's SAP catastrophe loss ratio for the year ended December 31, 2014 was 3.1%, compared to 3.0% and 5.7% for the same 2013 and 2012 periods, respectively. The personal auto SAP catastrophe loss ratio increased slightly compared to the same 2013 period (Table 2), primarily due to catastrophe events in Colorado and Texas during 2014. Partially offsetting the personal auto increase were improvements in both the as reported homeowners and other personal SAP catastrophe loss ratios of 2.8 points and 4.1 points, respectively, when compared to the same 2013 period (Table 2). The improvements were attributable to a combination of successful remediation efforts in our homeowners line of business, where we have reduced our exposure in previously identified unprofitable states, and fewer and less severe catastrophe events during the year as compared to the same 2013 and 2012 periods, respectively. The 2013 SAP catastrophe loss ratio improved as a result of underwriting actions, rate increases and a return to better weather patterns when compared to 2012, when catastrophe losses were primarily related to a tornado, wind and hail activity in Louisville, Kentucky, and St. Louis, Missouri and wind activity from a storm in the Midwest and Mid-Atlantic states.

The personal insurance segment’s SAP non-catastrophe loss and ALAE ratio for the year ended December 31, 2014 was 57.8%, compared to 61.6% and 58.9% for the same 2013 and 2012 periods (Table 2). The 2014 improvement was primarily driven by the personal auto SAP non-catastrophe loss & ALAE ratio decline of 3.8 points compared to the same 2013 period (Table 2), as a result of improved personal injury protection and physical damage results, as well as the impact of prior year rate increases. In addition, our pricing and agency management actions in Arizona, Colorado, Georgia, Illinois and Michigan have reversed the unfavorable loss ratio trends in those states. Our remediation efforts in these five states will continue in 2015.

The following tables set forth, on a SAP and pro forma basis, certain of our key performance indicators for the homeowners line of business before and after the impact of the HO QS Arrangement cession for the year ended December 31, 2014 and 2013 and 2012:

Reconciliation Table 7

($ millions)	SAP HO QS Arrangement Cession – Homeowners		
December 31, 2014	As Reported	HO QS Cession	Pro-Forma without HO QS Cession
Net written premiums	$146.4	$83.3	$229.7
Earned premiums	58.8	175.6	234.4
Losses and LAE incurred:			
Cat loss and ALAE	5.5	19.0	24.5
Non-cat loss and ALAE	21.3	66.8	88.1
Total Loss and ALAE incurred	$26.8	$85.8	$112.6
Cat loss and ALAE ratio	9.4 %	10.8 %	10.5 %
Non-cat loss and ALAE ratio	36.1 %	38.1 %	37.6 %
Total Loss and ALAE ratio	45.5 %	48.9 %	48.1 %

Reconciliation Table 8

($ millions)	SAP HO QS Arrangement Cession – Homeowners		
December 31, 2013	As Reported	HO QS Cession	Pro-Forma without HO QS Cession
Net written premiums	$58.8	$176.9	$235.7
Earned premiums	56.1	177.0	233.1
Losses and LAE incurred:			
Cat loss and ALAE	6.8	22.7	29.5
Non-cat loss and ALAE	20.9	70.0	90.9
Total Loss and ALAE incurred	$27.7	$92.7	$120.4
Cat loss and ALAE ratio	12.2 %	12.9 %	12.7 %
Non-cat loss and ALAE ratio	37.4 %	39.5 %	39.0 %
Total Loss and ALAE ratio	49.6 %	52.4 %	51.7 %

Reconciliation Table 9

($ millions)	SAP HO QS Arrangement Cession – Homeowners		
December 31, 2012	As Reported	HO QS Cession	Pro-Forma without HO QS Cession
Net written premiums	$ 56.5	$ 172.3	$ 228.8
Earned premiums	59.7	166.2	225.9
Losses and LAE incurred:			
Cat loss and ALAE	8.5	49.5	58.0
Non-cat loss and ALAE	23.2	74.5	97.7
Total Loss and ALAE incurred	$ 31.7	$ 124.0	$ 155.7
Cat loss and ALAE ratio	14.3 %	29.8 %	25.7 %
Non-cat loss and ALAE ratio	38.9 %	44.8 %	43.2 %
Total Loss and ALAE ratio	53.2 %	74.6 %	68.9 %

Business Insurance Segment

The following table sets forth the net written premiums by major product line of business for our business insurance segment for the years ended December 31, 2014, 2013 and 2012.

Table 3

($ millions)	2014	2013	2012
Net Written Premiums			
Commercial auto	$ 101.8	$ 96.2	$ 88.4
Commercial multi-peril	121.4	113.5	101.1
Fire & allied lines	76.9	77.8	75.6
Other & product liability	71.4	69.5	66.5
Other commercial	17.7	17.8	17.8
Total business	$ 389.2	$ 374.8	$ 349.4

The following table sets forth the SAP loss and ALAE ratios by major product line of business for our business insurance segment with the catastrophe and non-catastrophe impact shown separately for the years ended December 31, 2014, 2013 and 2012:
Table 4
($ millions)

Statutory Loss and LAE Ratios	Earned Premium	Cat Loss & ALAE	Non-Cat Loss & ALAE	Statutory Loss & LAE	Cat loss Ratio	Non-Cat loss Ratio	Total Loss and LAE Ratio
2014							
Commercial auto	$98.5	$0.8	$56.6	$57.4	0.8	57.5	58.3
Commercial multi-peril	118.0	7.0	68.1	75.1	6.0	57.6	63.6
Fire & allied lines	77.4	8.7	34.1	42.8	11.3	44.0	55.3
Other & product liability	70.2	—	32.6	32.6	—	46.5	46.5
Other commercial	17.7	—	5.3	5.3	(0.3)	30.3	30.0
Total business	$381.8	$16.5	$196.7	$213.2	4.3	51.5	55.8
ULAE	—	—	—	18.1	—	—	4.7
Total Loss and LAE	$381.8	$16.5	$196.7	$231.3	4.3	51.5	60.5
2013							
Commercial auto	$93.0	$0.8	$53.2	$54.0	0.9	57.1	58.0
Commercial multi-peril	108.1	11.2	57.1	68.3	10.3	52.9	63.2
Fire & allied lines	77.0	8.6	28.6	37.2	11.1	37.3	48.4
Other & product liability	68.0	—	35.6	35.6	—	52.3	52.3
Other commercial	18.1	0.3	7.4	7.7	2.0	40.4	42.4
Total business	$364.2	$20.9	$181.9	$202.8	5.7	50.0	55.7
ULAE	—	—	—	19.0	—	—	5.2
Total Loss and LAE	$364.2	$20.9	$181.9	$221.8	5.7	50.0	60.9
2012							
Commercial auto	$81.4	$0.7	$51.6	$52.3	0.9	63.3	64.2
Commercial multi-peril	94.3	13.0	52.8	65.8	13.8	55.9	69.7
Fire & allied lines	74.5	23.8	22.9	46.7	31.9	30.8	62.7
Other & product liability	59.3	—	33.6	33.6	—	56.8	56.8
Other commercial	17.7	0.3	4.8	5.1	1.3	27.3	28.6
Total business	$327.2	$37.8	$165.7	$203.5	11.5	50.7	62.2
ULAE	—	—	—	19.0	—	—	5.8
Total Loss and LAE	$327.2	$37.8	$165.7	$222.5	11.5	50.7	68.0

Net written premiums for the business insurance segment for the years ended December 31, 2014 and 2013 increased 3.8% and 7.3%, respectively, compared to the same 2013 and 2012 periods. The 2014 increase in premiums was primarily due to growth in commercial auto and commercial multi-peril, resulting from (i) writing policies with larger average premiums for new business accounts, (ii) achieving price increases in the low-single digits, and (iii) higher retention. The 2013 increase in premiums was primarily due to (i) writing larger average premium new business accounts, (ii) achieving price increases in the high single digits, and (iii) experiencing more growth on existing polices due to improved economic conditions. Net written premiums for the year ended December 31, 2012 reflected the impact of the termination of an umbrella quota share reinsurance agreement, effective July 1, 2012, and included $7.2 million related to the transfer of unearned premium remaining under the agreement.
We are in the process of implementing several strategies to capitalize on opportunities to grow our business insurance segment. With the implementation of Business Insurance Evolution ("BIE") in 2013, our ongoing initiative to

automate our small commercial accounts with premiums less than $25,000, we have been able to shift our underwriting focus from smaller to larger commercial accounts. Through our practice group initiative, we provide expertise for all lines of insurance solutions for niche or target markets, with a focus on writing premiums in excess of $25,000. For example, in 2013, we launched our food industry practice group, which focuses on food manufacturing and processing risks. We continue to identify industries and areas of focus where we believe we have underwriting expertise and look to expand into those markets through 2015.

BIE has proven successful as we continue to increase the number of small commercial accounts processed without human intervention. As we move forward, we are also looking to automate the processing of new business, provide more consistent pricing and underwriting service to our agents and insureds, and improving our overall efficiency.

The business insurance segment's SAP non-catastrophe loss and ALAE ratio for the year ended December 31, 2014 was 51.5% compared to 50.0% and 50.7%, respectively for the same 2013 and 2012 periods (Table 4). The increase was primarily driven by commercial multi-peril and fire & allied lines SAP non-catastrophe loss and ALAE ratio increases of 4.7 points and 6.7 points, respectively, when compared to the same 2013 period (Table 4). The commercial multi-peril increase was driven by an increase in large loss activity during the third quarter of 2014 in addition to wind events, large fire losses and the extreme cold weather during the first quarter of 2014. The fire & allied lines increase was driven by large fire losses during the first half of 2014 and the extreme cold weather during the first quarter of 2014. Partially offsetting these increases were improvements in other & product liability and other commercial compared to the same 2013 period (Table 4). These improvements were primarily the result of prior period rate actions emerging in earned premiums and greater favorable development of prior accident year losses in 2014 compared to 2013.

The business insurance segment's 2013 SAP non-catastrophe loss and ALAE ratio improved by 0.7 points when compared to the same 2012 period (Table 4). This improvement was primarily driven by prior period rate increases taken on all lines of business in this segment. The commercial auto and other & product liability SAP non-catastrophe loss and ALAE ratios improved 6.2 points and 4.5 points, respectively, when compared to the same 2012 period (Table 4), primarily as the result of an increase in earned premiums and greater favorable development of prior accident year losses. The improvement was partially offset by an increase in the fire & allied SAP non-catastrophe loss and ALAE ratio of 6.5 points, compared to the same 2012 period (Table 4) primarily driven by an increase in the severity of losses.

The business insurance segment's SAP catastrophe loss and ALAE ratio for 2014 was 4.3% compared to 5.7% and 11.5%, respectively, for the same 2013 and 2012 periods (Table 4). The improvements in 2014 and 2013 were primarily due to fewer and less severe catastrophe events during the years ended 2014 and 2013 when compared to the same 2013 and 2012 periods.

Specialty Insurance Segment

In our specialty insurance segment, we offer commercial coverages that require specialized product underwriting, claims handling or risk management services through a distribution channel of retail agents and wholesale brokers, which may include program administrators and other specialty sources.

Effective January 1, 2013, the units within the specialty insurance segment changed from the three units of RED, Rockhill and Workers' compensation to the four units of E&S property, E&S casualty, Programs (which includes the former RED unit) and Workers' compensation. Previously reported financial information has been revised to reflect the effect of the change in units.

The following table sets forth the net written premiums by unit for our specialty insurance segment for the years ended December 31, 2014, 2013 and 2012.

Table 5

($ millions)	2014	2013	2012
Net Written Premiums			
E&S property	$40.5	34.7	25.4
E&S casualty	60.9	42.0	36.1
Programs	87.6	73.2	106.1
Workers' compensation	83.9	72.0	68.8
Total specialty	$272.9	$221.9	$236.4

The following table sets forth the SAP loss and LAE ratios for our specialty insurance segment with the catastrophe and non-catastrophe impact shown separately for the years ended December 31, 2014, 2013 and 2012:
Table 6
($ millions)

Statutory Loss and LAE Ratios	Earned Premium	Cat Loss & ALAE	Non-Cat Loss & ALAE	Statutory Loss & LAE	Cat loss Ratio	Non-Cat loss Ratio	Total Loss and LAE Ratio
2014							
E&S property	$38.1	$1.9	$1.9	$3.8	4.8	5.2	10.0
E&S casualty	48.6	—	20.0	20.0	—	41.3	41.3
Programs	76.1	—	141.5	141.5	—	185.7	185.7
Workers' compensation	78.1	—	45.9	45.9	—	58.8	58.8
Total specialty	$240.9	$1.9	$209.3	$211.2	0.8	86.9	87.7
ULAE	—	—	—	7.8	—	—	3.3
Total Loss and LAE	$240.9	$1.9	$209.3	$219.0	0.8	86.9	91.0
2013							
E&S property	$31.1	$1.3	$3.9	$5.2	4.2	12.5	16.7
E&S casualty	39.3	—	20.3	20.3	—	51.7	51.7
Programs	87.1	0.1	87.4	87.5	0.2	100.2	100.4
Workers' compensation	69.3	—	38.4	38.4	—	55.5	55.5
Total specialty	$226.8	$1.4	$150.0	$151.4	0.6	66.2	66.8
ULAE	—	—	—	7.3	—	—	3.2
Total Loss and LAE	$226.8	$1.4	$150.0	$158.7	0.6	66.2	70.0
2012							
E&S property	$20.4	$0.3	$1.0	$1.3	1.6	4.8	6.4
E&S casualty	33.7	—	13.3	13.3	—	39.5	39.5
Programs	124.2	2.1	136.3	138.4	1.6	109.9	111.5
Workers' compensation	66.8	—	50.0	50.0	—	74.8	74.8
Total specialty	$245.1	$2.4	$200.6	$203.0	1.0	81.8	82.8
ULAE	—	—	—	8.7	—	—	3.5
Total Loss and LAE	$245.1	$2.4	$200.6	$211.7	1.0	81.8	86.3

Net written premiums for the specialty insurance segment for the year ended December 31, 2014 increased 23.0% when compared to the same 2013 period (Table 5). The increase in premiums was primarily due to (i) new business growth in our E&S property unit, (ii) growth in our E&S casualty unit due to the addition of underwriters in more geographic locations and new distribution relationships, including Partners General Insurance Agency which was acquired by our parent State Auto Mutual in the second quarter 2014, (iii) rate increases and new programs in the Programs unit, and (iv) rate increases and new business growth in our Workers' compensation unit.

