

Edgar Filing: State Auto Financial CORP - Form 10-Q

State Auto Financial CORP  
Form 10-Q  
November 06, 2017

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us-gaap:IntersegmentEliminationMember 2016-07-01 2016-09-30 0000874977  
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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-Q**

**ý Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended September 30, 2017

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**

(State or other jurisdiction of  
incorporation or organization)

**31-1324304**

(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

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 (§232.405 of this chapter) 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 whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See definition of "large accelerated filer", "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ``

Accelerated filer ý

Non-accelerated filer ``

Smaller reporting company ``

(Do not check if a smaller reporting company) Emerging growth company ``

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ``





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Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

On October 27, 2017, the Registrant had 42,266,472 Common Shares outstanding.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

**PART I – FINANCIAL STATEMENTS**

See accompanying notes to condensed consolidated financial statements.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

**Item 1. Condensed Consolidated Balance Sheets**

(\$ and shares in millions, except per share amounts)

	<b>September 30, 2017</b>	December 31, 2016 (unaudited)
<b>Assets</b>		
Fixed maturities, available-for-sale, at fair value (amortized cost \$2,149.5 and \$2,095.9, respectively)	<b>\$ 2,178.7</b>	\$2,109.3
Equity securities, available-for-sale, at fair value (cost \$297.1 and \$323.1, respectively)	<b>354.9</b>	382.8
Other invested assets, available-for-sale, at fair value (cost \$25.6 and \$25.5, respectively)	<b>53.1</b>	45.1
Other invested assets	<b>5.6</b>	5.4
Notes receivable from affiliate	<b>70.0</b>	70.0
<i>Total investments</i>	<b>2,662.3</b>	2,612.6
Cash and cash equivalents	<b>111.1</b>	51.1
Accrued investment income and other assets	<b>38.1</b>	40.0
Deferred policy acquisition costs (affiliated net assumed \$40.7 and \$50.7, respectively)	<b>122.1</b>	129.8
Reinsurance recoverable on losses and loss expenses payable	<b>4.9</b>	3.6
Prepaid reinsurance premiums	<b>6.7</b>	6.1
Due from affiliate	<b>3.8</b>	—
Current federal income taxes	<b>6.7</b>	6.7
Net deferred federal income taxes	<b>93.4</b>	102.1
Property and equipment, at cost	<b>7.3</b>	7.4
<b>Total assets</b>	<b>\$ 3,056.4</b>	\$2,959.4
<b>Liabilities and Stockholders' Equity</b>		
Losses and loss expenses payable (affiliated net assumed \$723.5 and \$630.9, respectively)	<b>\$ 1,280.5</b>	\$1,181.6
Unearned premiums (affiliated net assumed \$217.0 and \$220.9, respectively)	<b>630.5</b>	617.8
Notes payable (affiliates \$15.2 and \$15.2, respectively)	<b>122.1</b>	122.1
Pension and postretirement benefits (affiliated net ceded \$34.5 and \$40.1, respectively)	<b>64.1</b>	74.4
Due to affiliate	<b>—</b>	2.4
Other liabilities (affiliated net assumed \$18.8 and \$11.0, respectively)	<b>62.0</b>	69.8
<b>Total liabilities</b>	<b>2,159.2</b>	2,068.1
Stockholders' equity:		
Class A Preferred stock (nonvoting), without par value. Authorized 2.5 shares; none issued	<b>—</b>	—
Class B Preferred stock, without par value. Authorized 2.5 shares; none issued	<b>—</b>	—
Common stock, without par value. Authorized 100.0 shares; 49.0 and 48.6 shares issued, respectively, at stated value of \$2.50 per share	<b>122.5</b>	121.6
Treasury stock, 6.8 and 6.8 shares, respectively, at cost	<b>(116.7)</b>	(116.5)
Additional paid-in capital	<b>167.3</b>	159.9
Accumulated other comprehensive income (affiliated net ceded \$51.0 and \$53.7, respectively)	<b>47.9</b>	32.5
Retained earnings	<b>676.2</b>	693.8
<b>Total stockholders' equity</b>	<b>897.2</b>	891.3
<b>Total liabilities and stockholders' equity</b>	<b>\$ 3,056.4</b>	\$2,959.4

**Condensed Consolidated Statements of Income**

(\$ in millions, except per share amounts)

Three months  
ended September  
30

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(unaudited)	2017	2016
Earned premiums (affiliated net assumed \$115.3 and \$121.4, respectively)	<b>\$319.0</b>	\$325.8
Net investment income (affiliates \$1.3 and \$1.3, respectively)	<b>18.7</b>	17.6
Net realized gains (losses) on investments:		
Total other-than-temporary impairment losses	<b>(0.6)</b>	(1.1)
Other net realized investment gains	<b>20.8</b>	9.9
Total net realized gains on investments	<b>20.2</b>	8.8
Other income from affiliates	<b>0.5</b>	0.6
<b>Total revenues</b>	<b>358.4</b>	352.8
Losses and loss expenses (affiliated net assumed \$128.9 and \$100.9, respectively)	<b>253.5</b>	232.3
Acquisition and operating expenses (affiliated net assumed \$78.9 and \$73.9, respectively)	<b>112.7</b>	109.9
Interest expense (affiliates \$0.2 and \$0.2, respectively)	<b>1.5</b>	1.4
Other expenses	<b>1.9</b>	1.8
<b>Total expenses</b>	<b>369.6</b>	345.4
<b>(Loss) income before federal income taxes</b>	<b>(11.2)</b>	7.4
Federal income tax benefit:		
Current	<b>(0.1)</b>	(1.5)
Deferred	<b>(1.6)</b>	(1.2)
<b>Total federal income tax benefit</b>	<b>(1.7)</b>	(2.7)
<b>Net (loss) income</b>	<b>\$(9.5)</b>	\$10.1
(Loss) earnings per common share:		
Basic	<b>\$(0.23)</b>	\$0.24
Diluted	<b>\$(0.23)</b>	\$0.24
Dividends paid per common share	<b>\$0.10</b>	\$0.10

See accompanying notes to condensed consolidated financial statements.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

**Condensed Consolidated Statements of Income**

	Nine months ended September 30	
	<b>2017</b>	2016
<i>(\$ in millions, except per share amounts)</i>		
(unaudited)		
Earned premiums (affiliated net assumed \$348.2 and \$352.4, respectively)	<b>\$956.4</b>	\$968.1
Net investment income (affiliates \$3.7 and \$3.7, respectively)	<b>56.5</b>	54.1
Net realized gains (losses) on investments:		
Total other-than-temporary impairment losses	<b>(3.5 )</b>	(5.4 )
Other net realized investment gains	<b>47.3</b>	22.0
Total net realized gains on investments	<b>43.8</b>	16.6
Other income from affiliates	<b>1.7</b>	1.7
<b>Total revenues</b>	<b>1,058.4</b>	1,040.5
Losses and loss expenses (affiliated net assumed \$298.5 and \$281.4, respectively)	<b>717.9</b>	720.2
Acquisition and operating expenses (affiliated net assumed \$231.0 and \$217.0, respectively)	<b>334.8</b>	324.6
Interest expense (affiliates \$0.6 and \$0.6, respectively)	<b>4.4</b>	4.1
Other expenses	<b>5.8</b>	5.5
<b>Total expenses</b>	<b>1,062.9</b>	1,054.4
<b>Loss before federal income taxes</b>	<b>(4.5 )</b>	(13.9 )
Federal income tax expense (benefit):		
Current	<b>—</b>	(1.5 )
Deferred	<b>0.4</b>	(0.9 )
<b>Total federal income tax expense (benefit)</b>	<b>0.4</b>	(2.4 )
<b>Net loss</b>	<b>\$(4.9 )</b>	\$(11.5 )
Loss per common share:		
Basic	<b>\$(0.12 )</b>	\$(0.28 )
Diluted	<b>\$(0.12 )</b>	\$(0.28 )
Dividends paid per common share	<b>\$0.30</b>	\$0.30

**Consolidated Statements of Comprehensive Income**

	Three months ended September 30	
	<b>2017</b>	2016
<i>(\$ in millions, except per share amounts)</i>		
(unaudited)		
Net (loss) income	<b>\$(9.5 )</b>	\$10.1
Other comprehensive income, net of tax:		
Net unrealized holding gains (losses) on investments:		
Unrealized holding gains	<b>11.0</b>	6.3
Reclassification adjustments for gains realized in net income	<b>(20.2 )</b>	(8.8 )
Income tax expense	<b>3.2</b>	0.8
<b>Total net unrealized holding losses on investments</b>	<b>(6.0 )</b>	(1.7 )
Net unrecognized benefit plan obligations:		
Reclassification adjustments for amortization to statements of income:		
Negative prior service cost	<b>(1.3 )</b>	(1.3 )

Net actuarial loss	<b>2.1</b>	2.4
Income tax expense	<b>(0.3 )</b>	(0.4 )
<i>Total net unrecognized benefit plan obligations</i>	<b>0.5</b>	0.7
<i>Other comprehensive loss</i>	<b>(5.5 )</b>	(1.0 )
<b>Comprehensive (loss) income</b>	<b>\$(15.0)</b>	\$9.1

