

Report of Examination of

State Automobile Mutual Insurance Company
Columbus, Ohio

As of December 31, 2013

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Columbus, Ohio

October 3, 2014

Honorable Mary Taylor
Lt. Governor/Director
State of Ohio
Department of Insurance
50 West Town Street
Suite 300
Columbus, Ohio 43215

Dear Madam:

In accordance with Section 3901.07 of the Ohio Revised Code (“ORC”), the Ohio Department of Insurance (“Department”) conducted an examination of

State Automobile Mutual Insurance Company

an Ohio domiciled, mutual, property and casualty insurance company, hereinafter referred to as the “Company.”

Scope of Examination

The Department last examined the Company as of December 31, 2008. The Department’s current examination covers the period of January 1, 2009 to and including December 31, 2013.

Representatives of the Ohio Department of Insurance, as the coordinating state regulator of the insurance company affiliates of the State Auto Insurance Companies, led the multi-state coordinated examination that included representatives from the States of Arizona, Connecticut, Indiana, Iowa, Minnesota, Ohio, and Wisconsin.

The examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook (“Handbook”). The Handbook requires that the Department plan and perform the examination to evaluate the Company’s financial condition and identify prospective risks including corporate governance, identify and assess inherent risks and evaluate system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management’s compliance with Statutory Accounting Principles and Annual Statement instructions when applicable to domestic state regulations.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

For all years under examination, the Certified Public Accounting firm of Ernst & Young, LLP provided an unqualified opinion on the Company's financial statements based on Statutory Accounting Principles. The audited financial statements were reviewed during the examination.

Management and Control

Board of Directors

Management of the Company is vested in its Board of Directors, which was comprised of the following members as of the examination date:

<u>Name</u>	<u>Principal Occupation</u>
Alison Coolbrith	Director, Heffernan Group
Michael J. Fiorile	President and Chief Operating Officer, Dispatch Printing Company
James E. Kunk	Regional President, Huntington National Bank
Paul J. Otte	President Emeritus, Franklin University
Robert P. Restrepo, Jr.	President, Chairman, and Chief Executive Officer, State Auto Insurance Companies
Marsha P. Ryan	Retired
Edwin J. Simcox	President, Indiana Energy Association
Dwight E. Smith	Chief Executive Officer, Sophisticated Systems Inc.
Roger P. Sugarman	Attorney, Kegler, Brown, Hill & Ritter

Officers

As of the examination date, the following officers were serving in the designated positions:

<u>Name</u>	<u>Title</u>
Robert P. Restrepo, Jr.	President
Matthew R. Pollak	Treasurer
James A. Yano	Secretary
Joel E. Brown	Senior Vice President
Jessica E. Buss	Senior Vice President
Steven E. English	Senior Vice President
Clyde H. Fitch, Jr.	Senior Vice President
Stephen P. Hunckler	Senior Vice President
Cynthia A. Powell	Senior Vice President
Lyle D. Rhodebeck	Senior Vice President
Lorraine M. Siegworth	Senior Vice President
Douglas E. Allen	Vice President
David W. Dalton	Vice President
Steven R. Hazelbaker	Vice President
Ricky L. Holbein	Vice President
Scott A. Jones	Vice President
Karen L. Longshore	Vice President
Charles E. McShane, Jr.	Vice President
Matthew S. Mrozek	Vice President
Paul E. Nordman	Vice President
John M. Petrucci	Vice President
Timothy G. Reik	Vice President
Mary J. Reynolds	Vice President
Larry E. Willeford	Vice President

Insurance Holding Company System

The Company is a member of a holding company system as defined under Section 3901.32 of the ORC.

The Company is the controlling parent within the State Auto Holding Company System. The Company's 100% owned subsidiaries are State Auto Insurance Company of Wisconsin ("SA Wisconsin"), Risk Evaluation & Design, LLC ("RED"), a Missouri managing general underwriter, Meridian Insurance Group, Inc. ("MIGI"), an Indiana insurance holding company, and Rockhill Holding Company ("RHC"), a Delaware insurance holding company. MIGI owns 100% of Meridian Security Insurance Company ("Meridian Security") and is party to an affiliation agreement with Meridian Citizens Mutual Insurance Company ("Meridian Citizens Mutual"). The Company owns approximately 62.1% of State Auto Financial Corporation's

("State Auto Financial") outstanding shares. State Auto Financial is an Ohio insurance holding company and its 100% owned insurance subsidiaries are State Auto Property & Casualty Insurance Company ("State Auto P&C"), Milbank Insurance Company ("Milbank"), and State Auto Insurance Company of Ohio ("SA Ohio"). The Company is party to an affiliation agreement with Patrons Mutual Insurance Company of Connecticut ("Patrons Mutual").