The specialty insurance segment's SAP non-catastrophe loss and ALAE ratio for the year ended December 31, 2014 was 86.9%, compared to 66.2% and 81.8%, respectively, for the same 2013 and 2012 periods (Table 6). The SAP non-catastrophe loss and ALAE ratio increase was primarily driven by reserve strengthening for terminated RED program business which is in run-off. Beginning in the third quarter 2013, we increased our involvement in managing litigated and higher severity RED program claim files. During the third quarter 2014, we assumed full file management of claim files for certain terminated RED programs from the third party administrators that had been managing the claims and performed a detailed, ground up analysis of those files, which we completed in the fourth quarter 2014. For the year ended December 31, 2014, RED reserves were strengthened by $96.7 million, which included the net cost of the ADC reinsurance agreement, compared to reserve strengthening in 2013 and 2012 of

$21.3 million and $30.5 million, respectively.

In addition to the 2014 reserve strengthening, the State Auto Group entered into an ADC reinsurance agreement as of December 31, 2014, that provides $40.0 million of coverage for adverse development in excess of carried reserves for the terminated RED restaurant program, which represented approximately 59.0% of carried RED reserves at December 31, 2014. Partially offsetting the impact of the RED reserve strengthening were improvements in the SAP non-catastrophe loss and ALAE ratios for the E&S property and E&S casualty units for the year ended December 31, 2014.

The E&S property unit's 2014 SAP non-catastrophe loss and ALAE ratio improved 7.3 points when compared to the same 2013 period (Table 6), primarily due to prior year rate actions emerging in earned premiums and favorable prior accident year development. The E&S property unit's 2013 SAP non-catastrophe loss and ALAE ratio increased 7.7 points, when compared to the same 2012 period (Table 6), primarily due to favorable prior accident year development in 2012 that affected year- over- year comparisons.

The E&S casualty unit's 2014 SAP non-catastrophe loss and ALAE ratio improved 10.4 points, when compared to the same 2013 period (Table 6), primarily due to prior year rate actions emerging in earned premiums. The E&S casualty unit's 2013 SAP non-catastrophe loss and ALAE ratio increased 12.2 points when compared to the same 2012 period (Table 6), primarily due to greater prior year favorable development in 2012 compared to prior accident year favorable development in 2013.

The strategy of the Workers' compensation unit focuses on accounts under $25,000 and debit mod accounts over $100,000 with higher average losses driven mostly by injuries that impact soft tissue. The Workers' compensation unit's 2014 SAP non-catastrophe loss and ALAE ratio was 58.8% compared to 55.5% and 74.8% for 2013 and 2012, respectively (Table 6). The 3.3 point increase in the Workers' compensation unit's 2014 SAP non-catastrophe loss and ALAE ratio compared to the same 2013 period (Table 6), was primarily driven by greater prior year favorable development in 2013 compared to 2014. The improvement from 2012 to 2013 was primarily due to favorable reserve development of prior accident years in 2013 as compared to 2012. The favorable development in 2013 was primarily attributable to better than anticipated severity emerging across all accident years, with approximately one third coming from accident year 2012.

Acquisition and Operating Expenses

Our GAAP expense ratio was 33.7% in 2014 compared to 33.6% and 33.2% in 2013 and 2012, respectively.

Our acquisition and operating expenses were $361.9 million in 2014 compared to $354.8 million and $345.9 million in 2013 and 2012, respectively. The change from 2013 to 2014 was primarily a result of (i) $4.6 million of employee severance expenses recognized as a result of the reorganization of our IT department and (ii) increased contingent commissions and incentive compensation expenses. Partially offsetting these increases was the recognition of $19.0 million of profit commission in accordance with the terms of the HO QS Arrangement. The change from 2012 to 2013 was primarily driven by increases in agent and employee incentive compensation.

Loss and LAE Development

Losses and loss expenses for a calendar year represent the combined estimated ultimate liability for claims occurring in the current calendar year along with any change in estimated ultimate liability for claims occurring in prior years. The following table sets forth the provision for losses and loss expenses for those claims occurring in the current and prior years, along with the GAAP loss and LAE ratio for the years ended December 31, 2014, 2013 and 2012:

($ millions)	2014	% GAAP Loss and LAE Ratio	2013	% GAAP Loss and LAE Ratio	2012	% GAAP Loss and LAE Ratio
Provision for losses and loss expenses occurring:						
Current year	$726.2	67.6	$741.0	70.2	$795.2	76.3
Prior years	45.1	4.2	(21.2)	(2.0)	(16.9)	(1.6)
Total losses and loss expenses	$771.3	71.8	$719.8	68.2	$778.3	74.7

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As shown above, the 2014 loss and loss expenses attributable to prior years was $45.1 million, or an unfavorable development, in the estimated ultimate liability for prior years' claims. The following table sets forth a tabular presentation of the adverse development by accident year for the year ended December 31, 2014:

($ millions) Accident Year	Current Year Development of Ultimate Liability Redundancy /(Deficiency)
2004 and prior	$ 1.4
2005	0.3
2006	0.5
2007	0.5
2008	1.3
2009	3.9
2010	(4.5)
2011	(21.4)
2012	(37.2)
2013	10.1
Total	$ (45.1)

While emergence by accident year includes normal fluctuations due to the uncertainty associated with loss reserve development and claim settlement, the adverse development in 2014 resulted primarily from accident years 2012 and 2011. The more notable items contributing to the 2014 development were as follows:

- ULAE was $12.5 million lower than anticipated in the reserves at December 31, 2013.
- We experienced favorable catastrophe loss development of $5.2 million in 2014 related to catastrophe losses primarily from accident year 2013.
- In the personal and business insurance segments, the non-catastrophe loss and ALAE reserves contributed $23.1 million of favorable development. The business insurance segment contributed $16.7 million of this favorable development, driven by other & product liability and commercial auto, which developed favorably by $11.9 million and $5.3 million, respectively. The favorable development in these lines was driven by lower than anticipated severity from accident years 2012 and prior. The personal insurance segment contributed $6.4 million of this favorable development, primarily from accident year 2013.
- In the specialty insurance segment, the non-catastrophe loss and ALAE reserves accounted for $85.9 million of adverse development related primarily to accident years 2011 and 2012, which was driven by RED reserve strengthening. Adverse development of prior accident year RED reserves was $96.7 million. Somewhat offsetting the unfavorable development of RED reserves was favorable development of $5.7 million in the Workers' compensation unit, $3.9 million in the E&S property unit and $2.1 million in the E&S casualty unit. Favorable development in these lines was driven by better than anticipated severity emerging primarily from the 2012 and 2013 accident years.

The following table sets forth a tabular presentation of the favorable development by accident year for the year ended December 31, 2013:

($ millions) Accident Year	Current Year Development of Ultimate Liability Redundancy /(Deficiency)
2003 and prior	$ (0.9)
2004	0.9
2005	(0.1)
2006	0.4
2007	1.3
2008	0.8
2009	4.8
2010	7.1
2011	2.8
2012	4.1
Total	$ 21.2

The favorable development in 2013 resulted primarily from accident years 2012, 2011, 2010 and 2009. The more notable items contributing to the 2013 favorable development were:

- ULAE was $8.0 million lower than anticipated in the reserves at December 31, 2012.
- We experienced favorable catastrophe loss development of $5.4 million in 2013 related to catastrophe losses primarily from accident year 2012.
- In the personal and business insurance segments, the non-catastrophe loss and ALAE reserves contributed $18.3 million of favorable development related to the prior four accident years, primarily in the other & product liability, commercial auto and homeowners with $8.3 million, $8.0 million and $2.9 million of the favorable development, respectively. The favorable development in these lines was driven by lower than anticipated severity in the casualty lines.
- In the specialty insurance segment, the non-catastrophe loss and ALAE reserves contributed $10.5 million of adverse development related to the prior three accident years, which was driven by RED reserve strengthening. Somewhat offsetting the unfavorable development was favorable development of prior accident year non-catastrophe loss and ALAE reserves of $10.9 million in 2013, of which $12.3 million related to the Workers' compensation unit. The favorable Workers' compensation unit development was primarily attributable to better than anticipated severity emerging across all accident years, with approximately one third coming from accident year 2012. Adverse development of prior accident year RED reserves was $21.3 million, more than offsetting the favorable development reported by non-RED specialty insurance segment units.

The following table sets forth a tabular presentation of the favorable development by accident year for the year ended December 31, 2012:

($ millions) Accident Year	Current Year Development of Ultimate Liability Redundancy /(Deficiency)
2002 and prior	$ 0.9
2003	0.2
2004	0.3
2005	—
2006	(0.1)
2007	2.4
2008	2.3
2009	4.9
2010	8.0
2011	(2.0)
Total	$ 16.9

The favorable development in 2012 resulted primarily from accident years 2011 and 2010. The more notable items contributing to the 2012 favorable development were:

- ULAE was $6.3 million lower than anticipated in the reserves at December 31, 2011.
- We experienced favorable catastrophe loss development of $10.4 million in 2012 related to the higher level of catastrophe losses we experienced in accident year 2011.
- In the personal and business insurance segments, the non-catastrophe loss and ALAE reserves contributed $28.0 million of favorable development related to the prior three accident years, primarily in the personal auto liability, other & product liability, and fire & allied lines with $10.5 million, $9.4 million and $5.1 million of the favorable development, respectively. The favorable development in these lines was driven by emergence of lower than anticipated claim severity.
- In the specialty insurance segment, the non-catastrophe loss and ALAE reserves contributed $27.8 million of adverse development related to the prior two accident years, which was driven by RED reserve strengthening.

The following table sets forth loss and loss expenses payable by major line of business at December 31, 2014 and 2013:

($ millions)	2014	2013	$ Change
Personal insurance segment:			
Personal auto	$ 176.0	$ 188.8	$ (12.8)
Homeowners	18.2	24.3	(6.1)
Other personal	7.7	10.6	(2.9)
Total personal	201.9	223.7	(21.8)
Business insurance segment:			
Commercial auto	79.0	83.4	(4.4)
Commercial multi-peril	94.2	91.5	2.7
Fire & allied lines	19.9	22.1	(2.2)
Other & product liability	154.2	159.8	(5.6)
Other business	2.5	2.8	(0.3)
Total business	349.8	359.6	(9.8)
Specialty insurance segment:			
Excess & Surplus property	8.3	7.4	0.9
Excess & Surplus casualty	69.9	61.1	8.8
Programs	190.1	150.7	39.4
Workers' compensation	153.6	148.3	5.3
Total specialty	421.9	367.5	54.4
Total losses and loss expenses payable net of reinsurance recoverable on losses and loss expenses payable	$ 973.6	$ 950.8	$ 22.8

The loss and loss expenses payable at December 31, 2014 increased $22.8 million from the loss and loss expenses payable at December 31, 2013. This change reflected an increase of $39.4 million in the Programs unit driven primarily by revised loss and loss expense reserve estimates for the two largest RED programs, both of which are in run-off. Loss and loss expenses payable in our personal auto line of business declined $12.8 million primarily due to a decline in exposure. We conduct quarterly reviews of loss development reports and make judgments in determining the reserves for ultimate losses and loss expenses payable. Several factors are considered by us when estimating ultimate liabilities including consistency in relative case reserve adequacy, consistency in claims settlement practices, recent legal developments, historical data, actuarial projections, exposure changes, anticipated inflation, current business conditions, catastrophe developments, late reported claims, and other analytical reviews.

The risks and uncertainties inherent in our estimates include, but are not limited to, actual settlement experience different from historical data trends, changes in business and economic conditions, court decisions creating unanticipated liabilities, ongoing interpretation of policy provisions by the courts, inconsistent decisions in lawsuits regarding coverage and additional information discovered before settlement of claims. Our results of operations and financial condition could be impacted, perhaps significantly, in the future if the ultimate payments required to settle claims vary from the liability currently recorded.

Investment Operations Segment

Our investment portfolio and the investment portfolios of other members of the State Auto Group are managed by our subsidiary, Stateco. Stateco utilizes its own personnel to invest in fixed maturities, large-cap equities and small-cap equity funds, and outside investment managers to invest in small-cap equities and international funds. The Investment Committee (the “Committee”) of our Board of Directors establishes the investment policies to be followed by Stateco. Our primary investment objectives are to maintain adequate liquidity and capital to meet our responsibilities to policyholders, grow long term economic surplus to increase our capital position, maintain a consistent level of income to support operations and manage investment risk. Our current investment strategy does not rely on the use of derivative financial instruments.