See accompanying notes to condensed consolidated financial statements.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

**Consolidated Statements of Comprehensive Income**

	Nine months ended September 30	
	2017	2016
<i>(\$ in millions, except per share amounts)</i>		
(unaudited)		
Net loss	<b>\$(4.9)</b>	\$(11.5)
Other comprehensive income, net of tax:		
Net unrealized holding gains on investments:		
Unrealized holding gains	<b>65.6</b>	81.5
Reclassification adjustments for gains realized in net income	<b>(43.8)</b>	(16.6)
Income tax expense	<b>(7.6)</b>	(22.8)
<i>Total net unrealized holding gains on investments</i>	<b>14.2</b>	42.1
Net unrecognized benefit plan obligations:		
Reclassification adjustments for amortization to statements of income:		
Negative prior service cost	<b>(4.1)</b>	(4.1)
Net actuarial loss	<b>6.1</b>	7.1
Income tax expense	<b>(0.8)</b>	(1.0)
<i>Total net unrecognized benefit plan obligations</i>	<b>1.2</b>	2.0
<i>Other comprehensive income</i>	<b>15.4</b>	44.1
<b>Comprehensive income</b>	<b>\$10.5</b>	\$32.6

See accompanying notes to condensed consolidated financial statements.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

**Condensed Consolidated Statements of Cash Flows**

	Nine months ended September 30	
	2017	2016
<i>(\$ in millions)</i>		
(unaudited)		
<b>Cash flows from operating activities:</b>		
Net loss	<b>\$(4.9 )</b>	\$(11.5 )
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization, net	<b>9.9</b>	11.5
Share-based compensation	<b>3.0</b>	3.2
Net realized gains on investments	<b>(43.8 )</b>	(16.6 )
Changes in operating assets and liabilities:		
Deferred policy acquisition costs	<b>7.7</b>	(4.7 )
Accrued investment income and other assets	<b>2.0</b>	(3.4 )
Postretirement and pension benefits	<b>(9.1 )</b>	(30.6 )
Other liabilities and due to/from affiliates, net	<b>(14.8 )</b>	(17.4 )
Reinsurance recoverable on losses and loss expenses payable and prepaid reinsurance premiums	<b>(1.9 )</b>	2.5
Losses and loss expenses payable	<b>98.9</b>	112.6
Unearned premiums	<b>12.7</b>	17.9
Deferred tax expense (benefit) on share-based awards	<b>1.3</b>	(0.1 )
Federal income taxes	<b>(0.3 )</b>	(1.4 )
<b>Net cash provided by operating activities</b>	<b>60.7</b>	62.0
<b>Cash flows from investing activities:</b>		
Purchases of fixed maturities available-for-sale	<b>(409.2 )</b>	(414.6 )
Purchases of equity securities available-for-sale	<b>(104.1 )</b>	(77.9 )
Purchases of other invested assets	<b>(1.0 )</b>	(1.0 )
Maturities, calls and pay downs of fixed maturities available-for-sale	<b>192.1</b>	177.1
Sales of fixed maturities available-for-sale	<b>156.3</b>	138.0
Sales of equity securities available-for-sale	<b>171.3</b>	113.9
Sales of other invested assets available-for-sale	<b>0.8</b>	0.7
<b>Net cash provided by (used in) investing activities</b>	<b>6.2</b>	(63.8 )
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of common stock	<b>6.0</b>	4.2
Payments to acquire treasury stock	<b>(0.2 )</b>	(0.2 )
Payment of dividends	<b>(12.7 )</b>	(12.4 )
Deferred tax expense on share-based awards	<b>—</b>	0.1
Proceeds from long-term debt	<b>—</b>	21.5
<b>Net cash (used in) provided by financing activities</b>	<b>(6.9 )</b>	13.2
Net increase in cash and cash equivalents	<b>60.0</b>	11.4
Cash and cash equivalents at beginning of period	<b>51.1</b>	58.1
<b>Cash and cash equivalents at end of period</b>	<b>\$111.1</b>	\$69.5
<u>Supplemental disclosures:</u>		
Interest paid (affiliates \$0.6 and \$0.6, respectively)	<b>\$4.3</b>	\$4.0

See accompanying notes to condensed consolidated financial statements.



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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Condensed Consolidated Financial Statements (Unaudited)

**1. Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements of State Auto Financial Corporation and Subsidiaries (“State Auto Financial” or the “Company”) have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles (“GAAP”) for complete financial statements. In the opinion of the Company, all adjustments (consisting of normal, recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine month period ended September 30, 2017, are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. The balance sheet at December 31, 2016, has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete financial statements.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Company’s annual report on Form 10-K for the year ended December 31, 2016, (the “2016 Form 10-K”). Capitalized terms used herein and not otherwise defined shall have the meaning ascribed to them in the 2016 Form 10-K.

**Adoption of Recent Accounting Pronouncements**

*Employee Share-Based Payment Accounting*

The amendments in this guidance simplify the accounting for share-based payment award transactions including: income tax consequences, classification of awards as either equity or liabilities, classification of excess tax benefits, and classification on the statement of cash flows. The guidance is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The Company adopted this guidance prospectively at January 1, 2017, and prior periods were not adjusted. For the nine months ended September 30, 2017, the Company recognized \$1.3 million of income tax expense as a result of adopting this guidance.

**Pending Adoption of Recent Accounting Pronouncements**

*Revenue from Contracts with Customers*

In May 2014, the Financial Accounting Standards Board (the "FASB") issued guidance that requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Insurance contracts do not fall within the scope of this new guidance. The guidance is effective for annual reporting periods beginning after December 15, 2017, with early adoption permitted. The guidance has not yet been adopted. The Company completed its contract analysis during the third quarter of 2017 and noted that 0.1% of revenue, primarily affiliated investment management fee revenue, is subject to the new revenue recognition guidance. Revenue will not change under the new guidance; thus, upon adoption, the Company does not expect any impact to its' results of operations and consolidated financial position.

For information regarding other accounting pronouncements that the Company has not yet adopted, see the “Pending Adoption of Recent Accounting Pronouncements” section of Note 1 of the Notes to Consolidated Financial Statements in the 2016 Form 10-K.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

**2. Investments**

The following tables set forth the cost or amortized cost and fair value of available-for-sale securities by lot at September 30, 2017 and December 31, 2016:

(\$ millions)

**September 30, 2017**

	Cost or amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
Fixed maturities:				
U.S. treasury securities and obligations of U.S. government agencies	\$418.6	\$8.3	\$(4.5)	\$422.4
Obligations of states and political subdivisions	553.7	19.9	(0.4)	573.2
Corporate securities	534.9	6.9	(1.4)	540.4
U.S. government agencies mortgage-backed securities	642.3	8.9	(8.5)	642.7
<i>Total fixed maturities</i>	<b>2,149.5</b>	<b>44.0</b>	<b>(14.8)</b>	<b>2,178.7</b>
Equity securities:				
Large-cap securities	71.5	29.9	(0.7)	100.7
Small-cap securities	48.3	17.1	—	65.4
Mutual and exchange traded funds	177.3	18.3	(6.8)	188.8
<i>Total equity securities</i>	<b>297.1</b>	<b>65.3</b>	<b>(7.5)</b>	<b>354.9</b>
Other invested assets	25.6	27.5	—	53.1
<i>Total available-for-sale securities</i>	<b>\$2,472.2</b>	<b>\$136.8</b>	<b>\$(22.3)</b>	<b>\$2,586.7</b>

(\$ millions)

## December 31, 2016

	Cost or amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
Fixed maturities:				
U.S. treasury securities and obligations of U.S. government agencies	\$401.9	\$8.9	\$(6.1)	\$404.7
Obligations of states and political subdivisions	634.6	12.3	(3.2)	643.7
Corporate securities	445.7	6.1	(2.2)	449.6
U.S. government agencies mortgage-backed securities	613.7	8.5	(10.9)	611.3
<i>Total fixed maturities</i>	<b>2,095.9</b>	<b>35.8</b>	<b>(22.4)</b>	<b>2,109.3</b>
Equity securities:				
Large-cap securities	108.9	32.7	(2.6)	139.0
Small-cap securities	57.2	21.9	—	79.1
Mutual and exchange traded funds	157.0	8.5	(0.8)	164.7
<i>Total equity securities</i>	<b>323.1</b>	<b>63.1</b>	<b>(3.4)</b>	<b>382.8</b>
Other invested assets	25.5	19.6	—	45.1
<i>Total available-for-sale securities</i>	<b>\$2,444.5</b>	<b>\$118.5</b>	<b>\$(25.8)</b>	<b>\$2,537.2</b>

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

The following tables set forth the Company's gross unrealized losses and fair value on its investments by lot, aggregated by investment category and length of time for individual securities that have been in a continuous unrealized loss position at September 30, 2017 and December 31, 2016:

(\$ millions, except # of positions)