The operations of the former State Auto Pool Company, Litchfield Mutual Fire Insurance Company ("Litchfield"), were merged with Patrons Mutual at the close of business March 31, 2013.

RHC owns 100% of Rockhill Insurance Company ("Rockhill") and RTW, Inc., a Minnesota holding company. Rockhill owns 100% of Plaza Insurance Company ("Plaza"). RTW, Inc. owns 100% of American Compensation Insurance Company ("American Compensation"), which owns 100% of Bloomington Compensation Insurance Company ("Bloomington Compensation"). RHC is a specialty property and casualty insurance group, serving both the standard and excess and surplus lines insurance markets. RHC writes specialty property and casualty insurance through two of its insurance subsidiaries, Rockhill on a nonadmitted basis, and Plaza on an admitted basis. RHC writes workers' compensation insurance through two of its insurance subsidiaries, American Compensation and Bloomington Compensation.

Territory and Plan of Operations

The Company is licensed to do business in the District of Columbia and all states except California where it is an accredited reinsurer. The Company markets its personal and business insurance through independent retail agencies. In 2013, approximately 32% of the Company's direct written premium was written in the State of Ohio.

Reinsurance

Assumed Reinsurance

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.

The only financially significant amounts of reinsurance assumed by the Company relate to business assumed in connection with the intercompany pooling arrangement.

Ceded 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.

Homeowners Quota Share

The Company entered into a 75% quota share reinsurance agreement with three reinsurers for the pooled homeowners business, effective December 31, 2011 and terminating on December 31, 2014. The quota share agreement is intended to deleverage the ratio of premiums written to surplus as well as to provide additional downside protection for homeowners catastrophe losses. Certain material adverse change clauses were incorporated into the agreement to ensure that the State Auto Group is implementing the necessary steps in order to become profitable in its homeowners line of business. There is also a cap on profitability to ensure that the reinsurers do not benefit excessively from the agreement.

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. The State Auto Group has 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.

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, 2013, 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 \$265.0 million (previously \$245.0 million) of covered loss, each occurrence. The reinsurers are responsible for 95% of the excess over \$55.0 million up to \$320.0 million (previously \$300.0 million) of covered losses, each occurrence. Under this agreement, the State Auto Group is responsible for losses above \$320.0 million (previously \$300.0 million).

The State Auto Group also maintains a separate property catastrophe excess of loss reinsurance agreement covering Excess & Surplus 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% of the excess over \$15.0 million up to \$55.0

million of covered loss, each occurrence. The rates for this reinsurance are negotiated annually.

Property Per Risk

At June 1, 2013, the State Auto Group renewed the July 1, 2012 property per risk excess of loss reinsurance agreement, aligning its effective date with that of the property catastrophe treaty. This reinsurance agreement provides that the State Auto Group is responsible for the first \$1.0 million of each covered loss for Excess & Surplus 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 100.0% of the loss in excess of \$1.0 million for the Excess and Surplus property and Programs units and \$3.0 million for other property business up to \$20.0 million of covered loss. The rates for this reinsurance are negotiated annually.

For the Excess & Surplus property unit policies, the State Auto Group also maintains a property Surplus share agreement for wind-only insurance products. This agreement provides for a proportional share of losses on all coastal wind policies written with limits greater than \$5.0 million and up to \$10.0 million of covered loss and all non-coastal wind policies written with limits greater than \$10.0 million and up to \$16.0 million of covered loss. The reinsurers' limit cannot exceed more than \$5.0 million on any one risk.

Casualty and Workers' Compensation

As of July 1, 2013, the State Auto Group renewed its 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. Excess & Surplus 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 Excess & Surplus 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% 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 Excess & Surplus casualty and Programs unit risks, the State Auto Group has a combined casualty treaty whereby under Section A, it retains the first \$1.0 million of covered loss and the reinsurers are responsible for 90% (previously 87%) 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. Under Section B, as respects excess policies over another carrier's primary policy, State Auto Group has a \$10.0 million proportional agreement where it retains \$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 retained bears to the total policy limit. The rates for this reinsurance are negotiated annually.

Reinsurance Pooling Arrangement

The Company participates in an intercompany quota share reinsurance pooling arrangement with its subsidiaries and affiliates. Under the arrangement, the Company assumes net premiums, losses, and expenses from each of the pooled companies and then cedes a portion of premiums, losses, and expenses to the pooled companies in specific percentages, with the Company retaining the balance of the pooled business. Below is a table which lists the pooling percentages as of December 31, 2013:

<u>Company</u>	<u>State of Domicile</u>	<u>Pooling %</u>
State Automobile Mutual Insurance Company	Ohio	34%
State Auto Property & Casualty Insurance Company	Iowa	51%
Milbank Insurance Company	Iowa	14%
Meridian Citizens Mutual Insurance Company	Indiana	0.5%
Patrons Mutual Insurance Company of Connecticut	Connecticut	0.5%
Plaza Insurance Company	Iowa	0%
Rockhill Insurance Company	Arizona	0%
Meridian Security Insurance Company	Indiana	0%
American Compensation Insurance Company	Minnesota	0%
Bloomington Compensation Insurance Company	Minnesota	0%
State Auto Insurance Company of Ohio	Ohio	0%
State Auto Insurance Company of Wisconsin	Wisconsin	<u>0%</u>
		100%

Significant Operating Results

The Company reported the following net underwriting results during the examination period, reported in thousands.