Our decision to make a specific investment is influenced primarily by the following factors: (a) investment risks; (b) general market conditions; (c) relative valuations of investment vehicles; (d) general market interest rates; (e) our liquidity requirements at any given time; and (f) our current federal income tax position and relative spread between after tax yields on tax exempt and taxable fixed maturity investments.

We have investment policy guidelines with respect to purchasing fixed maturity investments for our insurance subsidiaries which preclude investments in bonds that are rated below investment grade by a recognized rating service. For the insurance subsidiaries, the maximum investment in any single note or bond is limited to 5.0% or less of the investment portfolio, other than obligations of the U.S. government or government agencies, for which there is no limit. Our fixed maturity portfolio is composed of high quality, investment grade issues, comprised mostly of debt issues rated A or higher. We obtain investment ratings from Moody's, Standard & Poor's and Fitch. If there is a split rating, we assign the lowest rating obtained. At December 31, 2014, there were no fixed maturity investments rated below investment grade in our available-for-sale investment portfolio.

Our internally managed equity portfolio invests in U.S. large-cap, dividend-paying companies across many different industries selected based upon their potential for appreciation as well as ability to continue paying dividends. This diversification across companies and industries reduces volatility in the value of the large-cap equity portfolio. Our investment policy guidelines limit the purchase of a specific stock to no more than 5.0% of the market value of the stock at the time of purchase, and no single equity holding should exceed 5.0% of the total equity portfolio. In addition, we also invest in U.S. large-cap, dividend-paying exchange traded funds which adds to the diversification of the portfolio by allowing us to invest in a large number of companies via one security.

Our externally managed equity portfolios invest in U.S. small-cap equities and international funds. These managers are permitted to manage the portfolios according to their own respective portfolio objectives. In selecting our outside investment managers we confirm that their portfolio objectives, including risk tolerance, are acceptable to us; however, there may be slight differences in their objectives with respect to dividend payments and other constraints that we apply to our large-cap equity holdings.

At December 31, 2014, our investments in fixed maturities, equity securities and certain other invested assets were held as available-for-sale and carried at fair value. The unrealized holding gains or losses, net of applicable deferred taxes, are included as a separate component of stockholders' equity as accumulated other comprehensive income (loss) and as such are not included in the determination of net income.

Composition of Investment Portfolio

The following table sets forth the composition of our investment portfolio at carrying value at December 31, 2014 and 2013:

($ millions)	2014	% of Total	2013	% of Total
Cash and cash equivalents	$ 86.3	3.5	$ 80.3	3.4
Fixed maturities, at fair value:				
Fixed maturities	1,680.0	68.7	1,630.6	69.9
Treasury inflation-protected securities	211.9	8.7	199.5	8.6
Total fixed maturities	1,891.9	77.4	1,830.1	78.5
Notes receivable from affiliate (1)	70.0	2.9	70.0	3.0
Equity securities, at fair value:				
Large-cap securities	242.2	9.9	194.4	8.4
Small-cap securities	68.2	2.8	70.9	3.0
Total equity securities	310.4	12.7	265.3	11.4
Other invested assets, at fair value:				
International instruments	72.9	3.0	74.2	3.2
Other invested assets	7.4	0.3	6.7	0.3
Total other invested assets, at fair value	80.3	3.3	80.9	3.5
Other invested assets, at cost	5.3	0.2	5.0	0.2
Total portfolio	$ 2,444.2	100.0	$ 2,331.6	100.0

(1) In May 2009, we entered into two separate Credit Agreements with State Auto Mutual. Under these Credit Agreements, State Auto Mutual borrowed a total of $70.0 million from us on an unsecured basis. Interest is payable semi-annually at a fixed annual interest rate of 7.00%. Principal is payable May 2019.

The following table sets forth the amortized cost and fair value of available-for-sale fixed maturities by contractual maturity at December 31, 2014:

($ millions)	Amortized Cost	Fair Value
Due in 1 year or less	$ 55.7	$ 56.5
Due after 1 year through 5 years	369.8	382.4
Due after 5 years through 10 years	299.9	312.4
Due after 10 years	647.2	668.1
U.S. government agencies residential mortgage-backed securities	458.7	472.5
Total	$ 1,831.3	$ 1,891.9

Expected maturities may differ from contractual maturities as issuers may have the right to call or prepay the obligations with or without call or prepayment penalties.

At December 31, 2014, our equity portfolio consisted of approximately 32 different large-cap stocks and 72 small-cap stocks. The largest single fund holding was 16.3% of the equity portfolio based on fair value and the top ten positions accounted for 50.1% of the equity portfolio. At December 31, 2013, our equity portfolio consisted of approximately 40 different large-cap stocks and 76 small-cap stocks. The largest single fund holding was 9.2% of the equity portfolio based on fair value, and the top ten positions accounted for 33.7% of the equity portfolio. Since our equity portfolio consists primarily of large-cap value-oriented stocks, with a smaller allocation to small-cap equities, when large-cap stocks and/or value-oriented stocks perform well our equity portfolio typically performs well compared to benchmarks. Conversely, when growth stocks outperform value and/or small- to mid-cap stocks outperform large-cap stocks, our equity portfolio does not perform as well compared to benchmarks.

Market Risk

Our primary market risk exposures are to changes in market prices for equity securities and changes in interest rates and credit ratings for fixed maturity securities. Our fixed maturity securities are subject to interest rate risk whereby the value of the securities varies as market interest rates change. We manage this risk by closely monitoring the duration of the fixed maturity portfolio. The duration of the fixed maturity portfolio was approximately 4.32 and 4.83 as of December 31, 2014 and 2013, respectively. The following table sets forth our interest rate risk and the effects of a parallel change in interest rates on the fair value of the available-for-sale fixed maturity portfolio at December 31, 2014:

($ millions)	Fair Value				
	-200 bps Change	-100 bps Change	Actual	+100 bps Change	+200 bps Change
Fixed maturities:					
U.S. treasury securities and obligations of U.S. government agencies	$ 342.4	$ 325.2	$ 309.3	$ 291.9	$ 275.7
Obligations of states and political subdivisions	831.5	800.6	769.5	735.5	698.7
Corporate securities	372.2	359.5	340.6	331.7	317.9
U.S. government agencies residential mortgage-backed securities	488.6	484.4	472.5	454.8	434.3
Balance as of December 31, 2014	$ 2,034.7	$ 1,969.7	$ 1,891.9	$ 1,813.9	$ 1,726.6

This table summarizes only the effects that a parallel change in interest rates could have on the fixed maturity portfolio. Changes in rates would also change the value of our liabilities and possibly other financial assets. We caution the reader that this analysis does not take into account nonparallel changes in interest rates. It is likely that some rates would increase or decrease more than others depending upon market conditions at the time of the change. This nonparallel change would alter the value of the fixed maturity portfolio. The analysis is also limited in that it does not take into account any actions that might be taken by us in response to these changes. As a result, the actual impact of a change in interest rates and the resulting fixed maturity values may differ significantly from what is shown in the table.

We believe that the fixed maturity portfolio's exposure to credit risk is minimal as approximately 77.4% of the bonds we own are rated AA or better. We do not intend to change our investment policy or the quality of our fixed maturity investments. The fixed maturity portfolio is managed in a laddered-maturity style and considers business mix and liability payout patterns to ensure adequate cash flow to meet claims as they are presented. We also manage liquidity risk by maintaining sufficient cash balances, owning some agency and U.S. Treasury securities at all times, purchasing bonds of major issuers, and purchasing bonds that are part of a medium or large issue. The fixed maturity portfolio does not have any direct exposure to either exchange rate risk or commodity risk. We do not rely on the use of derivative financial instruments. We categorize our fixed maturities as available-for-sale in order to provide us greater flexibility in managing our portfolio. We do not maintain a trading portfolio.

There are no mortgage backed securities in our fixed maturity portfolio which may be labeled sub-prime mortgage backed securities. We invest only in conventional mortgage backed securities issued by a federal agency or that are U.S. Government guaranteed. Specifically, at December 31, 2014, approximately $472.5 million, or 25.0%, of our fixed maturity available-for-sale investment portfolio was in either GNMA pools, which are guaranteed by the full faith and credit of the U.S. Government, or FNMA or Freddie Mac pools.

At December 31, 2014, our fixed maturity investment portfolio included obligations of states and political subdivisions with a total carrying value of $769.5 million, with $181.4 million of these securities, or 23.6% of our municipal securities portfolio ("Muni Portfolio"), enhanced by third party monoline insurers (a "Credit Enhancement") for the payment of principal and interest in the event of an issuer default. A Credit Enhancement is not a primary consideration to us when purchasing a municipal security, as we consider the underlying credit quality of the security as the primary rating factor in our evaluation process. At December 31, 2014, 79.4% of the total $769.5 million of municipal securities in our investment portfolio were rated AA or better, without the benefit of a Credit Enhancement. We do not believe that a loss of a Credit Enhancement would have a material adverse impact on our results of operations, financial position or liquidity, due to the underlying strength of the issuers of the securities, as well as our ability and intent to hold the securities. In addition, at December 31, 2014, we had no direct investment in any guarantor including any bond insurer.

The following table sets forth the credit ratings of our municipal securities, excluding Credit Enhancements, based on ratings by nationally recognized rating agencies at December 31, 2014:

($ millions)

Rating	Total fair value	%
AAA	$71.2	9.3
AA*	539.6	70.1
A*	117.8	15.3
Other	40.9	5.3
Total	$769.5	100.0

* Our AA and A rating categories include securities which have been either pre-funded or escrowed to maturity.

The following table sets forth the composition of the insurers providing Credit Enhancements, along with the corresponding underlying credit rating of the issuer of the security, at December 31, 2014:
($ millions)

Monoline Insurer / Underlying Rating	Total fair value
Assured Guaranty Municipal Corp.:	
AA	$91.5
A	17.1
	108.6
AMBAC:	
AA	29.4
A	3.7
	33.1
National Public Finance Guarantee:	
AA	27.7
A	9.7
	37.4
XLCA:	
A	2.3
Total municipal securities enhanced by third party monoline insurers	$181.4

We believe our Muni Portfolio is well diversified by issuer and state. We have 20.8% invested in securities which have been either pre-refunded or escrowed to maturity bonds. No single issuer comprises more than 5.0% of our Muni Portfolio. For the bonds that are not in the pre-refunded category, no more than 10.0% is concentrated in any one state. We believe our Muni Portfolio is invested within the strongest sectors of the municipal bond market. Revenue bonds represent 38.0% of our Muni Portfolio and state and local government general obligation bonds make up 18.8% of our Muni Portfolio. Our credit research is an important part of our investment management process, and we continually monitor all holdings for any signs of deterioration. We believe that our municipal holdings will maintain their high credit quality and that the issuers will be able to make all principal and interest payments as they come due. Generally, we reinvest the proceeds from the call, maturity, or sale of securities within our Muni Portfolio, into both tax exempt and taxable fixed income securities with lower rates of return.

At December 31, 2014, our small-cap and large-cap equity portfolios had a beta of 0.38 and 0.97, respectively, using the Russell 2000 and the S&P 500 Index as benchmarks, respectively. Beta estimates the degree the portfolio's price will fluctuate based on a given movement in the market index. The following tables set forth what changes might occur in the value of the small-cap and large-cap equity portfolios given a change in the S&P 500 Index at December 31, 2014:

Small-cap equity portfolio:					
Fair value ($ millions)	$73.4	$70.8	$68.2	$65.6	$63.0
Change in S&P 500 Index	+20%	+10%	—	-10%	-20%
Value as % of original value	108%	104%	100%	96%	92%
Large-cap equity portfolio:					
Fair value ($ millions)	$289.3	$265.7	$242.2	$218.6	$195.0
Change in S&P 500 Index	+20%	+10%	—	-10%	-20%
Value as % of original value	119%	110%	100%	90%	81%

The above analysis is limited in that it does not take into account any actions that might be taken by us in response to these changes. As a result, the actual impact of a change in equity market prices and the resulting equity values may differ significantly from what is shown in the table. By investing in mostly large-cap issues we hope to limit liquidity risk in the equity portfolio. The small-cap and large-cap equity portfolios do not have any direct exposure to exchange rate risk since we do not directly hold any

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foreign stocks. We constantly monitor the equity portfolio holdings for any credit risk issues that may arise. We do not invest in any commodity futures or commodity oriented mutual funds.

At December 31, 2014, we have two international funds, Fund 1 and Fund 2, which are included in other invested assets available-for-sale. Fund 1 and Fund 2 had betas of 0.69 and 0.84 respectively, using the MSCI EAFE Index as a benchmark. The following tables set forth what changes might occur in the values of Funds 1 and 2 given a change in the MSCI EAFE Index at December 31, 2014:

Fund 1:

Fair value ($ millions)	$37.5	$35.2	$32.9	$30.7	$28.4
Change in MSCI EAFE Index	+20%	+10%	—	-10 %	-20 %
Value as % of original value	114 %	107 %	100 %	93 %	86 %

Fund 2:

Fair value ($ millions)	$46.7	$43.3	$40.0	$36.6	$33.2
Change in MSCI EAFE Index	+20%	+10%	—	-10 %	-20 %
Value as % of original value	117 %	108 %	100 %	92 %	83 %

The above analysis does not take into account any actions that might be taken by the portfolio managers in response to these changes. As a result, the actual impact of a change in international equity market prices and the resulting international equity values may differ significantly from what is shown in the tables above.