	Less than 12 months			12 months or more			Total		
	Fair value	Unrealized losses	Number of positions	Fair value	Unrealized losses	Number of positions	Fair value	Unrealized losses	Number of positions
<b>September 30, 2017</b>									
<b>Fixed maturities:</b>									
U.S. treasury securities and obligations of U.S. government agencies	\$150.0	\$(1.9)	25	\$104.0	\$(2.6)	7	\$254.0	\$(4.5)	32
Obligations of states and political subdivisions	60.2	(0.4)	8	—	—	—	60.2	(0.4)	8
Corporate securities	114.4	(0.6)	16	45.5	(0.8)	7	159.9	(1.4)	23
U.S. government agencies mortgage-backed securities	282.6	(5.5)	41	99.6	(3.0)	19	382.2	(8.5)	60
<i>Total fixed maturities</i>	<b>607.2</b>	<b>(8.4)</b>	<b>90</b>	<b>249.1</b>	<b>(6.4)</b>	<b>33</b>	<b>856.3</b>	<b>(14.8)</b>	<b>123</b>
<b>Equity securities:</b>									
Large-cap equity securities	5.8	(0.6)	5	3.2	(0.1)	1	9.0	(0.7)	6
Mutual and exchange traded funds	67.5	(6.8)	1	—	—	—	67.5	(6.8)	1
<i>Total equity securities</i>	<b>73.3</b>	<b>(7.4)</b>	<b>6</b>	<b>3.2</b>	<b>(0.1)</b>	<b>1</b>	<b>76.5</b>	<b>(7.5)</b>	<b>7</b>
<i>Total temporarily impaired securities</i>	<b>\$680.5</b>	<b>\$(15.8)</b>	<b>96</b>	<b>\$252.3</b>	<b>\$(6.5)</b>	<b>34</b>	<b>\$932.8</b>	<b>\$(22.3)</b>	<b>130</b>

(\$ millions, except # of positions)

	Less than 12 months			12 months or more			Total		
	Fair value	Unrealized losses	Number of positions	Fair value	Unrealized losses	Number of positions	Fair value	Unrealized losses	Number of positions
<b>December 31, 2016</b>									
<b>Fixed maturities:</b>									
U.S. treasury securities and obligations of U.S. government agencies	\$229.1	\$(6.1)	30	\$—	\$—	—	\$229.1	\$(6.1)	30
Obligations of states and political subdivisions	178.9	(3.2)	26	—	—	—	178.9	(3.2)	26
Corporate securities	102.9	(1.4)	16	29.4	(0.8)	4	132.3	(2.2)	20
U.S. government agencies mortgage-backed securities	341.7	(10.1)	43	20.5	(0.8)	11	362.2	(10.9)	54
<i>Total fixed maturities</i>	<b>852.6</b>	<b>(20.8)</b>	<b>115</b>	<b>49.9</b>	<b>(1.6)</b>	<b>15</b>	<b>902.5</b>	<b>(22.4)</b>	<b>130</b>
<b>Equity securities:</b>									
Large-cap equity securities	9.1	(0.9)	7	8.8	(1.7)	5	17.9	(2.6)	12
Mutual and exchange traded funds	29.9	(0.8)	2	—	—	—	29.9	(0.8)	2
<i>Total equity securities</i>	<b>39.0</b>	<b>(1.7)</b>	<b>9</b>	<b>8.8</b>	<b>(1.7)</b>	<b>5</b>	<b>47.8</b>	<b>(3.4)</b>	<b>14</b>
<i>Total temporarily impaired securities</i>	<b>\$891.6</b>	<b>\$(22.5)</b>	<b>124</b>	<b>\$58.7</b>	<b>\$(3.3)</b>	<b>20</b>	<b>\$950.3</b>	<b>\$(25.8)</b>	<b>144</b>

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

The Company reviewed its investments at September 30, 2017, and determined that no additional other-than-temporary impairment ("OTTI") existed in the gross unrealized holding losses other than those listed in the table below. The following table sets forth the realized losses related to other-than-temporary impairments on the Company's investment portfolio recognized for the three and nine months ended September 30, 2017 and 2016:

(\$ millions)	Three months ended		Nine months ended	
	September 30 2017	2016	September 30 2017	2016
Equity securities:				
Large-cap securities	\$—	\$—	\$(1.5)	\$(0.2)
Small-cap securities	(0.6)	(1.1)	(2.0)	(2.9)
Fixed maturities:	—	—	—	(2.3)
<i>Total other-than-temporary impairments</i>	<b>\$(0.6)</b>	<b>\$(1.1)</b>	<b>\$(3.5)</b>	<b>\$(5.4)</b>

The Company regularly monitors its investments that have fair values less than cost or amortized cost for signs of other-than-temporary impairment, 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. Among the factors that management considers for fixed maturity securities are the financial condition of the issuer including receipt of scheduled principal and interest cash flows, and intent to sell, including if it is more likely than not that the Company 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 accumulated other comprehensive income. Future increases or decreases in fair value, if not other-than-temporary, are included in accumulated other comprehensive income.

Among the factors that management considers for equity securities and other invested assets are the length of time and/or the significance of decline below cost, the Company's ability and intent to hold these securities through their recovery periods, the current financial condition of the issuer and its future business prospects, and the ability of the market value to recover to cost 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, the cost basis of the security is adjusted 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 accumulated other comprehensive income.

The following table sets forth the amortized cost and fair value of available-for-sale fixed maturities by contractual maturity at September 30, 2017:

(\$ millions)	Amortized cost	Fair value
Due in 1 year or less	\$ 12.8	\$ 12.8
Due after 1 year through 5 years	549.5	554.5
Due after 5 years through 10 years	418.3	422.8
Due after 10 years	526.6	545.9
U.S. government agencies mortgage-backed securities	642.3	642.7
<i>Total</i>	<b>\$ 2,149.5</b>	<b>\$ 2,178.7</b>

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

At September 30, 2017, State Auto P&C had U.S. government agencies mortgage-backed fixed maturity securities, with a carrying value of approximately \$106.5 million, that were pledged as collateral for the FHLB Loans (as defined in Note 3). In accordance with the terms of the FHLB Loans, State Auto P&C retains all rights regarding these pledged securities.

Fixed maturities with fair values of \$9.3 million and \$9.2 million were on deposit with insurance regulators as required by law at September 30, 2017, and December 31, 2016, respectively. The Company retains all rights regarding these securities.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

The following table sets forth the components of net investment income for the three and nine months ended September 30, 2017 and 2016:

(\$ millions)	Three months ended September 30		Nine months ended September 30	
	2017	2016	2017	2016
Fixed maturities	\$15.4	\$15.4	\$47.1	\$47.0
Equity securities	2.0	1.3	5.7	4.3
Cash and cash equivalents, and other	1.6	1.4	4.6	4.1
<i>Investment income</i>	<b>19.0</b>	18.1	<b>57.4</b>	55.4
Investment expenses	0.3	0.5	0.9	1.3
<i>Net investment income</i>	<b>\$18.7</b>	\$17.6	<b>\$56.5</b>	\$54.1

The Company's current investment strategy does not rely on the use of derivative financial instruments.

Proceeds on sales of available-for-sale securities were \$328.4 million and \$252.6 million for the nine months ended September 30, 2017, and 2016, respectively.

The following table sets forth the realized and unrealized holding gains (losses) on the Company's investment portfolio for the three and nine months ended September 30, 2017 and 2016:

(\$ millions)	Three months ended September 30		Nine months ended September 30	
	2017	2016	2017	2016
Realized gains:				
Fixed maturities	\$0.4	\$—	\$2.7	\$2.1
Equity securities	20.9	9.9	45.2	20.6
Other invested assets	—	—	0.1	0.1
<i>Total realized gains</i>	<b>21.3</b>	9.9	<b>48.0</b>	22.8
Realized losses:				
Equity securities:				
Sales	(0.5 )	—	(0.7 )	(0.8 )
OTTI	(0.6 )	(1.1 )	(3.5 )	(3.1 )
Fixed maturities:				
OTTI	—	—	—	(2.3 )
<i>Total realized losses</i>	<b>(1.1 )</b>	(1.1 )	<b>(4.2 )</b>	(6.2 )
<i>Net realized gains on investments</i>	<b>\$20.2</b>	\$8.8	<b>\$43.8</b>	\$16.6
Change in unrealized holding gains (losses), net of tax:				
Fixed maturities	\$0.4	\$(11.2)	\$15.8	\$54.5
Equity securities	(12.1 )	4.2	(1.9 )	6.0
Other invested assets	2.5	4.5	7.9	4.4
Deferred federal income tax liability	3.2	0.8	(7.6 )	(22.8 )
<i>Change in net unrealized holding (losses) gains, net of tax</i>	<b>\$(6.0 )</b>	\$(1.7 )	<b>\$14.2</b>	\$42.1





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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

**3. Fair Value of Financial Instruments**

Below is the fair value hierarchy that categorizes into three levels the inputs to valuation techniques that are used to measure fair value:

Level 1 includes observable inputs which reflect quoted prices for identical assets or liabilities in active markets at the measurement date.

Level 2 includes observable inputs for assets or liabilities other than quoted prices included in Level 1, and it includes valuation techniques which use prices for similar assets and liabilities.

Level 3 includes unobservable inputs which reflect the reporting entity's estimates of the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk).