	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Premiums earned	<u>\$ 551,867</u>	<u>\$ 545,112</u>	<u>\$ 339,322</u>	<u>\$ 298,619</u>	<u>\$ 270,234</u>
Losses incurred	309,934	334,103	237,700	178,101	155,614
Loss adjustment exp. incurred	67,914	72,761	41,379	29,844	31,818
Underwriting expenses incurred	<u>195,447</u>	<u>189,446</u>	<u>139,759</u>	<u>105,578</u>	<u>94,613</u>
Net underwriting loss	<u>\$ (21,428)</u>	<u>\$ (51,198)</u>	<u>\$ (79,516)</u>	<u>\$ (14,904)</u>	<u>\$ (11,811)</u>

Financial Statements

The financial condition and the results of its operations for the year ending December 31, 2013 as reported and filed by the Company with the Department and audited by the Company's external auditors are reflected in the following:

Statement of Assets, Liabilities, Surplus and Other Funds

Statement of Income

Statement of Changes in the Capital and Surplus Account

Statement of Assets, Liabilities, Surplus and Other Funds
As of December 31, 2013

Bonds	\$ 428,826,105
Common stocks	724,136,121
Properties occupied by the company	32,876,257
Cash, cash equivalents and short-term investments	92,651,225
Other invested assets	<u>79,289,847</u>
Subtotal, cash and invested assets	<u>1,357,779,555</u>
Investment income due and accrued	3,527,361
Uncollected premiums	219,883,056
Deferred premiums, agents' balances, and installments	396,254,830
Amounts recoverable from reinsurers	189,668,627
Current federal income tax recoverable	1,798,155
Guaranty funds receivable or on deposit	163,743
Electronic data processing equipment and software	2,865,606
Receivables from parent, subsidiaries and affiliates	22,691,034
Equities and deposits in pools and associations	357,057
Loss deductibles	<u>1,084,188</u>
Total assets	<u>\$2,196,073,212</u>

Losses	403,072,234
Reinsurance payable on paid losses and expenses	182,443,283
Loss adjustment expenses	94,494,778
Commissions payable and contingent commissions	15,979,938
Other expenses	12,192,112
Taxes, licenses and fees	7,467,920
Borrowed money	89,897,814
Unearned premiums	254,378,592
Advance premium	12,580,323
Dividends declared to policyholders and unpaid	55,209
Ceded reinsurance premiums payable	115,250,028
Funds held by the company under reinsurance treaties	28,175
Amounts withheld or retained for account of others	6,586,193
Remittances and items not allocated	831,207
Provision for reinsurance	19,557
Drafts outstanding	49,620,596
Payable to parent, subsidiaries and affiliates	54,131,974
Escheated funds payable	2,099,979
Premium deficiency reserve	29,240
Equities and deposits in pools and associations	226,454
Miscellaneous liabilities	181,323
Retroactive reinsurance reserves - assumed	211,689
Excess ceding commissions	8,831
Pension benefits liability	25,210,091
Retiree medical benefits liability	<u>10,990,855</u>
Total liabilities	<u>1,337,988,395</u>
Retroactive reinsurance gain	385,800
Unassigned funds	<u>857,699,017</u>
Surplus as regards policyholders	<u>858,084,817</u>
Total liabilities, surplus and other funds	<u>\$ 2,196,073,212</u>

Statement of Income
For the Year Ending December 31, 2013

Premiums earned	<u>\$ 551,866,955</u>
Losses incurred	309,933,916
Loss adjustment expenses incurred	67,914,237
Other underwriting expenses incurred	195,454,530
Premium deficiency reserve	<u>(7,480)</u>
Total underwriting deductions	<u>573,295,203</u>
Net underwriting loss	<u>(21,428,248)</u>
Net investment income earned	19,229,195
Net realized capital losses	<u>(4,282,714)</u>
Net investment gain	<u>14,946,481</u>
Net loss from agents' or premium balances charged off	(1,352,932)
Finance and service charges not included in premiums	3,213,983
Miscellaneous income	101,252
Loss on sale of fixed assets	(134,109)
Governmental fines and penalties	(60,215)
Retroactive reinsurance gain	19,367
Loss on foreign exchange	<u>(4)</u>
Total other income	<u>1,787,342</u>
Net loss before federal income taxes	(4,694,425)
Dividends to policyholders	85,098
Federal income taxes incurred	<u>(1,741,953)</u>
Net loss	<u>\$ (3,037,570)</u>