Investment Operations Revenue

The following table sets forth the components of net investment income for the years ended December 31, 2014, 2013 and 2012:

($ millions)	Year Ended December 31		
	2014	2013	2012
Gross investment income:			
Fixed maturities	$64.3	$63.2	$66.9
Equity securities	6.2	6.0	4.9
Other	6.2	5.7	5.6
Total gross investment income	76.7	74.9	77.4
Less: Investment expenses	2.0	2.1	2.0
Net investment income	$74.7	$72.8	$75.4
Average invested assets (at cost)	$2,153.7	$2,134.3	$2,173.4
Annualized investment yield	3.5 %	3.4 %	3.5 %
Annualized investment yield, after tax	2.6 %	2.7 %	2.7 %
Net investment income, after tax	$57.0	$56.7	$58.0
Effective tax rate	23.7 %	22.1 %	23.0 %

Our investment operations revenue for the year ended December 31, 2014 was primarily impacted by the following factors.

- Interest earned on our fixed maturity securities in 2014 increased slightly compared to 2013, primarily due to an increase of $0.9 million in Treasury Inflation-Protected Securities ("TIPS") interest income. Because TIPS are dependent on changes in the Consumer Price Index, they are directly impacted by the change in the rate of inflation (as inflation declines TIPS income decreases and vice versa). Income earned on our TIPS securities in 2013 decreased by $2.7 million when compared to 2012.
- Interest rates generally declined in 2014 compared to 2013. As a result, the proceeds from bonds that matured, or were called by the issuers, were reinvested at lower rates.

The following table sets forth realized gains (losses) and the proceeds received on sale for our investment portfolio for the years ended December 31, 2014, 2013 and 2012:

($ millions)	2014		2013		2012	
	Realized gains (losses)	Proceeds received on sale	Realized gains (losses)	Proceeds received on sale	Realized gains (losses)	Proceeds received on sale
Realized gains:						
Fixed maturities	$3.1	$159.9	$2.5	$108.1	$15.7	$327.8
Equity securities	21.3	89.2	26.1	98.9	19.0	97.2
Other invested assets	0.1	0.1	0.1	0.2	0.1	0.2
Total realized gains	$24.5	$249.2	$28.7	$207.2	$34.8	$425.2
Realized losses:						
Equity securities:						
Sales	$(1.3)	$10.4	$(1.2)	$7.4	$(2.6)	$7.3
OTTI	(2.5)	—	(4.0)	—	(3.2)	—
Fixed maturities:						
Sales	—	—	(0.3)	5.2	—	—
OTTI	—	—	—	—	(0.2)	—
Total realized losses	$(3.8)	$10.4	$(5.5)	$12.6	$(6.0)	$7.3
Net realized gains on investments	$20.7	$259.6	$23.2	$219.8	$28.8	$432.5

When a fixed maturity security has been determined to have an other-than-temporary decline in fair value, the impairment charge is separated into an amount representing the credit loss, which is recognized in earnings, and the amount related to non-credit factors, which is recognized in accumulated other comprehensive income. See “Critical Accounting Policies – Investments” included in this Item 7 for OTTI impairment indicators. Future increases or decreases in fair value, if not other-than-temporary, are included in accumulated other comprehensive income (loss). We did not recognize any impairments on our fixed maturity portfolio during 2014 or 2013, but we recognized OTTI on our fixed maturity portfolio during 2012 of $0.2 million.

When an equity security or other invested asset has been determined to have a decline in fair value that is other-than-temporary, we adjust the cost basis of the security to fair value. See “Critical Accounting Policies – Investments” included in this Item 7 for OTTI impairment indicators. This results in a charge to earnings as a realized loss, which is not reversed for subsequent recoveries in fair value. Future increases or decreases in fair value, if not other-than-temporary, are included in accumulated other comprehensive income (loss).

The following table sets forth the realized losses related to OTTI on our investment portfolio recognized for the years ended December 31, 2014, 2013 and 2012:

($ millions)	2014		2013		2012	
	Number of positions	Total impairment	Number of positions	Total impairment	Number of positions	Total impairment
Equity securities:						
Large-cap securities	1	$(0.3)	2	$(1.8)	—	$—
Small-cap securities	33	(2.2)	26	(2.2)	38	(3.2)
Fixed maturities:						
Bonds	—	—	—	—	1	(0.2)
Total OTTI	34	$(2.5)	28	$(4.0)	39	$(3.4)

Gross Unrealized Investment Gains and Losses

Based upon our review of our investment portfolio at December 31, 2014, we determined that there were no individual investments with an unrealized holding loss that had a fair value significantly below cost continually for more than one year. The following table sets forth detailed information on our available-for-sale investment portfolio by lot at fair value for our gross unrealized holding gains (losses) at December 31, 2014:

($ millions, except number of positions)	Cost or amortized cost	Gross unrealized holding gains	Number of gain positions	Gross unrealized holding losses	Number of loss positions	Fair value
Fixed Maturities:						
U.S. treasury securities and obligations of U.S. government agencies	$296.7	$14.1	28	$(1.5)	21	$309.3
Obligations of states and political subdivisions	742.5	27.4	266	(0.4)	14	769.5
Corporate securities	333.4	10.2	66	(3.0)	19	340.6
U.S. government agencies residential mortgage-backed securities	458.7	15.6	95	(1.8)	21	472.5
Total fixed maturities	1,831.3	67.3	455	(6.7)	75	1,891.9
Equity Securities:						
Large-cap securities	185.5	57.3	30	(0.6)	2	242.2
Small-cap securities	50.0	18.2	72	—	—	68.2
Total equity securities	235.5	75.5	102	(0.6)	2	310.4
Other invested assets	50.5	29.8	3	—	—	80.3
Total available-for-sale investments	$2,117.3	$172.6	560	$(7.3)	77	$2,282.6

The following table sets forth our unrealized holding gains by investment type, net of deferred tax that was included as a component of accumulated comprehensive income at December 31, 2014 and 2013, and the change in unrealized holding gains, net of deferred tax, for the year ended December 31, 2014:

($ millions)	2014	2013	$ Change
Available-for-sale investments			
Unrealized gains:			
Fixed maturities	$60.6	$26.1	$34.5
Equity securities	74.9	68.7	6.2
Other invested assets	29.8	31.4	(1.6)
Unrealized gains	165.3	126.2	39.1
Deferred federal income tax liability	(55.3)	(41.6)	(13.7)
Unrealized gains, net of tax	$110.0	$84.6	$25.4

Fair Value Measurements

We primarily use one independent nationally recognized pricing service in developing fair value estimates. We obtain one price per security, and our processes and control procedures are designed to ensure the value is accurately recorded on an unadjusted basis. Through discussions with the pricing service, we gain an understanding of the methodologies used to price the different types of securities, that the data and the valuation methods utilized are appropriate and consistently applied, and that the assumptions are reasonable and representative of fair value. To validate the reasonableness of the valuations obtained from the pricing service, we compare to other fair value pricing information gathered from other independent pricing sources. See Note 3, “Fair Value of Financial Instruments” to our consolidated financial statements included in Item 8 of this Form 10-K for a presentation of our available-for-sale investments within the fair value hierarchy at December 31, 2014.

As of December 31, 2014, Level 3 assets as a percentage of total assets were 0.3%, which we have determined to be insignificant.

Other Items

Income Taxes

For the year ended December 31, 2014, the federal income tax benefit was $80.6 million compared to federal income tax expense of $0.5 million for 2013 and a federal income tax benefit of $0.1 million for 2012. The income tax benefit was primarily due to $82.6 million of deferred tax benefit resulting from the reversal of the valuation allowance against net deferred tax assets at December 31, 2014.

See “Critical Accounting Policies — Income Taxes” included in this Item 7. See Note 8, “Federal Income Taxes” to our consolidated financial statements included in Item 8 of this Form 10-K for a reconciliation between our actual federal income tax (benefit) expense and the amount computed at the indicated statutory rate for the years ended December 31, 2014, 2013 and 2012.

LIQUIDITY AND CAPITAL RESOURCES

General

Liquidity refers to our ability to generate adequate amounts of cash to meet our short and long-term needs. Our primary sources of cash are premiums, investment income, investment sales and the maturity of fixed income security investments. The significant outflows of cash are payments of claims, commissions, premium taxes, operating expenses, income taxes, dividends, interest and principal payments on debt and investment purchases. The cash outflows may vary due to uncertainties regarding settlement of large losses or catastrophe events. As a result, we continually monitor our investment and reinsurance programs to ensure they are appropriately structured to enable the insurance subsidiaries to meet anticipated short and long-term cash requirements without the need to sell investments to meet fluctuations in claim payments.

Liquidity

Our insurance subsidiaries must have adequate liquidity to ensure that their cash obligations are met. However, as discussed below, the STFC Pooled Companies do not have the day-to-day liquidity concerns normally associated with an insurance company due to their participation in, and the terms of, the Pooling Arrangement. In addition, State Auto P&C’s $100.0 million credit facility is available for general corporate purposes such as funding liquidity needs. See “Borrowing Arrangements - Credit Facility” included in this Item 7.

Under the terms of the Pooling Arrangement, State Auto Mutual receives all premiums and pays all losses and expenses associated with the insurance business produced by the STFC Pooled Companies and the other pool participants, and then it settles the intercompany balances generated by these transactions with the pool participants within 60 days following each quarter end. We believe this provides State Auto Mutual with sufficient liquidity to pay losses and expenses of our insurance operations on a timely basis. When settling the intercompany balances, State Auto Mutual provides the pool participants with full credit for the premiums written net of losses paid during the quarter, retaining all receivable amounts from insureds and agents and reinsurance recoverable on paid losses from unaffiliated reinsurers. Any receivable amounts that are ultimately deemed to be uncollectible are charged-off by State Auto Mutual and allocated to the pool participant on the basis of its pooling percentage.

As a result of the Pooling Arrangement, we have an off-balance sheet credit risk related to the balances due to State Auto Mutual from insureds, agents and reinsurers, which are offset by the unearned premiums from the respective policies. While the total amount due to State Auto Mutual from policyholders and agents is significant, the individual amounts due are relatively small at the policyholder and agency level. Based on historical data, this credit risk exposure is not considered to be material to our financial position, though the impact to income on a quarterly basis may be material. The State Auto Group mitigates its exposure to this credit risk through its in-house collections unit for both personal and commercial accounts which is supplemented by third party collection service providers. The amounts deemed uncollectible by State Auto Mutual and allocated to the STFC Pooled Companies are included in the other expenses line item in the accompanying consolidated statements of income.

We generally manage our cash flows through current operational activity and maturing investments, without a need to liquidate any of our other investments. However, should our written premiums decline or paid losses increase significantly, or a combination thereof, our cash flows from operations could be impacted requiring us to liquidate investments. This action was not necessary in 2014, 2013 or 2012.

We maintain a portion of our investment portfolio in relatively short-term and highly liquid investments to ensure the immediate availability of funds to pay claims and expenses. At December 31, 2014 and 2013, we had $86.3 million and $80.3 million, respectively, in cash and cash equivalents, and $2,282.6 million and $2,176.3 million, respectively, of total available-for-sale investments. Included in our fixed maturities available-for-sale were $8.8 million and $8.7 million of securities on deposit with insurance regulators, as required by law, at December 31, 2014 and 2013, respectively. In addition, substantially all of our fixed maturity and equity securities are traded on public markets. For a further discussion regarding investments, see “Investments Operations Segment” included in this Item 7.

Net cash provided by operating activities was $75.6 million and $72.1 million in 2014 and 2013, respectively, compared to net cash used in operating activities of $285.6 million in 2012. Net cash from operations will vary from period to period if there are significant changes in underwriting results, primarily a combination of the level of premiums written and loss and loss expenses paid, changes in cash flows from investment income or federal income tax activity. The change from 2014 and 2013 compared to 2012 was primarily due to our settlement payment of $261.4 million related to the December 31, 2011 change to the Pooling Arrangement in which, among other things, the overall participation percentage of the STFC Pooled Companies was reduced from 80% to 65% (the "12.31.11 pool change") and our payment of $75.5 million related to our share of the State Auto Group’s initial net unearned premium transfer under the HO QS Arrangement, both of which occurred in 2012.

Net cash used in investing was $56.5 million and $23.0 million in 2014 and 2013, respectively, compared to net cash provided by investing activities of $9.3 million for 2012. The following factors significantly contributed to the fluctuations between those years:

- The change in 2014 was primarily attributable to the level of purchases, sales and maturities in our investment portfolio in 2014 when compared to the same 2013 period.
- The change in 2013 was primarily attributable to less sales proceeds of available for sale securities when compared to 2012, as well as, a lower level of call activity in 2013 compared to the same 2012 period.
- In 2012, we continued to raise funds to complete the settlement of amounts owed in connection with the 12.31.11 pool change and the HO QS Arrangement.