The Company utilizes one nationally recognized pricing service to estimate the majority of its available-for-sale investment portfolio's fair value. The Company obtains one price per security and the processes and control procedures employed by the Company are designed to ensure the value is accurately recorded on an unadjusted basis. Through discussions with the pricing service, the Company gains 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, the Company compares to other fair value pricing information gathered from other independent pricing sources. At September 30, 2017, and December 31, 2016, the Company did not adjust any of the prices received from the pricing service.

Transfers between level categorizations may occur due to changes in the availability of market observable inputs.

Transfers in and out of level categorizations are reported as having occurred at the beginning of the quarter in which the transfer occurred. There were no transfers between level categorizations during the three and nine months ended September 30, 2017, and 2016.

The following sections describe the valuation methods used by the Company for each type of financial instrument it holds that are carried at fair value.

*Fixed Maturities*

The Company utilizes a third party pricing service to estimate fair value measurements for the majority of its fixed maturities. The fair value estimate of the Company's fixed maturity investments are determined by evaluations that are based on observable market information rather than market quotes. Inputs to the evaluations include, but are not limited to, market prices from recently completed transactions and transactions of comparable securities, interest rate yield curves, credit spreads, and other market-observable information. The fixed maturity portfolio pricing obtained from the pricing service is reviewed for reasonableness. The Company regularly selects a random sample of security prices which are compared to one or more alternative pricing sources for reasonableness. Any discrepancies with the pricing are returned to the pricing service for further explanation and, if necessary, adjustments are made. To date, the Company has not identified any significant discrepancies in the pricing provided by its third party pricing service.

Investments valued using these inputs include U.S. treasury securities and obligations of U.S. government agencies, obligations of states and political subdivisions, corporate securities (except for a security discussed below), and U.S. government agencies mortgage-backed securities. All unadjusted estimates of fair value for fixed maturities priced by the pricing service are included in the amounts disclosed in Level 2 of the hierarchy. If market inputs are unavailable, then no fair value is provided by the pricing service. For these securities, fair value is determined either by requesting brokers who are knowledgeable about these securities to provide a quote; or the Company internally determines the fair values by employing widely accepted pricing valuation models, and depending on the level of observable market inputs, renders the fair value estimate as Level 2 or Level 3. The Company held one corporate fixed maturity security included in Level 3 and estimated its fair value using the present value of the future cash flows. Due to the limited amount of observable market information for this security, the Company included the fair value estimate in Level 3. This security was sold during the second quarter of 2017.



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*Equities*

The fair value of each equity security is based on an observable market price for an identical asset in an active market and is priced by the same pricing service discussed above. All equity securities are recorded using unadjusted market prices and have been disclosed in Level 1.

*Other Invested Assets*

Included in other invested assets is one international fund (“the fund”) that invests in equity securities of foreign issuers and is managed by a third party investment manager. The fund had a fair value of \$42.9 million and \$35.7 million at September 30, 2017, and December 31, 2016, respectively, which was determined using the fund’s net asset value. The Company employs procedures to assess the reasonableness of the fair value of the fund including obtaining and reviewing the fund’s audited financial statements. There are no unfunded commitments related to the fund. The Company may not sell its investment in the fund; however, the Company may redeem all or a portion of its investment in the fund at net asset value per share with the appropriate prior written notice. In accordance with Accounting Standard Codification 820-10, this investment is measured at fair value using the net asset value per share practical expedient and has not been classified in the fair value hierarchy. Fair values presented here are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the condensed consolidated balance sheets. The remainder of the Company’s other invested assets consist primarily of holdings in publicly-traded mutual funds. The Company believes that its prices for these publicly-traded mutual funds based on an observable market price for an identical asset in an active market reflect their fair values and consequently these securities have been disclosed in Level 1.

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The following tables set forth the Company's available-for-sale investments within the fair value hierarchy at September 30, 2017 and December 31, 2016:

<i>(\$ millions)</i>	Total	Level 1	Level 2	Level 3
<b>September 30, 2017</b>				
Fixed maturities:				
U.S. treasury securities and obligations of U.S. government agencies	<b>\$422.4</b>	<b>\$—</b>	<b>\$422.4</b>	<b>\$—</b>
Obligations of states and political subdivisions	<b>573.2</b>	<b>—</b>	<b>573.2</b>	<b>—</b>
Corporate securities	<b>540.4</b>	<b>—</b>	<b>540.4</b>	<b>—</b>
U.S. government agencies mortgage-backed securities	<b>642.7</b>	<b>—</b>	<b>642.7</b>	<b>—</b>
<i>Total fixed maturities</i>	<b>2,178.7</b>	<b>—</b>	<b>2,178.7</b>	<b>—</b>
Equity securities:				
Large-cap securities	<b>100.7</b>	<b>100.7</b>	<b>—</b>	<b>—</b>
Small-cap securities	<b>65.4</b>	<b>65.4</b>	<b>—</b>	<b>—</b>
Mutual and exchange traded funds	<b>188.8</b>	<b>188.8</b>	<b>—</b>	<b>—</b>
<i>Total equity securities</i>	<b>354.9</b>	<b>354.9</b>	<b>—</b>	<b>—</b>
Other invested assets	<b>10.2</b>	<b>10.2</b>	<b>—</b>	<b>—</b>
<i>Total available-for-sale investments</i>	<b>\$2,543.8</b>	<b>\$365.1</b>	<b>\$2,178.7</b>	<b>\$—</b>

<i>(\$ millions)</i>	Total	Level 1	Level 2	Level 3
December 31, 2016				
Fixed maturities:				
U.S. treasury securities and obligations of U.S. government agencies	\$404.7	\$—	\$404.7	\$—
Obligations of states and political subdivisions	643.7	—	643.7	—
Corporate securities	449.6	—	446.1	3.5
U.S. government agencies mortgage-backed securities	611.3	—	611.3	—
<i>Total fixed maturities</i>	<b>2,109.3</b>	<b>—</b>	<b>2,105.8</b>	<b>3.5</b>
Equity securities:				
Large-cap securities	139.0	139.0	—	—
Small-cap securities	79.1	79.1	—	—
Mutual and exchange traded funds	164.7	164.7	—	—
<i>Total equity securities</i>	<b>382.8</b>	<b>382.8</b>	<b>—</b>	<b>—</b>
Other invested assets	9.4	9.4	—	—
<i>Total available-for-sale investments</i>	<b>\$2,501.5</b>	<b>\$392.2</b>	<b>\$2,105.8</b>	<b>\$3.5</b>

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

For assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3), the following tables set forth a reconciliation of the beginning and ending balances for the nine months ended September 30, 2017, and the year ended December 31, 2016, separately for each major category of assets. This security was sold during the second quarter of 2017.

<i>(\$ millions)</i>	Fixed maturities
Balance at January 1, 2017	<b>\$ 3.5</b>
Total realized gains – included in earnings	—
Total unrealized losses – included in other comprehensive income	—
Purchases	<b>0.1</b>
Sales	—
Transfers into Level 3	—
Transfers out of Level 3	—
Balance at March 31, 2017	<b>\$ 3.6</b>
Total realized gains – included in earnings	<b>1.4</b>
Total unrealized losses – included in other comprehensive income	—
Purchases	—
Sales	<b>(5.0 )</b>
Transfers into Level 3	—
Transfers out of Level 3	—
Balance at June 30, 2017	<b>\$ —</b>
Total realized gains – included in earnings	—
Total unrealized gains – included in other comprehensive income	—
Purchases	—
Sales	—
Transfers into Level 3	—
Transfers out of Level 3	—
Balance at September 30, 2017	<b>\$ —</b>

<i>(\$ millions)</i>	Fixed maturities
Balance at January 1, 2016	<b>\$ 3.3</b>
Total realized gains – included in earnings	—
Total unrealized gains – included in other comprehensive income	—
Purchases	<b>0.2</b>
Sales	—
Transfers into Level 3	—
Transfers out of Level 3	—
Balance at December 31, 2016	<b>\$ 3.5</b>

The following sections describe the valuation methods used by the Company for each type of financial instrument it holds that is not measured at fair value but for which fair value is disclosed:

**Financial Instruments Disclosed, But Not Carried, At Fair Value***Other Invested Assets*

Included in other invested assets are common stock of the Federal Home Loan Bank of Cincinnati (the "FHLB") and the Trust Securities. The Trust Securities and FHLB common stock are carried at cost, which approximates fair value. The fair value of the FHLB common stock at September 30, 2017, was \$5.1 million and the fair value of the Trust Securities was \$0.5 million. The investments have been placed in Level 3 of the fair value hierarchy.

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*Notes Receivable from Affiliate*

In May 2009, the Company entered into two separate credit agreements with State Automobile Mutual Insurance Company ("State Auto Mutual") pursuant to which it loaned State Auto Mutual a total of \$70.0 million. The Company estimates the fair value of the notes receivable from affiliate using market quotations for U.S. treasury securities with similar maturity dates and applies an appropriate credit spread. Consequently this has been placed in Level 2 of the fair value hierarchy.