**Statement of Changes in the Capital and Surplus Account
(in thousands)**

	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Capital and surplus, beginning of the year	\$ 748,701	\$ 785,494	\$ 1,033,349	\$ 924,639	\$ 1,223,861
Net income	(3,038)	(10,417)	(42,466)	7,498	5,242
Change in net unrealized capital gains or (losses)	65,192	(66,636)	(130,938)	84,615	(250,601)
Change in net deferred income tax	8,082	1,259	(27,390)	2,442	(3,040)
Change in non-admitted assets	53,252	39,301	(22,633)	14,057	(79,114)
Change in provision for reinsurance	(10)	448	(245)	24	62
Deferred gain on intercompany asset transfers	181	25	66	74	2,079
Prior period dividend adjustment	0	0	0	0	26,150
Net excess of pension liability over intangible asset	25,544	(1,295)	(24,249)	0	0
Unrecognized pension	(50,811)	0	0	0	0
Affiliate cost basis adjustment	0	522	0	0	0
Unrecognized retiree medical	<u>10,992</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Net change in capital and surplus during the year	<u>109,384</u>	<u>(36,793)</u>	<u>(247,855)</u>	<u>108,710</u>	<u>(299,222)</u>
Capital and surplus, end of the year	<u>\$ 858,085</u>	<u>\$ 748,701</u>	<u>\$ 785,494</u>	<u>\$ 1,033,349</u>	<u>\$ 924,639</u>

Notes to Financial Statements

Investments

The Company's investments were in compliance with ORC Section 3925.08 and valued in accordance with the relevant Statements of Statutory Accounting Principles and the NAIC Securities Valuation Office.

Loss and Loss Adjustment Expense Reserves

The Company's Board of Directors appointed Matthew S. Mrozek, FCAS, MAAA, of the Company, to render the Company's Statement of Actuarial Opinion ("Opinion"). Mr. Mrozek prepared an Actuarial Report supporting the Opinion in connection with the preparation of the Company's December 31, 2013 Annual Statement.

Thomas S. Botsko, ACAS, MAAA, Chief Property & Casualty Actuary of the Department, reviewed the actuarial report provided by Mr. Mrozek. Based on his review, Mr. Botsko determined that the loss and loss adjustment expense reserves presented in the Company's 2013 Annual Statement were reasonably stated.

Conclusion

The balance sheet contained in this Report of Examination reflects the financial condition of the Company as of December 31, 2013, and is summarized as follows:

Total Admitted Assets	<u>\$ 2,196,073,212</u>
Liabilities	\$ 1,337,988,395
Surplus	<u>858,084,817</u>
Total Liabilities and Surplus	<u>\$ 2,196,073,212</u>

Subsequent Events

The Department approved the merger of Meridian Citizens Mutual Insurance Company with and into the Company, effective July 2, 2014.

Acknowledgement

In addition to the aforementioned and undersigned, David Finkler, CPA, CFE, CISA, AES; Metty Nyangoro, CPA, CFE, CISA, AES; Louis Radecky, CPA (Inactive), CFE; and Bradley Schroer of the Department participated in this examination.

Respectfully,



Nicholas J. Kostoff, CFE
Examiner-In-Charge
Ohio Department of Insurance



David A. Cook, CFE
Assistant Chief Examiner
Ohio Department of Insurance

Verification

As required by Section 3901.07 of the Ohio Revised Code, the undersigned hereby attest to the best of their knowledge and belief that the attached is a true Report of Examination as of December 31, 2013.

Nicholas J. Kostoff 10/29/14
Examiner-In-Charge Date

[Signature] 10/29/14
Assistant Chief Examiner Date

State of Ohio

County of Franklin

Personally appeared before me the above named Nicholas J. Kostoff personally known to me, who executed the above instrument and that the statements and answers contained therein are true and correct to the best of his knowledge and belief.

Subscribed and sworn to before me this 29 day of October, 2014.

Elizabeth Chase
(Notary Public)
ELIZABETH CHASE
NOTARY PUBLIC, STATE OF OHIO
MY COMMISSION EXPIRES MAY 22, 2017
My Commission Expires

State of Ohio

County of Franklin

Personally appeared before me the above named David A. Cook personally known to me, who executed the above instrument and that the statements and answers contained therein are true and correct to the best of his knowledge and belief.

Subscribed and sworn to before me this 29 day of October, 2014.

Elizabeth Chase
(Notary Public)
ELIZABETH CHASE
NOTARY PUBLIC, STATE OF OHIO
MY COMMISSION EXPIRES MAY 22, 2017
My Commission Expires