Borrowing Arrangements

Credit Facility

On July 26, 2013, State Auto P&C entered into a credit facility (the “SPC Credit Facility”) with a syndicate of lenders. The SPC Credit Facility provides State Auto P&C with a $100.0 million five-year revolving credit facility maturing in July 2018. During the term of the SPC Credit Facility, State Auto P&C has the right to increase the total facility to a maximum amount of $150.0 million, provided that no event of default has occurred. The SPC Credit Facility is available for general corporate purposes and provides for interest-only payments during its term, with principal and interest due in full at maturity. Interest is based on LIBOR or a base rate plus a calculated margin amount. All advances under the SPC Credit Facility are to be fully secured by a pledge of specific investment securities of State Auto P&C. The SPC Credit Facility includes certain covenants and requirements, including financial requirements that State Auto Financial maintain a minimum net worth and a certain debt to capitalization ratio. As of December 31, 2014, State Auto P&C had not made any borrowings under the SPC Credit Facility and State Auto P&C and State Auto Financial were in compliance with all covenants and requirements of the SPC Credit Facility.

FHLB Loan

On July 11, 2013, State Auto P&C obtained a loan (the “FHLB Loan”) from the Federal Home Loan Bank of Cincinnati (the “FHLB”). State Auto P&C became a member of the FHLB during the first quarter of 2013. The FHLB Loan is a 20-year term loan, callable after three years with no prepayment penalty thereafter, in the principal amount of $85.0 million. The FHLB Loan provides for interest-only payments during its term, with principal due in full at maturity. The interest rate is fixed over the term of the loan at 5.03%. The FHLB Loan is fully secured by a pledge of specific investment securities of State Auto P&C. Proceeds from the FHLB Loan, along with cash on hand, were used by State Auto Financial to redeem all of its outstanding Senior Notes.

Subordinated Debentures

State Auto Financial’s Delaware business trust subsidiary (the “Capital Trust”) has outstanding $15.0 million liquidation amount of capital securities, due 2033. In connection with the Capital Trust’s issuance of the capital securities and the related purchase by State Auto Financial of all of the Capital Trust’s common securities (liquidation amount of $0.5 million), State Auto Financial has issued to the Capital Trust $15.5 million aggregate principal amount of unsecured Floating Rate Junior Subordinated Debt Securities due 2033 (the “Subordinated Debentures”). The sole assets of the Capital Trust are the Subordinated Debentures and any interest accrued thereon. Interest on the Capital Trust’s capital and common securities is payable quarterly at a rate equal to the three-month LIBOR rate plus 4.20%, adjusted quarterly. The applicable interest rates for December 31, 2014 and 2013 were 4.44%, respectively.

Notes Payable Summary
The following table sets forth our notes payable at December 31, 2014:

($ millions)	Carrying Value	Fair Value	Interest Rate	
Subordinated Debentures due 2033: issued $15.5 million, May 2003 with variable interest adjusting quarterly	15.5	15.5	4.44	%
FHLB loan due 2033; issued $85.0 million, July 2013 with fixed interest	85.3	86.4	5.03	%
Total notes payable	$ 100.8	$ 101.9		

Related to our notes payable, our primary market risk exposure is to the change in interest rates and our credit rating. For a discussion regarding our credit ratings see “Credit and Financial Strength Ratings” included in this Item 7. Based upon the notes payable carrying value at December 31, 2014, we had $15.5 million notes payable with variable interest and $85.3 million notes payable with interest fixed at 5.03%, which equated to approximately 15.2% variable interest debt and 84.8% fixed interest debt. Our decision to obtain fixed versus variable interest rate debt is influenced primarily by the following factors: (a) current market interest rates; (b) anticipated future market interest rates; (c) availability of fixed versus variable interest instruments; and (d) our currently existing notes payable fixed and variable interest rate position. See our contractual obligations table included in “Contractual Obligations” included in this Item 7.

Reinsurance Arrangements

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.

To minimize the risk of reinsurer default, the State Auto Group cedes only to third-party reinsurers who are rated A- or better by A.M. Best or Standard & Poor’s and also utilizes both domestic and international markets to diversify its credit risk. We utilize reinsurance to limit our loss exposure and contribute to our liquidity and capital resources.

Expired Homeowners Quota Share Reinsurance Arrangement

On December 31, 2011, the State Auto Group entered into the HO QS Arrangement, which was a three-year quota share reinsurance agreement covering our homeowners line of business. Under the HO QS Arrangement, the State Auto Group ceded to reinsurers 75% of its homeowners business under policies in force at the effective date and new and renewal policies thereafter issued during the term of the agreement. The HO QS Arrangement expired December 31, 2014 and was replaced with a one-year property aggregate excess catastrophe reinsurance agreement, effective January 1, 2015. See the "Property Catastrophe" discussion below for further information.

Other Reinsurance Arrangements

Each member of the State Auto Group is party to working reinsurance treaties for casualty, workers’ compensation and property lines with several reinsurers arranged through reinsurance intermediaries. These agreements are described in more detail below. We have also secured other reinsurance to limit the net cost of large loss events for certain types of coverage. The State Auto Group also makes use of facultative reinsurance for unique risk situations. The State Auto Group also participates in state insurance pools and associations. In general, these pools and associations are state sponsored and/or operated, impose mandatory participation by insurers doing business in that state, and offer coverage for hard-to-place risks at premium rates established by the state sponsor or operator, thereby transferring risk of loss to the participating insurers in exchange for premiums which may not be commensurate with the risk assumed.

As of December 31, 2014, the State Auto Group entered into an ADC reinsurance agreement that provides $40.0 million of coverage for adverse development in excess of carried reserves for the terminated RED restaurant program.

Property Catastrophe

Members of the State Auto Group maintain a property catastrophe excess of loss reinsurance agreement, covering property catastrophe related events affecting at least two risks. As of June 1, 2014, this property catastrophe reinsurance agreement was revised to increase the treaty limit. Under this agreement, the State Auto Group retains the first $55.0 million of catastrophe loss, each occurrence, with a 5.0% co-participation on the next $285.0 million (previously $265.0 million) of covered loss, each

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occurrence. The reinsurers are responsible for 95% of the excess over $55.0 million up to $340.0 million (previously $320.0 million) of covered losses, each occurrence. Under this agreement, our companies are responsible for losses above $340.0 million (previously $320.0 million).

The State Auto Group also maintains a separate property catastrophe excess of loss reinsurance agreement covering E&S property and Programs catastrophe related events affecting at least two risks. Under this agreement, the State Auto Group retains the first $15.0 million of catastrophe loss, each occurrence, and the reinsurers are responsible for 100.0% of the excess over $15.0 million up to $55.0 million of covered loss, each occurrence.

As of January 1, 2015, the State Auto Group entered into a one-year property aggregate excess catastrophe reinsurance agreement with a syndicate of reinsurers covering property business underwritten by its personal insurance and business insurance segments, including automobile physical damage. This agreement provides reinsurance coverage of $75.0 million during 2015 for ISO PCS numbered catastrophes and certain other weather-related events after the retention of $165.0 million of losses by the State Auto Group. Individual occurrences are not subject to an occurrence deductible, but are subject to a maximum amount of $55.0 million consistent with the State Auto Group’s retention under its existing property catastrophe excess of loss reinsurance agreement. The agreement excludes property risks underwritten by the specialty insurance segment.

Property Per Risk

At June 1, 2014, the State Auto Group renewed the property per risk excess of loss reinsurance agreement. This reinsurance agreement provides that the State Auto Group is responsible for the first $1.0 million of each covered loss for E&S property and Programs units, and the first $3.0 million of each covered loss for other property business. The State Auto Group is also responsible for an additional $2.0 million in aggregate retention per treaty year for losses exceeding $3.0 million. The reinsurers are responsible for 75% of the loss in excess of $1.0 million for the E&S property and Programs units and 100.0% of the loss excess of $3.0 million for other property business up to $20.0 million of covered loss. The rates for this reinsurance are negotiated annually.

Casualty and Workers’ Compensation

As of July 1, 2014, the State Auto Group renewed the casualty excess of loss reinsurance agreement. Under this agreement, the State Auto Group is responsible for the first $1.0 million of workers' compensation losses, each loss occurrence, subject to an additional $1.0 million in annual aggregate retention, and $2.0 million of losses that involve auto liability, other liability and umbrella liability policies, subject to an additional $2.0 million in annual aggregate retention. The reinsurance agreement provides coverage up to $10.0 million, except for umbrella policies which are covered for limits up to $15.0 million. E&S casualty and Programs units risks are not subject to this casualty excess of loss reinsurance agreement.

Also, certain unusual claim situations involving bodily injury liability, property damage, uninsured motorist and personal injury protection are covered by an arrangement that provides for $30.0 million of coverage in excess of $10.0 million retention for each loss occurrence. This reinsurance sits above the $8.0 million excess of $2.0 million arrangement. The rates for this reinsurance are negotiated annually. Policies underwritten by the E&S casualty and Programs units are not subject to this casualty excess of loss reinsurance agreement.

In addition to the workers’ compensation reinsurance described above, each company in the State Auto Group is party to a workers’ compensation catastrophe reinsurance agreement that provides additional reinsurance coverage for workers’ compensation losses involving multiple workers. Subject to $10.0 million of retention, reinsurers are responsible for 100.0% of the excess over $10.0 million up to $30.0 million of covered loss. For loss amounts over $30.0 million, the casualty excess of loss reinsurance agreement provides $20.0 million coverage in excess of $30.0 million. Workers’ compensation catastrophe coverage is subject to a “Maximum Any One Life” limitation of $10.0 million. This limitation means that losses associated with each worker may contribute no more than $10.0 million to covered loss under these agreements. The rates for the workers’ compensation catastrophe reinsurance agreement are negotiated annually.

For E&S casualty and Programs units risks, the State Auto Group has a combined casualty treaty whereby under Section A, we retain the first $1.0 million of covered loss and the reinsurers are responsible for 90.0% (previously 87.0%) of loss in excess of $1.0 million up to $10.0 million for all primary business and excess business written directly above a primary policy, at policy limits above $1.0 million. Under Section B, as respects excess policies over another carrier's primary policy, we have a $10.0 million proportional agreement where we retain $1.0 million of each risk and the reinsurers are responsible for 90.0% (previously 87.0%) of loss for each risk based on the percentage the $1.0 million we retain bears to the total policy limit. Under Section C, as respects policies at $1.0 million or less, we retain the first $1.25 million of Extra Contractual Obligations/Excess of Policy Limits ("ECO/XPL") and LAE coverage for policies with limits of $1.0 million or less, and the reinsurers are responsible for 100.0% of ECO/XPL and LAE coverage in excess of $1.3 million up to $4.0 million.

Contractual Obligations

The following table sets forth our significant contractual obligations at December 31, 2014:

($ millions)	Total	Due 1 year or less	Due 1-3 years	Due 3-5 years	Due after 5 years
Direct loss and ALAE reserves(1)	$ 973.6	396.0	335.2	126.1	116.3
Notes payable(2):					
Subordinated Debentures due 2033: issued $15.5, May 2003 with variable interest(3) adjusting quarterly	15.5	—	—	—	15.5
FHLB loan due 2033; issued $85.0 million, July 2013 with fixed interest	85.0	—	—	—	85.0
Total notes payable	100.5	—	—	—	100.5
Interest payable (2):					
Subordinated Debentures due 2033: issued $15.5, May 2003 with variable interest(3) adjusting quarterly	12.7	0.7	1.4	1.4	9.2
FHLB loan due 2033; issued $85.0 million, July 2013 with fixed interest	79.1	4.3	8.6	8.6	57.6
Total interest payable	91.8	5.0	10.0	10.0	66.8
Postretirement benefits	15.5	1.7	3.3	3.2	7.3
Pension funding(4)	56.9	5.5	10.9	11.7	28.8
Total	$ 1,238.3	$ 408.2	$ 359.4	$ 151.0	$ 319.7

(1) We derived expected payment patterns separately for the direct loss and ALAE reserves. Amounts included the STFC Pooled Companies net additional share of transactions assumed from State Auto Mutual through the Pooling Arrangement. For a reconciliation of management's best estimate, see "Critical Accounting Policies – Losses and Loss Expenses Payable" included in this Item 7. These patterns were applied to the December 31, 2013, loss and ALAE payable to generate estimated annual incremental loss and ALAE payments for each subsequent calendar year. These amounts are based on historical payment patterns and do not represent actual contractual obligations. The actual payment amounts and the related timing of those payments could differ significantly from these estimates.

(2) For a discussion of these debt instruments, see "Liquidity and Capital Resources—Borrowing Arrangements" included in this Item 7.

(3) Interest on the subordinated debentures was calculated using an interest rate equal to the three-month LIBOR rate at December 31, 2014 of 0.2356% plus 4.20%, or 4.4356%.

(4) These amounts are estimates of ERISA minimum funding levels based on adjustments to prior year assumptions for our defined benefit pension plan and do not represent an estimate of our expected contributions. Funding levels generally are not determined until later in the year with respect to the contribution year. See Note 9, "Pension and Postretirement Benefits Plans" to our consolidated financial statements included in Item 8 of this Form 10-K for a tabular presentation of STFC's share of expected benefit payments from the State Auto Group's defined benefit pension plan.

Leases and other purchase obligations of State Auto Mutual are allocated to us through the Pooling Arrangement.

Regulatory Considerations

At December 31, 2014, 2013 and 2012, each of our insurance subsidiaries was in compliance with statutory requirements relating to capital adequacy.