(\$ millions, except interest rates)

	September 30, 2017			December 31, 2016		
	Carrying value	Fair value	Interest rate	Carrying value	Fair value	Interest rate
Notes receivable from affiliate	\$70.0	\$74.1	7.00 %	\$70.0	\$75.7	7.00 %

*Notes Payable*

Included in notes payable are the FHLB Loans and Subordinated Debentures. The Company estimates the fair value of the FHLB Loans by discounting cash flows using a borrowing rate currently available to the Company for loans with similar terms. The FHLB Loans have been placed in Level 3 of the fair value hierarchy. The carrying amount of the Subordinated Debentures approximates its fair value as the interest rate adjusts quarterly and has been disclosed in Level 3.

(\$ millions, except interest rates)

	September 30, 2017			December 31, 2016		
	Carrying value	Fair Value	Interest rate	Carrying value	Fair value	Interest rate
FHLB Loan due 2021: issued \$21.5, September 2016 with fixed interest	\$21.5	\$21.1	1.73 %	\$21.5	\$21.0	1.73 %
FHLB Loan due 2033: issued \$85.0, July 2013 with fixed interest	85.4	85.9	5.03 %	85.4	85.6	5.03 %
Affiliate Subordinated Debentures due 2033: issued \$15.5, May 2003 with variable interest	15.2	15.2	5.52 %	15.2	15.2	5.13 %
<i>Total notes payable</i>	<b>\$122.1</b>	<b>\$122.2</b>		\$122.1	\$121.8	

**4. Losses and Loss Expenses Payable**

The following table sets forth the activity in the liability for losses and loss expenses for the nine months ended September 30, 2017 and 2016:

(\$ millions)

	2017	2016
Losses and loss expenses payable, at beginning of period	\$1,181.6	\$1,053.0
Less: reinsurance recoverable on losses and loss expenses payable	3.6	5.9
<i>Net balance at beginning of period</i>	<b>1,178.0</b>	1,047.1
Incurred related to:		
Current year	752.5	686.8
Prior years	(34.6)	33.4
<i>Total incurred</i>	<b>717.9</b>	720.2
Paid related to:		
Current year	302.0	286.6
Prior years	318.3	319.2
<i>Total paid</i>	<b>620.3</b>	605.8
<i>Net balance at end of period</i>	<b>1,275.6</b>	1,161.5



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Plus: reinsurance recoverable on losses and loss expenses payable	<b>4.9</b>	4.1
<i>Losses and loss expenses payable, at end of period</i>	<b>\$1,280.5</b>	\$1,165.6

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

The Company recorded favorable development related to prior years' loss and loss expense reserves for the nine months ended September 30, 2017 of \$34.6 million compared to adverse development of \$33.4 million for the same 2016 period. Favorable development of prior years' unallocated loss adjustment expenses and catastrophe reserves were approximately \$4.4 million and \$1.8 million, respectively, of the 2017 development. Favorable development of prior accident years' non-catastrophe loss and ALAE reserves was primarily due to \$33.1 million of favorable development in the commercial insurance segment. Slightly offsetting the favorable development was adverse development in the specialty and personal insurance segments of \$2.6 million and \$2.1 million, respectively. The specialty insurance segment was impacted by \$3.0 million of adverse development in E&S property, driven by higher than anticipated severity for liability coverages on business in run-off. In the personal insurance segment, homeowners' contributed \$1.9 million of adverse development, primarily from accident year 2016, and other personal contributed \$2.5 million of adverse development, driven by higher than anticipated severity emerging from accident years 2015 and 2016. Slightly offsetting the adverse development was \$2.3 million of favorable development in personal auto, primarily driven by lower than anticipated severity emerging from accident years 2014 and 2015. Favorable development of catastrophe reserves was approximately \$1.3 million for the nine months ended September 30, 2016, and adverse development of unallocated loss adjustment expenses was \$3.8 million for the same 2016 period. Programs, personal auto and commercial auto contributed \$13.4 million, \$8.5 million and \$5.1 million of the adverse development. Adverse development in programs was primarily due to two programs with commercial auto exposures, both of which are in run-off. Adverse development in personal and commercial auto was primarily due to higher than anticipated bodily injury severity from the prior two accident years.

**5. Reinsurance**

The insurance subsidiaries of State Auto Financial, including State Auto P&C, Milbank and SA Ohio (collectively referred to as the "STFC Pooled Companies") participate in a quota share reinsurance pooling arrangement ("the Pooling Arrangement") with State Auto Mutual and its subsidiaries and affiliates (collectively referred to as the "Mutual Pooled Companies").

The following table sets forth a summary of the Company's external reinsurance transactions, as well as reinsurance transactions with State Auto Mutual under the Pooling Arrangement, for the three and nine months ended September 30, 2017 and 2016:

(\$ millions)	Three months ended September 30		Nine months ended September 30	
	2017	2016	2017	2016
<b>Premiums earned:</b>				
Assumed from external insurers and reinsurers	<b>\$2.3</b>	\$1.2	<b>\$4.7</b>	\$3.6
Assumed under Pooling Arrangement	<b>319.0</b>	325.8	<b>956.4</b>	968.1
Ceded to external insurers and reinsurers	<b>(4.9 )</b>	(6.0 )	<b>(17.1 )</b>	(19.3 )
Ceded under Pooling Arrangement	<b>(203.7 )</b>	(204.4 )	<b>(608.2 )</b>	(615.7 )
<i>Net assumed premiums earned</i>	<b>\$112.7</b>	\$116.6	<b>\$335.8</b>	\$336.7
<b>Losses and loss expenses incurred:</b>				
Assumed from external insurers and reinsurers	<b>\$2.2</b>	\$0.9	<b>\$4.7</b>	\$2.8
Assumed under Pooling Arrangement	<b>254.0</b>	232.8	<b>719.2</b>	721.5
Ceded to external insurers and reinsurers	<b>(2.7 )</b>	0.3	<b>(3.7 )</b>	(2.1 )
Ceded under Pooling Arrangement	<b>(125.1 )</b>	(131.9 )	<b>(420.7 )</b>	(440.1 )
<i>Net assumed losses and loss expenses incurred</i>	<b>\$128.4</b>	\$102.1	<b>\$299.5</b>	\$282.1



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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

**6. Income Taxes**

The following table sets forth the reconciliation between actual federal income tax (benefit) expense and the amount computed at the indicated statutory rate for the three and nine months ended September 30, 2017 and 2016:

(\$ millions)	Three months ended September 30				Nine months ended September 30							
	2017		2016		2017		2016					
Amount at statutory rate	<b>\$(3.9)</b>	<b>35.0</b>	%	\$2.6	35.0	%	<b>\$(1.6)</b>	<b>35.0</b>	%	\$(4.8)	35.0	%
Tax-exempt interest and dividends received deduction	<b>(1.4)</b>	<b>) 12.4</b>		(1.6)	) (22.6)		<b>(4.4)</b>	<b>) 96.4</b>		(5.5)	) 40.0	
Other, net	<b>3.6</b>	<b>(32.6)</b>		(3.7)	) (48.6)		<b>5.1</b>	<b>(110.9)</b>		7.9	) (58.0)	
<i>Federal income tax benefit</i>	<b>(1.7)</b>	<b>) 14.8</b>		(2.7)	) (36.2)		<b>(0.9)</b>	<b>) 20.5</b>		(2.4)	) 17.0	
Deferred tax expense on share-based awards	—	—		—	—		<b>1.3</b>	<b>(29.2)</b>		—	—	
<i>Federal income tax (benefit) expense</i>	<b>\$(1.7)</b>	<b>14.8</b>	%	\$(2.7)	(36.2)%		<b>\$0.4</b>	<b>(8.7)</b>	%	\$(2.4)	17.0	%

**7. Pension and Postretirement Benefit Plans**

The following table sets forth the components of net periodic cost for the Company's pension and postretirement benefit plans for the three and nine months ended September 30, 2017 and 2016:

(\$ millions)	Pension		Postretirement		Pension		Postretirement	
	Three months ended September 30				Nine months ended September 30			
	2017	2016	2017	2016	2017	2016	2017	2016
Service cost	<b>\$1.4</b>	\$1.6	\$—	\$—	<b>\$4.4</b>	\$4.7	\$—	\$—
Interest cost	<b>2.9</b>	3.0	<b>0.1</b>	0.2	<b>8.6</b>	8.9	<b>0.5</b>	0.6
Expected return on plan assets	<b>(4.2)</b>	(3.9)	—	—	<b>(12.6)</b>	(11.3)	—	—
Amortization of:								
Negative prior service cost	—	—	<b>(1.3)</b>	(1.3)	—	—	<b>(4.1)</b>	(4.1)
Net actuarial loss	<b>2.0</b>	2.3	<b>0.1</b>	0.1	<b>5.9</b>	6.9	<b>0.2</b>	0.2
<i>Net periodic cost (benefit)</i>	<b>\$2.1</b>	\$3.0	<b>\$(1.1)</b>	\$(1.0)	<b>\$6.3</b>	\$9.2	<b>\$(3.4)</b>	\$(3.3)

The Company contributed \$9.8 million and \$34.5 million, respectively, to its pension plan for the nine months ended September 30, 2017 and 2016.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

**8. Other Comprehensive Income and Accumulated Other Comprehensive Income**

The following table sets forth the changes in the Company's accumulated other comprehensive income component ("AOCI"), net of tax, for the three and nine months ended September 30, 2017 and 2016:

(\$ millions)

	Unrealized Gains and Losses on Available-for-Sale Securities	Benefit Plan Items	Total
--	---	-----------------------	-------

Beginning  
balance

at  
July  
1,  
2017

\$ 83.0	\$ (29.6 )	\$ 53.4
---------	------------	---------

Other  
comprehensive  
income  
before  
reclassifications

Amounts reclassified from AOCI (a)	13.2 ) 0.5	(12.7 )
--	------------	---------

Net  
current  
period  
other  
comprehensive  
(loss)  
income

Ending balance	6.0 ) 0.5	(5.5 )
-------------------	-----------	--------

Ending  
balance

at  
September  
30,  
2017

\$ 77.0	\$ (29.1 )	\$ 47.9
---------	------------	---------

Beginning  
balance

at  
July  
1,  
2016

\$ 112.3	\$ (29.6 )	\$ 82.7
----------	------------	---------

Other comprehensive loss before reclassifications	—	4.0	
Amounts reclassified from AOCI (a)	0.7	(5.0)	
Net current period other comprehensive income	0.7	(1.0)	
<i>Ending balance at September 30, 2016</i>	\$ 110.6	\$(28.9)	\$81.7

(a) See separate table below for details about these reclassifications

(\$ millions)	Unrealized Gains and Losses on Available-for-Sale Securities	Benefit Plan Items	Total
Beginning balance at January 1, 2017	\$ 62.8	\$(30.3)	\$32.5

Other comprehensive income before reclassifications	—	42.7	
Amounts reclassified from AOCI (a)	1.2	(27.3)	
Net current period other	1.2	15.4	

comprehensive  
income  
*Ending  
balance*  
*at \$ 77.0*      *\$(29.1 ) \$47.9*  
*September*  
*30,*  
*2017*

Beginning  
balance  
*at \$ 68.5*      *\$(30.9 ) \$37.6*  
*January*  
*1,*  
*2016*

Other  
comprehensive  
loss *52.9*      —      *52.9*  
before  
reclassifications

Amounts  
reclassified  
from AOCI  
*(10.8 ) 2.0*      *(8.8 )*

(a)  
Net  
current  
period  
other  
*42.1*      *2.0*      *44.1*

comprehensive  
income  
*Ending  
balance*  
*at \$ 110.6*      *\$(28.9 ) \$81.7*  
*September*  
*30,*  
*2016*

(a) See separate table below for details about these reclassifications

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

The following table sets forth the reclassifications out of accumulated other comprehensive income, by component, to the Company's condensed consolidated statement of income for the three and nine months ended September 30, 2017 and 2016:

(\$  
millions)

Three months ended September 30	2017	2016	Details about Accumulated Other Comprehensive Income Components
			Unrealized gains on available securities
	\$20.2	\$8.8	Realized gain on sale of securities
			Total before tax
	(7.0)	(3.1)	Tax expense
	<b>13.2</b>	<b>5.7</b>	Net of tax
			Amortization of benefit plan items
			Negative prior service cost
	1.3	1.3	(b)
			Net actuarial loss
	(2.1)	(2.4)	(b)
			Total before tax
	<b>0.3</b>	<b>0.4</b>	Tax benefit
	<b>(0.5)</b>	<b>(0.7)</b>	Net of tax

*Total reclassifications for the period*  
for **\$12.7** \$5.0

These accumulated other comprehensive income components are (b) included in the computation of net periodic pension cost (see pension and postretirement benefit plans footnote for additional details).

(\$  
millions)



Nine months ended		September 30		2017		2016	
Unrealized gains on available for sale securities							
		\$43.8	\$16.6	Realized gain on sale of securities			
		43.8	16.6	Total before tax			
		(15.3)	(5.8)	Tax expense			
		28.5	10.8	Net of tax			
Amortization of benefit plan items							
Negative prior service cost		4.1	4.1	(b)			
Net actuarial loss		(6.1)	(7.1)	(b)			
		(2.0)	(3.0)	Total before tax			
		0.8	1.0	Tax benefit			
		(1.2)	(2.0)	Net of tax			
<i>Total reclassifications for the period</i>							
		\$27.3	\$8.8				

These accumulated other comprehensive income components are (b)included in the computation of net periodic pension cost (see pension and postretirement benefit plans footnote for additional details).

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

**9. Net (Loss) Earnings per Common Share**

The following table sets forth the compilation of basic and diluted (loss) earnings per common share for the three and nine months ended September 30, 2017 and 2016:

	Three months ended		Nine months ended	
	September 30		September 30	
	2017	2016	2017	2016
<i>(\$ and shares in millions, except per share amounts)</i>				
Numerator:				
Net (loss) income for basic (loss) earnings per common share	<b>\$(9.5 )</b>	\$10.1	<b>\$(4.9 )</b>	\$(11.5)
Denominator:				
Weighted average shares for basic (loss) earnings per common share	<b>42.2</b>	41.6	<b>42.0</b>	41.5
Effect of dilutive share-based awards	—	0.5	—	—
<i>Adjusted weighted average shares for diluted net (loss) earnings per common share</i>	<b>42.2</b>	42.1	<b>42.0</b>	41.5
Basic net (loss) earnings per common share	<b>\$(0.23)</b>	\$0.24	<b>\$(0.12)</b>	\$(0.28)
Diluted net (loss) earnings per common share	<b>\$(0.23)</b>	\$0.24	<b>\$(0.12)</b>	\$(0.28)

The following table sets forth common stock options, stock awards and restricted share units ("RSU award") of the Company that were not included in the computation of diluted earnings per common share because the exercise price of the options, or awards, was greater than the average market price or their inclusion would have been antidilutive for the three and nine months ended September 30, 2017 and 2016:

	Three months ended		Nine months ended	
	September 30		September 30	
	2017	2016	2017	2016
<i>(shares in millions)</i>				
Total number of antidilutive options and awards	<b>0.5</b>	1.1	<b>0.7</b>	1.4

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

**10. Segment Information**

The Company has four reportable segments: personal insurance, commercial insurance, specialty insurance and investment operations. The reportable insurance segments are business units managed separately because of the differences in the type of customers they serve, the products they provide or services they offer. The insurance segments market a broad line of property and casualty insurance products throughout the United States through independent insurance agencies, which include retail agents and wholesale brokers. The investment operations segment, managed by Stateco, provides investment services.

Effective January 1, 2017, the Company completed the transition of its internal decision-making process to a product management structure. Under this structure, the Company's principal operating decision makers assess performance based on the underwriting results of individual products. The products within each insurance segment, were as follows:

•*Personal Insurance Segment* - personal auto, homeowners, farm & ranch and other personal

•*Commercial Insurance Segment* - commercial auto, small commercial package, middle market commercial, workers' compensation and other commercial

•*Specialty Insurance Segment* - E&S property, E&S casualty and programs

Effective September 30, 2017, the farm & ranch product moved from the personal insurance segment to the commercial insurance segment as a result of product management changes that occurred during the third quarter of 2017. Prior reporting periods have been restated to conform to the new presentation.

The Company evaluates the performance of its insurance segments using industry financial measurements based on Statutory Accounting Practices ("SAP"), which include loss and loss adjustment expense ratios, underwriting expense ratios, combined ratios, statutory underwriting gain (loss), net premiums earned and net written premiums. One of the most significant differences between SAP and GAAP is that SAP requires all underwriting expenses to be expensed immediately and not deferred and amortized over the same period the premium is earned.

The investment operations segment is evaluated based on investment returns of assets managed by Stateco. Asset information by segment is not reported for the insurance segments because the Company does not produce such information internally.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

The following table sets forth financial information regarding the Company's reportable segments for the three and nine months ended September 30, 2017 and 2016:

(\$ millions)	Three months ended September 30		Nine months ended September 30	
	2017	2016	2017	2016
Revenue from external sources:				
Insurance segments				
Personal insurance	\$144.1	\$144.5	\$430.3	\$433.8
Commercial insurance	114.3	116.0	341.8	356.3
Specialty insurance	60.6	65.3	184.3	178.0
<i>Total insurance segments</i>	<b>319.0</b>	325.8	<b>956.4</b>	968.1
Investment operations segment				
Net investment income	18.7	17.6	56.5	54.1
Net realized capital gains	20.2	8.8	43.8	16.6
<i>Total investment operations segment</i>	<b>38.9</b>	26.4	<b>100.3</b>	70.7
All other	0.5	0.6	1.7	1.7
<i>Total revenue from external sources</i>	<b>358.4</b>	352.8	<b>1,058.4</b>	1,040.5
Intersegment revenue	1.6	1.5	3.0	4.4
<i>Total revenue</i>	<b>360.0</b>	354.3	<b>1,061.4</b>	1,044.9
Reconciling items:				
Eliminate intersegment revenue	(1.6 )	(1.5 )	(3.0 )	(4.4 )
<i>Total consolidated revenues</i>	<b>\$358.4</b>	\$352.8	<b>\$1,058.4</b>	\$1,040.5
Segment (loss) income before federal income tax:				
Insurance segments SAP underwriting (loss) gain				
Personal insurance	\$(7.4 )	\$1.9	\$(31.7 )	\$(21.7 )
Commercial insurance	1.3	(17.6 )	(7.0 )	(33.7 )
Specialty insurance	(39.1 )	(3.3 )	(52.5 )	(28.3 )
<i>Total insurance segments loss</i>	<b>(45.2 )</b>	(19.0 )	<b>(91.2 )</b>	(83.7 )
Investment operations segment				
Net investment income	18.7	17.6	56.5	54.1
Net realized capital gains	20.2	8.8	43.8	16.6
<i>Total investment operations segment</i>	<b>38.9</b>	26.4	<b>100.3</b>	70.7
All other	0.1	0.1	0.2	0.3
<i>Total segment (loss) income before tax expense</i>	<b>(6.2 )</b>	7.5	<b>9.3</b>	(12.7 )
Reconciling items:				
GAAP expense adjustments	(2.8 )	2.4	(6.8 )	5.8
Interest expense on corporate debt	(1.5 )	(1.4 )	(4.4 )	(4.1 )
Corporate expenses	(0.7 )	(1.1 )	(2.6 )	(2.9 )
<i>Total reconciling items</i>	<b>(5.0 )</b>	(0.1 )	<b>(13.8 )</b>	(1.2 )
<i>Total consolidated (loss) income before federal income tax expense</i>	<b>\$(11.2 )</b>	\$7.4	<b>\$(4.5 )</b>	\$(13.9 )

Investable assets attributable to the Company's investment operations segment totaled \$2,773.4 million and \$2,663.7 million at September 30, 2017, and December 31, 2016, respectively.

**Subsequent Event**

During the third quarter of 2017, management undertook a review of strategic alternatives for the Company's excess and surplus lines business, which constitutes all of the business, along with programs which was previously placed into run-off, within its specialty insurance segment, to determine whether or not this business was core to the Company's ongoing business strategy.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

As a result of this review, management determined this business was not core to the Company's strategy and decided to begin exiting the excess and surplus lines business either through a series of renewal right transactions or by placing lines of business into run-off. The impact of this decision on future results will result in the elimination of the specialty insurance segment and its related underwriting results from the State Auto Group. The timing of this cannot be quantified at this time.

**11. Contingencies and Litigation**

In accordance with the Contingencies Topic of the FASB's Accounting Standards Codification, the Company accrues for a litigation-related liability when it is probable that such a liability has been incurred and the amount can be reasonably estimated. The Company reviews all litigation on an ongoing basis when making accrual and disclosure decisions. For certain legal proceedings, the Company cannot reasonably estimate losses or a range of loss, if any, particularly for proceedings that are in their early stages of development or where the plaintiffs seek indeterminate damages. Various factors, including, but not limited to, the outcome of potentially lengthy discovery and the resolution of important factual questions, may need to be determined before probability can be established or before a loss or range of loss can be reasonably estimated. If the loss contingency in question is not both probable and reasonably estimable, the Company does not establish an accrual and the matter will continue to be monitored for any developments that would make the loss contingency both probable and reasonably estimable. Based on currently available information known to the Company, it believes that its reserves for litigation-related liabilities are reasonable. However, in the event that a legal proceeding results in a substantial judgment against, or settlement by, the Company, there can be no assurance that any resulting liability or financial commitment would not have a material adverse effect on the financial condition, results of operations or cash flows of the consolidated financial statements of the Company.

The Company is involved in 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, results of operations or cash flows.

Additionally, the Company may be impacted by adverse regulatory actions and adverse court decisions where insurance coverages are expanded beyond the scope originally contemplated in its insurance policies. The Company believes that the effects, if any, of such regulatory actions and published court decisions are not likely to have a material adverse effect on its consolidated financial position, results of operations or cash flows.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

**Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

The term “State Auto Financial” as used below refers only to State Auto Financial Corporation and the terms “our Company,” “we,” “us,” and “our” as used below refer to State Auto Financial Corporation and its consolidated subsidiaries.

The term “third quarter” as used below refers to the three months ended September 30, for the time period then ended.

For a glossary of terms for State Auto Financial Corporation and its subsidiaries and affiliates and a glossary of selected insurance and accounting terms, see the section entitled “Important Defined Terms Used in this Form 10-K” included in our Annual Report on Form 10-K for the year ended December 31, 2016 (the “2016 Form 10-K”).

The discussion and analysis presented below relates to the material changes in financial condition and results of operations for our consolidated balance sheets as of September 30, 2017 and December 31, 2016, and for the consolidated statements of income for the three and nine month periods ended September 30, 2017 and 2016. This discussion and analysis should be read together with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in the 2016 Form 10-K, and in particular the discussions in those sections thereof entitled “Overview,” “Executive Summary,” and “Critical Accounting Policies.” Readers are encouraged to review the entire 2016 Form 10-K, as it includes information regarding our Company not discussed in this Form 10-Q. This information will assist in your understanding of the discussion of our current period financial results.

The discussion and analysis presented below includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. 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 of the date the statements were made available. Although we believe that the expectations reflected in forward-looking statements have a reasonable basis, we 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 our actual results to differ materially from those projected, see “Risk Factors” in Item 1A of the 2016 Form 10-K, updated by Part II, Item 1A of this Form 10-Q. Except to the limited extent required by applicable law, we undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

We have four reportable segments: personal insurance, commercial insurance, specialty insurance and investment operations. As of January 1, 2017, we completed the transition of our internal decision-making process to a product management structure under which our principal operating decision makers assess performance based on the underwriting results of individual products. The products within each insurance segment were as follows:

- *Personal Insurance Segment* - personal auto, homeowners, farm & ranch and other personal
- *Commercial Insurance Segment* - commercial auto, small commercial package, middle market commercial, workers’ compensation and other commercial
- *Specialty Insurance Segment* - E&S property, E&S casualty and programs

Effective September 30, 2017, the farm & ranch product moved from the personal insurance segment to the commercial insurance segment as a result of product management changes that occurred during the third quarter of 2017. Prior reporting periods have been restated to conform to the new presentation.

The reportable insurance segments are business units managed separately because of the differences in the type of customers they serve or products they provide or services they offer. The insurance segments market a broad line of property and casualty insurance products throughout the United States through independent insurance agencies, which include retail agents and wholesale brokers. The investment operations segment, managed by Stateco, provides investment services. See “Personal and Business Insurance” and “Specialty Insurance” in Item 1 of the 2016 Form 10-K for more information about our insurance segments. Financial information about our reportable segments for 2017 is set forth in Note 10 of our condensed consolidated financial statements included in Item 1 of this Form 10-Q.

**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:

**STFC**

**Pooled**

**Companies:**

State  
 Auto 1.0 %  
 P&C  
 Milwaukee  
 SA  
 Ohio  
*Total*  
 STFC  
 Pooled 65.0 %  
 Companies

**State**

**Auto**

**Mutual**

**Pooled**

**Companies:**

State  
 Auto 4.5 %  
 Mutual  
 SA  
 Wisconsin  
 Meridian  
 Security  
 Patrons  
 Mutual 0.5  
 RIC  
 Plaza  
 American  
 Compensation  
 Bloomington  
 Compensation  
*Total*  
 State  
 Auto  
 Mutual 35.0 %  
 Pooled  
 Companies



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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

**RESULTS OF OPERATIONS**

Our pre-tax loss for the three and nine months ended September 30, 2017 was \$11.2 million and \$4.5 million, respectively, compared to pre-tax income of \$7.4 million and a pre-tax loss of \$13.9 million, respectively, for the same 2016 periods. The third quarter 2017 results were impacted by catastrophe losses of \$32.5 million and \$22.7 million from hurricanes Harvey and Irma, respectively. The specialty insurance segment, primarily E&S property, accounted for \$43.5 million of the hurricane catastrophe losses. The 2017 third quarter and nine month results included overall net favorable development of prior accident year losses and loss adjustment expenses compared to adverse development for the same 2016 periods. Current accident year non-catastrophe losses and loss adjustment expenses for the three and nine month periods ended September 30, 2017 improved 3.2 points and increased 2.3 points, respectively, compared to the same 2016 periods. In addition, for the three and nine months ended September 30, 2017 we reported net realized gains on investments of \$20.2 million and \$43.8 million, respectively, compared to \$8.8 million and \$16.6 million, respectively, for the same 2016 periods.