The NAIC utilizes a collection of analytical tools designed to assist state insurance departments with an integrated approach to screening and analyzing the financial condition of insurance companies operating in their respective states. One such set of analytical tools is 12 key financial ratios that are known in the insurance industry as the “IRIS” ratios. A “defined range” of results for each ratio has been established by the NAIC for solvency monitoring. While management utilizes each of these IRIS ratios in monitoring our insurance companies’ operating performance on a statutory accounting basis (each of our insurance subsidiaries operates within the defined range for the other measures), the net premiums written to surplus or leverage ratio is monitored to ensure that each of our insurance subsidiaries continue to operate within the “defined range” of 3.0 to 1.0. The higher the leverage ratio, the more risk a company bears in relation to statutory surplus available to absorb losses. In considering this range, management also considers the distribution of net premiums between property and liability lines of business. A company with a larger portion of net premiums from liability lines should generally maintain a lower leverage ratio.

The following table sets forth the statutory leverage ratios for our insurance subsidiaries at December 31, 2014, 2013 and 2012:

Statutory Leverage Ratios	2014	2013	2012
State Auto P&C	1.5	1.4	1.6
Milbank	1.9	1.7	2.2
Weighted Average	1.5	1.4	1.7

State Auto P&C, Milbank and SA Ohio are subject to regulations and restrictions under which payment of dividends from statutory surplus can be made to State Auto Financial during the year without prior approval of regulatory authorities. Under the insurance regulations of Iowa and Ohio (the states of domicile), the maximum amount of dividends that the Company may pay out of earned surplus to shareholders within a twelve month period without prior approval of the Department is limited to the greater of 10% of the most recent year-end policyholders' surplus or net income for the twelve month period ending the 31st day of December of the previous year-end. Pursuant to these rules, $77.8 million is available for payment to State Auto Financial from its insurance subsidiaries in 2015 without prior approval. State Auto Financial received dividends from its insurance subsidiaries in the amount of $20.0 million, $10.0 million and $20.0 million in 2014, 2013 and 2012, respectively.

The Company's insurance subsidiaries are subject to risk-based capital ("RBC") requirements that have been adopted by individual states. These requirements subject insurers having statutory capital less than that required by the RBC calculation to varying degrees of regulatory action, depending on the level of capital inadequacy. The RBC formulas specify various weighting factors to be applied to financial balances or various levels of activity based on the perceived degree of risk. Regulatory compliance is determined by a ratio of total adjusted capital to authorized control level RBC. Generally no remedial action is required by an insurance company if its adjusted statutory surplus exceeds 200% of the authorized level RBC. At December 31, 2014, the ratio of total adjusted statutory capital to authorized control level of State Auto Financial's insurance subsidiaries ranged from 462.8% to 5,824.1%.

Credit and Financial Strength Ratings

The following table sets forth our credit and insurance company financial strength ratings as of February 27, 2015:

	A.M. Best	Moody's	Standard & Poor's
State Auto Financial (credit rating)	bbb negative outlook	N/A	BB+ negative outlook
State Auto Group (financial strength)	A	A3	BBB+
	negative outlook	under review for downgrade	negative outlook

We are reviewed regularly by the independent rating agencies, including those rating agencies listed in the table above. We believe that these ratings provide a meaningful way for policyholders, agents, creditors, shareholders and others to compare us to our competitors. Our ratings are influenced by many factors, including operating and financial performance, asset quality, liquidity, financial leverage, exposure to catastrophe risks and operating leverage. 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.

Our management considers how its overall strategy and decisions may influence the rating agencies' evaluation of our credit strength and capital position, which may in turn directly impact the credit and financial strength ratings assigned by those agencies. In its decision-making process with respect to significant transactions, such as reinsurance, financing and investing activities, and acquisitions, management takes into consideration the potential impact these decisions will have on our earnings volatility and capital position.

The financial strength ratings set forth above relate to the State Auto Group and express the opinion of the rating agency as to the ability of the State Auto Group to meet its ongoing obligations to policyholders. The A.M. Best financial strength rating influences our ability to write insurance business as agents and policyholders generally prefer higher rated companies. Lower rated companies may be required to compete for agents and policyholders by offering higher commissions or lower premiums and expanded coverage, or a combination thereof.

OTHER

Impact of Inflation

Inflation can have a significant 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. Even when general inflation, as measured by the Consumer Price Index, has been relatively modest, as has been the case over the last several years, price inflation on the goods and services purchased by insurance companies in settling claims can steadily increase. For example, historically medical care costs have risen at a higher rate than general inflation over the last few years. Costs for building materials typically rise significantly following widespread natural catastrophes, such as what the industry experienced in areas affected by Superstorm Sandy in 2012. We continue to adjust our pricing projections to reflect current and anticipated changes in costs in all lines of business.

We consider inflation when estimating liabilities for losses and loss expenses, particularly for claims having a long period between occurrence and final settlement. The liabilities for losses and loss expenses are management's best estimates of the ultimate net cost of underlying claims and expenses and are not discounted for the time value of money. In times of high inflation, the normally higher yields on investment income may partially offset potentially higher claims and expenses.

CRITICAL ACCOUNTING POLICIES

Our significant accounting policies are more fully described in Note 1 of the notes to our consolidated financial statements included in Item 8 of this Form 10-K. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet, revenues and expenses for the period then ended and the financial entries in the accompanying notes to the financial statements. Such estimates and assumptions could change in the future, as more information becomes known which could impact the amounts reported and disclosed in this Item 7. We have identified the policies and estimates described below as critical to our business operations and the understanding of the results of our operations.

Investments

Our fixed maturity, equity security and certain other invested asset investments are classified as available-for-sale and carried at fair value. The unrealized holding gains or losses, net of applicable deferred taxes, are shown as a separate component of stockholders' equity in accumulated other comprehensive income (loss), and as such are not included in the determination of net income. Investment income is recognized when earned, and capital gains and losses are recognized when investments are sold.

We regularly monitor our investment portfolio for declines in value that are other-than-temporarily impaired ("OTTI"), an assessment that requires significant management judgment regarding the evidence known. Such judgments could change in the future as more information becomes known which could negatively impact the amounts reported herein.

We consider the following factors when assessing our equity securities and other invested assets for OTTI: (i) the length of time and/or the significance of decline below cost; (ii) our ability and intent to hold these securities through their recovery periods; (iii) the current financial condition of the issuer and its future business prospects; and (iv) the ability of the market value to recover to cost in the near term. We recognize OTTI charges on our externally managed small-cap equity portfolio and a segment of our large-cap portfolio, as we are unable to make the assertion regarding our intent to hold these securities that are currently valued below cost until recovery in the near term. When an equity security or other invested asset has been determined to have a decline in fair value that is other-than-temporary, we adjust the cost basis of the security to fair value. This results in a charge to earnings as a realized loss, which is not reversed for subsequent recoveries in fair value. Future increases or decreases in fair value, if not other-than-temporary, are included in other comprehensive income (loss).

We also consider the following factors when assessing our fixed maturity investments for OTTI: (i) the financial condition of the issuer including receipt of scheduled principal and interest cash flows; (ii) our intent to sell; and (iii) if it is more likely than not that we will be required to sell the investments before recovery. When a fixed maturity has been determined to have an other-than-temporary impairment, the impairment charge is separated into an amount representing the credit loss, which is recognized in earnings as a realized loss, and the amount related to non-credit factors, which is recognized in other comprehensive (loss) income. Future increases or decreases in fair value, if not

other-than-temporary, are included in other comprehensive (loss) income.
Deferred Acquisition Costs
Acquisition costs, consisting of net commissions (including ceding commissions), premium taxes and certain underwriting expenses related to the successful acquisition or renewal of property and casualty business, are deferred and amortized over the same period in which the related premiums are earned. Ceding commissions relating to reinsurance agreements reimburse us for both deferrable and non-deferrable acquisition costs. To the extent these ceding commissions exceed the deferrable amount of

acquisition costs, the excess is reported as a deferred liability and is included in other liabilities in our consolidated balance sheet. Excess ceding commissions are amortized in proportion to net revenue recognized on the underlying policies resulting in excess ceding commissions being recognized as a reduction of acquisition and operating expenses.

The method followed for computing the acquisition costs limits the amount of such deferred costs to their estimated realizable value. In determining estimated realizable value, the computation gives effect to the premium to be earned, losses and loss expenses expected to be incurred, and certain other costs expected to be incurred as premium is earned. Future changes in estimates, the most significant of which is expected losses and loss adjustment expenses, that indicate a reduction in expected future profitability may result in unrecoverable deferred acquisition costs. Anticipated investment income is considered in determining whether a premium deficiency exists.

Losses and Loss Expenses Payable

Our loss reserves reflect all unpaid amounts for claims that have been reported, as well as for IBNR claims. Our loss reserves are not discounted to present value.

Loss reserves are management's best estimates ("MBE") at a given point in time of what we expect to pay to settle all claims incurred as of that date based on known facts, circumstances and historical trends. Loss reserves at the individual claim level are established on either a case reserve basis or formula reserve basis depending on the type and circumstances of the loss. The case reserve amounts are determined by claims adjusters 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 data for similar claims with provision for changes caused by inflation. Case reserves and formula reserves are reviewed on a regular basis, and as new data becomes available, estimates are updated resulting in adjustments to loss reserves. Generally, reported losses initially reserved on a formula basis and not settled after six months are case reserved at that time. The process for calculating the IBNR component of the loss reserve is to develop an estimate of the ultimate losses and allocated loss expenses incurred, and subtract all amounts already paid or held as case or formula reserves.

The determination of ultimate losses integrates information and analysis provided by several disciplines within our Company, including claims, actuarial and accounting. This assessment requires considerable judgment in understanding how claims mature, which lines of business are the most volatile, and how trends change over time. Loss reserves represent an estimate at a given point in time based on many variables including historical and statistical information, inflation, legal developments, storm loss estimates and economic conditions. Although we consider many different sources of information, as well as a number of actuarial methodologies to estimate our loss reserves, there is no single method for determining the exact ultimate liability.

Our internal actuarial staff conducts quarterly reviews of projected loss development information to assist management in making estimates of ultimate losses and loss expenses. Several factors are considered in estimating ultimate liabilities including consistency in relative case reserve adequacy, consistency in claims settlement practices, recent legal developments, historical data, actuarial projections, accounting projections, exposure growth, current business conditions, catastrophe developments and late reported claims. In addition, reasonableness tests are performed on many of the assumptions underlying each reserving methodology, such as claim frequency, claim severity and loss ratios. Nonetheless, changes which are not contemplated do occur over time, and those changes are incorporated in subsequent valuations of our loss reserves.

We use a number of different methodologies to estimate the IBNR component of our loss reserves. Our loss reserves include amounts related to short tail and long tail lines of business. "Tail" refers to the time period between the occurrence of a loss and the settlement of the claim. In general, the longer the time span between the incidence of a loss and the settlement of the claim, the more the ultimate settlement amount can vary. The reserving methods and strengths and weaknesses of each are described below.

Short-Tail Business: For short-tail business, claims are typically settled within five years, and the most common actuarial estimates are based on techniques using link ratio projections of incurred losses, paid losses, claim counts and claim severities. Each of these methods is described below in detail. Separate projections are made for catastrophes that are in the very early stages of development based on specific information known through the reporting date.

Incurred Loss Development Method: The Incurred Loss Development Method is probably the most common actuarial method used in projecting indicated IBNR reserves. This method uses paid loss experience as well as the outstanding estimates (formula and case reserves) for claims that have been reported and are still open. The underlying assumption of the Incurred Loss Development Method is that case reserve adequacy remains consistent over time. This method's advantage is its responsiveness to changes in reported losses, which is particularly valuable in the less mature accident years. The disadvantage of the Incurred Loss Development Method is that case reserve adequacy changes will distort the IBNR projections.

Paid Loss Development Method: The Paid Loss Development Method uses calculations that are very similar to the Incurred Loss Development Method. The key difference is that the data used in the paid method exclude case reserve estimates, so only paid losses are utilized. With this method, a payment pattern is estimated to project ultimate settlement values for each accident year, with the underlying assumption that claims are settled at a consistent rate over time. Neither case reserves nor the rate at which claims are reported (except to the extent that the reporting pattern influences the payment pattern) is relevant to the results of this method. This method's advantage is that the estimates of ultimate loss are independent of case reserve adequacy and are unaffected by company changes in case reserving philosophy. The disadvantages are that the paid method does not use all of the available information, and in some cases the liability payment patterns require the application of very large development factors to relatively small payments in less mature accident years.

Claim Counts and Severities Method: The Counts and Severities Method calculations are very similar to the other methods. The incurred claim counts reported to date are projected to an ultimate number. Similarly, the incurred loss severities are projected to an ultimate value. The ultimate incurred count is multiplied by the ultimate incurred severity, for each accident year, to arrive at the ultimate incurred loss. Finally, as with the other loss development methods, an estimate of the IBNR reserve is calculated by subtracting the reported losses from the estimated ultimate losses.

Long-Tail Business: For long-tail business, a material portion of claims may not be settled within five years. Reserve estimates for long-tail business use the same methods listed above along with several other methods as determined by the actuary. For example, premium-based methods may be used in developing ultimate loss estimates, including the Expected Loss Ratio, Bornhuetter-Ferguson, and Least-Squares techniques as described below. We may also use statistical models when the historical patterns can be reasonably approximated.

Expected Loss Ratio Method: The Expected Loss Ratio Method generates indicated IBNR by multiplying an expected loss ratio by earned premiums, then subtracting incurred-to-date losses. For slower reporting lines of business, new products, or data that is very immature, the actual claim data is often too limited or too volatile for other projection methods. With this method the premiums are used as a measure of loss exposure, and the loss ratios can be derived from pricing expectations.

Bornhuetter-Ferguson Method: The Bornhuetter-Ferguson Method is a weighted average of the Expected Loss Ratio Method and the Incurred Loss Development Method, using the percentage of losses reported as the weight. This method is particularly useful where there is a low volume of data in the current accident period, or where the experience is volatile. In general, this method produces estimates that are similar to the Incurred Loss Development Method.

Least Square Loss Development Method: In the Least Squares Loss Development Method, the statistical technique of least squares regression is applied to a triangle of reported loss ratios to project the ultimate loss ratio in each accident year. Using historical loss ratios puts the data for each time period on a more consistent exposure basis, because premium levels are generally correlated with insured exposures. A by-product of the regression function is an estimate of credibility for each stage of development. In cases where the regression parameters fall outside of a reasonable range, the projection defaults to the incurred loss method.

Selection Process: In determining which reserving method to use for a particular line of business or accident year, diagnostic tests of loss ratios and severity trends are considered, as well as the historic case reserve adequacy and claim settlement rate. In general, the Incurred Loss Development Method is used if the projections are stable, the data is credible, historic case reserve adequacy is consistent, and the loss ratios and loss severities are reasonable. Other reserving methods are considered as well for particular lines of business or accident years, along with supplemental information such as open claim counts and prior period development. For example, if more than one method provides a reasonable projection, the actuary may select an average of those methods. There is considerable judgment applied in the analysis of the historical patterns and in applying business knowledge of our underwriting and claims functions.

Reserve ranges provide a quantification of the variability in the loss reserve projections. The primary determinant in estimating the loss reserve range boundaries are the variances measured within the historical reserving data for the various lines of business. MBE of loss reserves considers the expected variation to establish an appropriate position within a range. At December 31, 2014, MBE loss and ALAE reserves for the STFC Pooled Companies' share of the

Pooled Companies' reserves were $950.5 million, within an estimated range of $817.0 million to $984.1 million (dollar amounts presented are on a direct basis, gross of salvage and subrogation recoverable, and before reinsurance, except for the STFC Pooled Companies' participation in the inter-company Pooling Arrangement; therefore, these values cannot be compared to other loss and loss expenses payable tables included elsewhere within this Form 10-K).
The potential impact of the loss reserve variability on net income can be illustrated using the range end points and carried reserve amounts listed above. For example, if ultimate losses reach a level corresponding to the high point of the range, $984.1 million, the reserve increase of $33.6 million corresponds to an after-tax decrease of $21.8 million in net income, assuming a tax rate of 35%. Likewise, should ultimate losses decline to a level corresponding to the low point of the range, $817.0 million, the $133.5 million reserve decrease would add $86.8 million of after-tax net income. The loss reserve range noted above represents

a range of reasonably likely reserves, not a range of all possible reserves. Therefore, the ultimate losses could reach levels corresponding to reserve amounts outside the range provided.

An important assumption underlying the loss reserve estimation methods for casualty lines is that the loss cost trends implicitly built into the loss and ALAE patterns will continue into the future. To estimate the sensitivity of reserves to an unexpected change in inflation, projected calendar year payment patterns were applied to the December 31, 2014, other & product liability loss and ALAE reserve to generate estimated annual incremental loss and ALAE payments for each subsequent calendar year. Then, for purposes of sensitivity testing, an additional annual loss cost trend of 10% was added to the trend implicitly embedded in the estimated payment pattern, and revised incremental loss and ALAE payments were calculated. This type of inflationary increase could arise from a variety of sources including tort law changes, development of new medical procedures, social inflation, and other inflationary changes in costs beyond assumed levels.

The estimated cumulative impact that this additional, unexpected 10% increase in the loss cost trend would have on our results of operations over the lifetime of the underlying claims in other & product liability is an increase of $71.8 million on reserves, or a $46.7 million reduction to net income, assuming a tax rate of 35%. Inflation changes have much more impact on the longer tail commercial lines like other & product liability and workers' compensation, and much less impact on the shorter tail personal lines' reserves.

In addition to establishing loss reserves, as described above, we establish reserves for ULAE. Historical patterns of paid ULAE relative to paid loss are analyzed along with historical claim counts including claims opened, claims closed, and claims remaining open. The product of this analysis is an estimate of the relationship, or ratio, between ULAE and loss underlying the current loss reserves. This ratio is applied to the current outstanding loss reserves to estimate the required ULAE reserve. Consequently, this component of the loss expense reserve has a proportional relationship to the overall claim inventory and held loss reserves. The method assumes that the underlying claims process and mix of business do not change materially from period to period.

The following table sets forth a reconciliation of MBE of our direct loss and ALAE reserve to our net loss and loss expenses payable at December 31, 2014 and 2013. The STFC Pooled Companies net additional share of transactions assumed from State Auto Mutual through the Pooling Arrangement for the years ended December 31, 2014 and 2013, respectively, has been reflected in the table below as assumed by STFC Pooled Companies.

($ millions)	2014	2013
Direct loss and ALAE reserve:		
STFC Pooled Companies	$477.8	509.1
Assumed by STFC Pooled Companies	472.7	451.0
Total direct loss and ALAE reserve	950.5	960.1
Direct ULAE reserve:		
STFC Pooled Companies	27.0	29.2
Assumed by STFC Pooled Companies	22.9	21.8
Total direct ULAE reserve	49.9	51.0
Direct salvage and subrogation recoverable:		
STFC Pooled Companies	(20.4)	(21.4)
Assumed by STFC Pooled Companies	(3.4)	(3.3)
Total direct salvage and subrogation recoverable	(23.8)	(24.7)
Reinsurance recoverable	(9.6)	(9.1)
Assumed reinsurance	4.5	5.0
Reinsurance assumed by STFC Pooled Companies	2.1	(31.5)
Total losses and loss expenses payable, net of reinsurance recoverable on losses and loss expenses payable of $9.6 million and $9.1 million in 2014 and 2013, respectively	$973.6	950.8

The following tables set forth the loss and loss expenses payable by major line of business at December 31, 2014 and 2013:

($ millions) December 31, 2014	Ending Loss & ALAE Case & Formula	Ending Loss & ALAE IBNR	Ending ULAE Bulk	Total Reserves
Personal insurance segment:				
Personal auto	$114.1	52.7	9.2	176.0
Homeowners	12.1	4.2	1.9	18.2
Other personal	5.8	1.7	0.2	7.7
Total personal	132.0	58.6	11.3	201.9
Business insurance segment:				
Commercial auto	43.9	31.7	3.4	79.0
Commercial multi-peril	43.7	45.3	5.2	94.2
Fire & allied lines	17.2	2.1	0.6	19.9
Other & product liability	46.2	94.0	14.0	154.2
Other commercial	1.4	1.0	0.1	2.5
Total business	152.4	174.1	23.3	349.8
Specialty insurance segment:				
Excess & Surplus property	0.9	6.2	1.2	8.3
Excess & Surplus casualty	11.2	54.2	4.5	69.9
Programs	101.1	87.1	1.9	190.1
Workers' compensation	56.6	88.8	8.2	153.6
Total specialty	169.8	236.3	15.8	421.9

Total losses and loss expenses payable net of reinsurance recoverable on losses and loss expenses payable	$454.2	469.0	50.4	973.6

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($ millions) December 31, 2013	Ending Loss & ALAE Case & Formula	Ending Loss & ALAE IBNR	Ending ULAE Bulk	Total Reserves
Personal insurance segment:				
Personal auto	$127.7	51.5	9.6	188.8
Homeowners	14.1	8.0	2.2	24.3
Other personal	7.4	3.0	0.2	10.6
Total personal	149.2	62.5	12.0	223.7
Business insurance segment:				
Commercial auto	44.3	35.2	3.9	83.4
Commercial multi-peril	45.6	40.7	5.2	91.5
Fire & allied lines	18.7	2.8	0.6	22.1
Other & product liability	52.8	91.5	15.5	159.8
Other commercial	1.7	1.0	0.1	2.8
Total business	163.1	171.2	25.3	359.6
Specialty insurance segment:				
Excess & Surplus property	0.6	6.0	0.8	7.4
Excess & Surplus casualty	11.3	46.2	3.6	61.1
Programs	87.5	62.0	1.2	150.7
Workers' compensation	60.7	78.9	8.7	148.3
Total specialty	160.1	193.1	14.3	367.5
Total losses and loss expenses payable net of reinsurance recoverable on losses and loss expenses payable	$472.4	426.8	51.6	950.8

See discussion in “Results of Operations—Loss and LAE” section included in this Item 7.

The property and casualty industry has experienced significant loss from claims related to asbestos, environmental remediation, product liability, mold and other mass torts. Because we have insured primarily product retailers and distributors, we do not expect to incur the same level of liability, particularly related to asbestos, as companies that have insured manufacturing risks.

Asbestos reserves are $1.4 million, and environmental reserves are $10.5 million, for a total of $11.9 million, or 1.2% of net losses and loss expenses payable. Asbestos reserves remained the same and environmental reserves increased $0.8 million from 2013.

Pension and Postretirement Benefit Obligations

Pension and postretirement benefit obligations are long-term in nature and require management’s judgment in estimating the factors used to determine these amounts. We review these factors annually, including the discount rate and expected long-term rate of return on plan assets. Because these obligations are based on estimates which could change, the ultimate benefit obligation could be different from the amount estimated.

The State Auto Group has a defined benefit pension plan covering substantially all employees hired prior to January 1, 2010 and a postretirement healthcare plan covering certain associates and retirees (collectively “the benefit plans”). Several factors, which attempt to anticipate future events, are used in calculating the expense and liability related to the benefit plans. Key factors include assumptions about the expected rates of return on plan assets, discount rates, and health care cost trend rates. We consider market conditions, including changes in investment returns and interest rates, in making these assumptions. The actuarial assumptions used by us in determining benefit obligations may differ materially from actual results due to changing market and economic conditions, higher or lower turnover and retirement rates, or longer or shorter life spans of participants. While we believe that the assumptions used are appropriate, differences in actual experience or changes in assumptions may materially affect our financial position or results of operations.

In October 2014, the Retirement Plans Experience Committee of the Society of Actuaries released reports summarizing updated statistics and analysis for actuaries to consider in the selection of the mortality assumptions used in the valuation of benefit plans, including new mortality tables that reflect updated mortality rates observed during 2004 through 2008. Previously, the pension plan valuation utilized a mortality table required to be used for purposes of minimum funding requirements under ERISA. For the December 31, 2014 valuation, the RP-2014 mortality table was used as a baseline for the mortality assumption and the

MP-2014 improvement scale with indefinite improvement was used to project future mortality rates. The January 1, 2015 actuarial reports of the benefit plans included these revised mortality assumptions.
To calculate the State Auto Group's December 31, 2014 benefit obligation for each of the benefit plans, we used a discount rate of 3.85% based on an evaluation of the expected future benefit cash flows of our benefit plans used in conjunction with the Citigroup Pension Discount Curve at the measurement date. A lower discount rate results in, all else being equal, a higher present value of the benefit obligation. To calculate our benefit obligation at December 31, 2014 and net periodic benefit cost for the year ended December 31, 2015, a discount rate of 3.85% and an expected long-term rate of return on plan assets of 7.00% were used. We selected an expected long-term rate of return on our plan assets by considering the mix of investments and stability of investment portfolio along with actual investment experience during the lifetime of the plans. Our assumptions regarding the discount rate and expected return on plan assets could have a significant effect on the amounts related to our benefit obligations and net periodic benefit cost depending on the degree of change between reporting periods.
As a result of adopting the revised mortality assumptions and the change in the discount rate, the benefit plan's liabilities increased by $52.6 million for the year ended December 31, 2014.
The following table sets forth an illustration of variability with respect to the discount rate on our share of the State Auto Group's December 31, 2014 benefit obligation and expected net periodic benefit cost for the year ending December 31, 2015, along with the variability of the expected return on plan assets to our expected net periodic benefit cost for the year ending December 31, 2015. Holding all other assumptions constant, sensitivity to changes in any one of our key assumptions are as follows:

($ millions)	Pension			Postretirement		
	Discount rate			Discount rate		
	(0.25)%	3.85%	0.25%	(0.25)%	3.85%	0.25%
Benefit obligation	$ 304.5	292.5	281.2	$ 24.5	23.9	23.3
Net periodic benefit cost (benefit)	$ 17.2	16.0	14.8	$ (4.0)	(4.1)	(4.1)
	Expected return on plan assets					
	(0.25)%	7.00%	0.25%			
Net periodic benefit cost	$ 16.5	16.0	15.5			

The accumulated benefit obligation ("ABO") of a defined benefit pension plan represents the actuarial present value of benefits attributed by the pension benefit formula to employee service rendered prior to the measurement date and based on current and past compensation levels, while the projected benefit obligation ("PBO") is the ABO plus a factor for future compensation levels. The ABO, which considers current compensation levels only, provides information about the obligation an employer would have if the plan were discontinued at the measurement date. At December 31, 2014, our share of the State Auto Group's ABO and PBO was $260.1 million and $292.5 million, respectively. At December 31, 2014, STFC's share of the defined benefit pension plan's fair value of the assets was $205.1 million, which resulted in an underfunded status within our balance sheet of $87.4 million. On a cash flow basis, we target an annual contribution level that meets at least the targeted normal cost plus any shortfall amortizations of the plan, as defined by ERISA. Currently, we expect to make a cash contribution to the pension plan up to $13.0 million in 2014.
The unfunded status on the pension plan and supplemental executive retirement plan increased from $50.6 million at December 31, 2013, to $93.7 million at December 31, 2014. Primarily influencing this increase are actuarial gains and losses arising from factors that include a decrease in the discount rate and expected to actual demographic changes, such as retirement age, mortality, turnover, rate of compensation changes. In addition, we experienced greater returns on our plan assets.
See Note 9, "Pension and Postretirement Benefit Plans," to our consolidated financial statements included in Item 8 of this Form 10-K for further disclosures regarding our benefit plans.
Income Taxes
For 2014, we recognized a federal income tax benefit of $80.6 million compared to federal income tax expense of $0.5 million for 2013 and a federal income tax benefit of $0.1 million for 2012. The income tax benefit in 2014 was primarily due to the reversal of our deferred tax asset valuation allowance, which resulted in an income tax benefit of

$82.6 million.