The following table sets forth certain key performance indicators we use to monitor our operations for the three and nine months ended September 30, 2017 and 2016:

	Three months ended		Nine months ended		
	September 30	September 30	September 30	September 30	
	2017	2016	2017	2016	
<i>(\$ millions, except per share amounts)</i>					
<b>GAAP Basis:</b>					
Total revenues	\$358.4	\$352.8	\$1,058.4	\$1,040.5	
(Loss) income before federal income taxes	\$(11.2)	\$7.4	\$(4.5)	\$(13.9)	
Net (loss) income	\$(9.5)	\$10.1	\$(4.9)	\$(11.5)	
Basic (loss) earnings per share	\$(0.23)	\$0.24	\$(0.12)	\$(0.28)	
Diluted (loss) earnings per share	\$(0.23)	\$0.24	\$(0.12)	\$(0.28)	
Stockholders' equity	\$897.2	\$907.8			
Return on average equity (LTM)	3.1	% (0.9)	%	%	
Book value per share	\$21.28	\$21.82			
Debt to capital ratio	12.0	% 11.9	%	%	
Cat loss and ALAE ratio	17.6	% 2.5	% 12.1	% 6.8	%
Non-cat loss and LAE ratio	61.9	% 68.8	% 63.0	% 67.6	%
Loss and LAE ratio	79.5	% 71.3	% 75.1	% 74.4	%
Expense ratio	35.3	% 33.7	% 35.0	% 33.5	%
Combined ratio	114.8	% 105.0	% 110.1	% 107.9	%
Premium written growth	(4.3)	)% 3.5	)% (1.8)	)% 1.6	%
Investment yield	2.9	% 2.9	% 3.0	% 3.0	%
<b>SAP Basis:</b>					
Cat loss and ALAE ratio	17.6	% 2.5	% 12.1	% 6.8	%
Non-cat loss and ALAE ratio	56.9	% 63.7	% 57.5	% 61.7	%
ULAE ratio	5.1	% 5.3	% 5.6	% 6.0	%
Loss and LAE ratio	79.6	% 71.5	% 75.2	% 74.5	%
Expense ratio	34.3	% 33.4	% 33.9	% 33.5	%
Combined ratio	113.9	% 104.9	% 109.1	% 108.0	%

Twelve  
months  
ended

September

30

**2017** 2016

Net premiums written to surplus **1.5** 1.6

25

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

**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 Item 7 of our 2016 Form 10-K.

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

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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The following tables set forth our insurance segments' SAP underwriting gain (loss) and SAP combined ratios for the three and nine months ended September 30, 2017 and 2016:

(\$ in millions)

<b>Three months ended September 30, 2017</b>	Personal	Commercial	Specialty	Total	
Net written premiums	\$165.5	\$ 117.3	\$38.5	\$321.3	
Net earned premiums	144.1	114.3	60.6	319.0	
Losses and LAE incurred:					
Cat loss and ALAE	8.0	4.4	43.7	56.1	
Non-cat loss and ALAE	85.3	57.8	38.4	181.5	
<i>Total Loss and ALAE</i>	<b>93.3</b>	<b>62.2</b>	<b>82.1</b>	<b>237.6</b>	
ULAE	8.9	5.6	1.9	16.4	
<i>Total Loss and LAE</i>	<b>102.2</b>	<b>67.8</b>	<b>84.0</b>	<b>254.0</b>	
Underwriting expenses	49.3	45.2	15.7	110.2	
<i>Net underwriting (loss) gain</i>	<b>\$(7.4 )</b>	<b>\$ 1.3</b>	<b>\$(39.1)</b>	<b>\$(45.2 )</b>	
Cat loss and ALAE ratio	5.6	% 3.8	% 72.2	% 17.6	%
Non-cat loss and ALAE ratio	59.2	% 50.6	% 63.2	% 56.9	%
<i>Total Loss and ALAE ratio</i>	<b>64.8</b>	<b>% 54.4</b>	<b>% 135.4</b>	<b>% 74.5</b>	<b>%</b>
ULAE ratio	6.1	% 5.0	% 3.2	% 5.1	%
<i>Total Loss and LAE ratio</i>	<b>70.9</b>	<b>% 59.4</b>	<b>% 138.6</b>	<b>% 79.6</b>	<b>%</b>
Expense ratio	29.8	% 38.5	% 40.8	% 34.3	%
<i>Combined ratio</i>	<b>100.7</b>	<b>% 97.9</b>	<b>% 179.4</b>	<b>% 113.9</b>	<b>%</b>

(\$ in millions)

Three months ended September 30, 2016	Personal	Commercial	Specialty	Total	
Net written premiums	\$154.0	\$ 115.1	\$ 66.7	\$335.8	
Net earned premiums	144.5	116.0	65.3	325.8	
Losses and LAE incurred:					
Cat loss and ALAE	3.8	4.2	0.1	8.1	
Non-cat loss and ALAE	87.6	78.7	41.3	207.6	
<i>Total Loss and ALAE</i>	<b>91.4</b>	<b>82.9</b>	<b>41.4</b>	<b>215.7</b>	
ULAE	7.1	7.4	2.5	17.0	
<i>Total Loss and LAE</i>	<b>98.5</b>	<b>90.3</b>	<b>43.9</b>	<b>232.7</b>	
Underwriting expenses	44.1	43.3	24.7	112.1	
<i>Net underwriting gain (loss)</i>	<b>\$1.9</b>	<b>\$(17.6 )</b>	<b>\$(3.3 )</b>	<b>\$(19.0 )</b>	
Cat loss and ALAE ratio	2.6	% 3.6	% 0.2	% 2.5	%
Non-cat loss and ALAE ratio	60.6	% 67.9	% 63.2	% 63.7	%
<i>Total Loss and ALAE ratio</i>	<b>63.2</b>	<b>% 71.5</b>	<b>% 63.4</b>	<b>% 66.2</b>	<b>%</b>
ULAE ratio	5.0	% 6.5	% 3.7	% 5.3	%
<i>Total Loss and LAE ratio</i>	<b>68.2</b>	<b>% 78.0</b>	<b>% 67.1</b>	<b>% 71.5</b>	<b>%</b>
Expense ratio	28.6	% 37.6	% 37.1	% 33.4	%
<i>Combined ratio</i>	<b>96.8</b>	<b>% 115.6</b>	<b>% 104.2</b>	<b>% 104.9</b>	<b>%</b>



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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

(\$ in millions)

<b>Nine months ended September 30, 2017</b>	Personal	Commercial	Specialty	Total	
Net written premiums	\$447.6	\$ 344.6	\$176.4	\$968.6	
Net earned premiums	430.3	341.8	184.3	956.4	
Losses and LAE incurred:					
Cat loss and ALAE	43.7	25.4	46.6	115.7	
Non-cat loss and ALAE	257.3	171.5	121.4	550.2	
<i>Total Loss and ALAE</i>	<b>301.0</b>	<b>196.9</b>	<b>168.0</b>	<b>665.9</b>	
ULAE	28.0	18.4	6.9	53.3	
<i>Total Loss and LAE</i>	<b>329.0</b>	<b>215.3</b>	<b>174.9</b>	<b>719.2</b>	
Underwriting expenses	133.0	133.5	61.9	328.4	
<i>Net underwriting loss</i>	<b>\$(31.7)</b>	<b>\$(7.0)</b>	<b>\$(52.5)</b>	<b>\$(91.2)</b>	
Cat loss and ALAE ratio	10.2	% 7.4	% 25.3	% 12.1	%
Non-cat loss and ALAE ratio	59.8	% 50.2	% 65.8	% 57.5	%
<i>Total Loss and ALAE ratio</i>	<b>70.0</b>	<b>% 57.6</b>	<b>% 91.1</b>	<b>% 69.6</b>	<b>%</b>
ULAE ratio	6.5	% 5.4	% 3.8	% 5.6	%
<i>Total Loss and LAE ratio</i>	<b>76.5</b>	<b>% 63.0</b>	<b>% 94.9</b>	<b>% 75.2</b>	<b>%</b>
Expense ratio	29.7	% 38.7	% 35.1	% 33.9	%
<i>Combined ratio</i>	<b>106.2</b>	<b>% 101.7</b>	<b>% 130.0</b>	<b>% 109.1</b>	<b>%</b>

(\$ in millions)

<b>Nine months ended September 30, 2016</b>	Personal	Commercial	Specialty	Total	
Net written premiums	\$441.1	\$ 348.9	\$196.2	\$986.2	
Net earned premiums	433.8	356.3	178.0	968.1	
Losses and LAE incurred:					
Cat loss and ALAE	44.4	20.4	0.6	65.4	
Non-cat loss and ALAE	254.8	217.1	125.9	597.8	
<i>Total Loss and ALAE</i>	<b>299.2</b>	<b>237.5</b>	<b>126.5</b>	<b>663.2</b>	
ULAE	27.9	22.1	8.3	58.3	
<i>Total Loss and LAE</i>	<b>327.1</b>	<b>259.6</b>	<b>134.8</b>	<b>721.5</b>	
Underwriting expenses	128.4	130.4	71.5	330.3	
<i>Net underwriting loss</i>	<b>\$(21.7)</b>	<b>\$(33.7)</b>	<b>\$(28.3)</b>	<b>\$(83.7)</b>	
Cat loss and ALAE ratio	10.2	% 5.7	% 0.3	% 6.8	%
Non-cat loss and ALAE ratio	58.8	% 61.0	% 70.7	% 61.7	%
<i>Total Loss and ALAE ratio</i>	<b>69.0</b>	<b>% 66.7</b>	<b>% 71.0</b>	<b>% 68.5</b>	<b>%</b>
ULAE ratio	6.4	% 6.2	% 4.8	% 6.0	%
<i>Total Loss and LAE ratio</i>	<b>75.4</b>	<b>% 72.9</b>	<b>% 75.8</b>	<b>% 74.5</b>	<b>%</b>