Deferred income tax assets and liabilities represent the tax effect of the differences between the financial statement carrying value of existing assets and liabilities and their respective tax bases. During 2011, we experienced a net loss driven by the magnitude of record level catastrophe storm losses in the second quarter that significantly exceeded our projections. We considered both positive and negative evidence and concluded that a valuation allowance should be established.

In accordance with the Financial Accounting Standards Board's Accounting Standards Codification 740, Income Taxes (ASC 740), we periodically evaluate our deferred tax assets, which requires significant judgment, to determine if they are realizable based upon weighing all available evidence, both positive and negative, including our historical and anticipated future taxable income. In making such judgments, significant weight is given to evidence that can be objectively verified.

At December 31, 2014, consistent with the above process, we evaluated the need for a valuation allowance against our net deferred tax assets and determined that it was more likely than not that our deferred tax asset would be realized. As a result, in accordance with the guidance in ASC 740, we reversed our deferred tax asset valuation allowance and recognized an $82.6 million federal income tax benefit in the fourth quarter of 2014.

The principal positive evidence that led us to determine at December 31, 2014 that the valuation allowance against our net deferred tax assets was no longer necessary included (i) three consecutive years of pre-tax income; (ii) cumulative three-year pre-tax income of $98.7 million through December 31, 2014; and (iii) expected future pre-tax income.

Since the establishment of the valuation allowance in the second quarter of 2011, our homeowners line underwriting results, a key contributor to the initial establishment of the valuation allowance, have significantly improved. The improvement in our homeowners underwriting results is attributable to actions undertaken by management, including rate increases, deductible expansion, and changes in the geographic mix, among others. See the "Personal Insurance Segment" discussion included in this Item 7 for further information. Since 2011, underwriting results have also been impacted by our RED underwriting results, which have included reserve strengthening in 2012, 2013 and 2014. Due to the actions taken in 2014, including the reserve strengthening and the placement of the ADC reinsurance agreement, which provides $40.0 million of adverse development cover over carried Loss and LAE reserves for the RED restaurant program, along with the fact that the RED program business has been terminated and is in run-off, future underwriting results are not expected to be materially impacted by RED underwriting results. See the "Specialty Insurance Segment" discussion included in this Item 7 for further information.

Management anticipates generating taxable income over the next three years that will allow for the realization of all of our net operating loss ("NOL") carryforwards prior to the end of 2017. The NOL carryforwards do not begin to expire until 2030 and will not fully expire until 2032.

The following table sets forth the components of our federal income tax expense for the years ended December 31, 2014 and 2013:

($ millions)	2014	2013
Income before federal income taxes	$ 26.8	$ 61.3
Current tax expense	0.1	0.5
Deferred tax expense	1.9	11.8
	2.0	12.3
Valuation allowance	(82.6)	(11.8)
Total federal income tax (benefit) expense	(80.6)	0.5
Net income	$ 107.4	$ 60.8

During the year ended December 31, 2013, we recorded current tax expense in the income statement of $0.5 million related to the Alternative Minimum Tax (AMT). AMT is an alternative tax system whereby we calculate our tax and if it is greater than regular tax, we provide for the AMT. In our case, while we had both regular tax and AMT tax net operating loss carryforwards, the Internal Revenue Code only allows for a 90% offset of the AMT obligation; whereas, the Internal Revenue Code allows for an 100% offset of the regular tax obligation. This resulted in recording a current tax provision. The deferred tax benefit for the AMT was offset by the tax valuation allowance, which resulted in a net tax provision for the year ended December 31, 2013.

Based on ASC 740 intraperiod tax allocation guidelines, the following sets forth the change in valuation allowance attributable to continuing operations and other comprehensive income for the years ended December 31, 2014 and

2013:

($ millions)	2014	2013
Continuing operations	$ (82.6)	$ (11.8)
Other comprehensive income	—	(6.1)
Change in valuation allowance	$ (82.6)	$ (17.9)

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See Note 8, “Federal Income Taxes,” to our consolidated financial statements included in Item 8 of this Form 10-K for further disclosures regarding our income tax matters.

Other

Other items that could have a significant impact on the financial statements include the risks and uncertainties listed in Item 1A of this Form 10-K under “Risk Factors.” Actual results could differ materially using different estimates and assumptions, or if conditions are significantly different in the future.

Item 7A. Qualitative and Quantitative Disclosures about Market Risk

Qualitative and Quantitative Disclosures about Market Risk are included in Item 7 of this Form 10-K under “Results of Operations—Investment Operations Segment—Market Risk.”

Item 8. Financial Statements and Supplementary Data

Our consolidated financial statements, including the notes thereto, and the reports of Ernst & Young LLP on our consolidated financial statements and our internal controls over financial reporting are as follows:

Report of Independent Registered Public Accounting Firm
The Board of Directors and Stockholders of
State Auto Financial Corporation

We have audited the accompanying consolidated balance sheets of State Auto Financial Corporation and subsidiaries as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2014. Our audits also included the financial statement schedules listed in the Index at Item 15(a)(2). These financial statements and schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of State Auto Financial Corporation and subsidiaries at December 31, 2014 and 2013, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), State Auto Financial Corporation and subsidiaries’ internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control-Integrated Framework (2013 framework) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 3, 2015 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP
Columbus, Ohio
March 3, 2015

Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting
The Board of Directors and Stockholders of
State Auto Financial Corporation

We have audited State Auto Financial Corporation and subsidiaries' internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). State Auto Financial Corporation's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, State Auto Financial Corporation and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of State Auto Financial Corporation and subsidiaries as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2014, and our report dated March 3, 2015, expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP
Columbus, Ohio
March 3, 2015

STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES
(a majority-owned subsidiary of State Automobile Mutual Insurance Company)
Consolidated Balance Sheets

($ and shares in millions, except per share amounts)	December 31 2014	2013
Assets		
Fixed maturities, available-for-sale, at fair value (amortized cost $1,831.3 and $1,804.0, respectively)	$ 1,891.9	$ 1,830.1
Equity securities, available-for-sale, at fair value (cost $235.5 and $196.6, respectively)	310.4	265.3
Other invested assets, available-for-sale, at fair value (cost $50.5 and $49.5, respectively)	80.3	80.9
Other invested assets	5.3	5.0
Notes receivable from affiliate	70.0	70.0
Total investments	2,357.9	2,251.3
Cash and cash equivalents	86.3	80.3
Accrued investment income and other assets	33.8	33.6
Deferred policy acquisition costs (affiliated net assumed $46.8 and $19.2, respectively)	126.5	96.8
Reinsurance recoverable on losses and loss expenses payable	9.6	9.1
Prepaid reinsurance premiums	6.1	4.7
Due from affiliate	40.1	—
Current federal income taxes	1.1	0.3
Net deferred federal income taxes	97.4	11.9
Property and equipment, at cost (net of accumulated depreciation of $6.1 and $5.8, respectively)	8.1	8.4
Total assets	$ 2,766.9	$ 2,496.4
Liabilities and Stockholders' Equity		
Losses and loss expenses payable (affiliated net assumed $494.3 and $438.0, respectively)	$ 983.2	959.9
Unearned premiums (affiliated net assumed $201.7 and $78.4, respectively)	612.4	491.0
Notes payable (affiliates $15.5 and $15.5, respectively)	100.8	100.8
Postretirement and pension benefits (affiliated net ceded $63.2 and $37.3, respectively)	117.3	71.6
Due to affiliate	—	1.3
Other liabilities (affiliated net ceded $5.1 and affiliated net assumed $20.0, respectively)	80.3	86.8
Total liabilities	1,894.0	1,711.4
Stockholders' equity:		
Class A Preferred stock (nonvoting), without par value. Authorized 2.5 shares; none issued	—	—
Class B Preferred stock, without par value. Authorized 2.5 shares; none issued	—	—
Common stock, without par value. Authorized 100.0 shares; 47.7 and 47.5 shares issued, respectively, at stated value of $2.50 per share	119.3	118.8
Treasury stock, 6.8 and 6.8 shares, respectively, at cost	(116.0)	(115.9)
Additional paid-in capital	143.2	137.5
Accumulated other comprehensive income (affiliated net ceded $65.1 and $41.0, respectively)	71.7	80.8
Retained earnings	654.7	563.8
Total stockholders' equity	872.9	785.0
Total liabilities and stockholders' equity	$ 2,766.9	$ 2,496.4

See accompanying notes to consolidated financial statements.

STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES
(a majority-owned subsidiary of State Automobile Mutual Insurance Company)
Consolidated Statements of Income

($ millions, except per share amounts)	Year ended December 31		
	2014	2013	2012
Earned premiums (affiliated net assumed $212.4, $200.0 and $232.9, respectively)	$1,074.1	$1,055.0	$1,042.1
Net investment income (affiliates $4.9, $4.9 and $4.9, respectively)	74.7	72.8	75.4
Net realized gain on investments:			
Total other-than-temporary impairment losses	(2.5)	(4.0)	(3.4)
Portion of loss recognized in other comprehensive income	—	—	—
Other net realized investment gains	23.2	27.2	32.4
Total net realized gain on investments	20.7	23.2	29.0
Other income (affiliates $1.9, $2.0 and $3.6, respectively)	3.2	2.0	3.6
Total revenues	1,172.7	1,153.0	1,150.1
Losses and loss expenses (affiliated net assumed $250.8, $162.5 and $203.7, respectively)	771.3	719.8	778.3
Acquisition and operating expenses (affiliated net assumed $156.9, $172.7 and $190.8, respectively)	361.9	354.8	345.9
Interest expense (affiliates $0.7, $0.7 and $0.7, respectively)	5.4	8.5	7.0
Other expenses	7.3	8.6	8.3
Total expenses	1,145.9	1,091.7	1,139.5
Income before federal income taxes	26.8	61.3	10.6
Federal income tax (benefit) expense:			
Current	0.1	0.5	(0.1)
Deferred	(80.7)	—	—
Total federal income tax (benefit) expense	(80.6)	0.5	(0.1)
Net income	$107.4	$60.8	$10.7
Earnings per common share:			
Basic	$2.63	$1.50	$0.26
Diluted	$2.60	$1.49	$0.26
Dividends paid per common share	$0.40	$0.40	$0.55

See accompanying notes to consolidated financial statements.

STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES
(a majority-owned subsidiary of State Automobile Mutual Insurance Company)
Consolidated Statements of Comprehensive Income

($ millions)	Year ended December 31		
	2014	2013	2012
Net income	$ 107.4	$ 60.8	$ 10.7
Other comprehensive income, net of tax:			
Net unrealized holding gains (losses) on investments:			
Unrealized holding gains (losses) arising during year	59.8	(27.1)	53.5
Reclassification adjustments for gains realized in net income	(20.7)	(23.2)	(28.8)
Income tax (expense) benefit	(13.7)	10.9	0.6
Total net unrealized holding gains (losses) on investments	25.4	(39.4)	25.3
Amortization of gain on derivative used in cash flow hedge	—	(0.1)	(0.1)
Net unrecognized benefit plan obligations:			
Net actuarial (loss) gain arising during period	(54.4)	32.5	(7.4)
Reclassification adjustments for amortization to statements of income:			
Negative prior service cost	(5.5)	(5.5)	(5.2)
Net actuarial loss	6.9	9.1	7.8
Income tax benefit	18.5	—	—
Total net unrecognized benefit plan obligations	(34.5)	36.1	(4.8)
Other comprehensive (loss) income	(9.1)	(3.4)	20.4
Comprehensive income	$ 98.3	$ 57.4	$ 31.1

See accompanying notes to consolidated financial statements.

STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES
(a majority-owned subsidiary of State Automobile Mutual Insurance Company)
Consolidated Statements of Stockholders’ Equity

(in millions)	Year ended December 31		
	2014	2013	2012
Common shares:			
Balance at beginning of year	47.5	47.3	47.1
Issuance of shares	0.2	0.2	0.2
Balance at end of year	47.7	47.5	47.3
Treasury shares:			
Balance at beginning of year	(6.8)	(6.8)	(6.8)
Balance at end of year	(6.8)	(6.8)	(6.8)
Common stock:			
Balance at beginning of year	$ 118.8	$ 118.1	$ 117.8
Issuance of shares	0.5	0.7	0.3
Balance at end of year	$ 119.3	$ 118.8	$ 118.1
Treasury stock:			
Balance at beginning of year	$ (115.9)	(115.8	