

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

State Auto Financial CORP

Form 10-Q

November 06, 2017

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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<br/>30, 2017</b> | December<br>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**

(\$ in millions, except per share amounts)

|   | Nine months<br>ended September<br>30 |           |
|---|--------------------------------------|-----------|
| (unaudited)   | <b>2017</b>                          | 2016      |
| 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**

(\$ in millions, except per share amounts)

|  | Three months<br>ended<br>September 30 |        |
|--|---------------------------------------|--------|
| (unaudited)  | <b>2017</b>                           | 2016   |
| 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<br>ended<br>September 30 |          |
|--|--------------------------------------|----------|
|  | <b>2017</b>                          | 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<br>ended September<br>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<br>amortized<br>cost | Gross<br>unrealized<br>holding<br>gains | Gross<br>unrealized<br>holding<br>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<br>amortized<br>cost | Gross<br>unrealized<br>holding<br>gains | Gross<br>unrealized<br>holding<br>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

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

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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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

*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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## 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 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      |
|--|------------------|----------------|------------------|--------------|
| <b>December 31, 2016</b>   |                  |                |                  |              |
| 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

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

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<br>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<br>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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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

*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<br>value  | Fair<br>value | Interest<br>rate | Carrying<br>value | Fair<br>value | Interest<br>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<br>value  | Fair<br>Value  | Interest<br>rate | Carrying<br>value | Fair<br>value | Interest<br>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<br>ended September<br>30 |          | Nine months<br>ended September<br>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 |        | Three months ended September 30 |         | Nine 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<br>and Losses on<br>Available-for-Sale<br>Securities | Benefit Plan<br>Items | Total |
|--|---|-----------------------|-------|
|--|---|-----------------------|-------|

Beginning  
balance

at \$ 83.0                      \$(29.6 ) \$53.4

July  
1,  
2017

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

at \$ 77.0                      \$(29.1 ) \$47.9

September  
30,  
2017

Beginning  
balance

at \$ 112.3                      \$(29.6 ) \$82.7

July  
1,  
2016

|   |                   |                |
|---|-------------------|----------------|
| 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>       | <i>\$ (28.9 )</i> | <i>\$ 81.7</i> |

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

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

|   |     |         |
|---|-----|---------|
| 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<br>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 actual 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 \$12.7 \$5.0 the period*

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 |                                     | 2016 |  |
|---|---------------|--------------|-------------------------------------|------|--|
| Comprehensive Income Components               |               | 2017         |                                     | 2016 |  |
| Unrealized gains on available securities      | \$43.8        | \$16.6       | Realized gain on sale of securities |      |  |
|   | <b>43.8</b>   | 16.6         | Total before tax                    |      |  |
|   | <b>(15.3)</b> | (5.8)        | Tax expense                         |      |  |
|   | <b>28.5</b>   | 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)                                 |      |  |
|   | <b>(2.0)</b>  | (3.0)        | Total before tax                    |      |  |
|   | <b>0.8</b>    | 1.0          | Tax benefit                         |      |  |
|   | <b>(1.2)</b>  | (2.0)        | Net of tax                          |      |  |
| <i>Total reclassifications for the period</i> | <b>\$27.3</b> | \$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       |        |
| Millbrook |        |
| 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      |           |
|  | 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

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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

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

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> |
| Expense ratio                               | 29.1            | % 37.4          | % 36.5          | % 33.5          | %        |
| <i>Combined ratio</i>                       | <b>104.5</b>    | <b>% 110.3</b>  | <b>% 112.3</b>  | <b>% 108.0</b>  | <b>%</b> |



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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

*Personal Insurance Segment*

The following tables set forth the SAP underwriting gain (loss) and SAP combined ratios by major product line for our personal insurance segment for the three and nine months ended September 30, 2017 and 2016:

Table 1

(\$ in millions)

| <b>Three months ended September 30, 2017</b> | Personal<br>Auto | Homeowners     | Other<br>Personal | Total           |          |
|--|------------------|----------------|-------------------|-----------------|----------|
| Net written premiums                         | <b>\$96.5</b>    | <b>\$ 64.1</b> | <b>\$ 4.9</b>     | <b>\$165.5</b>  |          |
| Net earned premiums                          | <b>84.9</b>      | <b>54.6</b>    | <b>4.6</b>        | <b>144.1</b>    |          |
| Losses and LAE incurred:                     |                  |                |                   |                 |          |
| Cat loss and ALAE                            | <b>2.5</b>       | <b>5.1</b>     | <b>0.4</b>        | <b>8.0</b>      |          |
| Non-cat loss and ALAE                        | <b>59.8</b>      | <b>24.0</b>    | <b>1.5</b>        | <b>85.3</b>     |          |
| <i>Total Loss and ALAE</i>                   | <b>62.3</b>      | <b>29.1</b>    | <b>1.9</b>        | <b>93.3</b>     |          |
| ULAE   | <b>5.5</b>       | <b>3.2</b>     | <b>0.2</b>        | <b>8.9</b>      |          |
| <i>Total Loss and LAE</i>                    | <b>67.8</b>      | <b>32.3</b>    | <b>2.1</b>        | <b>102.2</b>    |          |
| Underwriting expenses                        | <b>26.8</b>      | <b>20.9</b>    | <b>1.6</b>        | <b>49.3</b>     |          |
| <i>Net underwriting (loss) gain</i>          | <b>\$(9.7 )</b>  | <b>\$ 1.4</b>  | <b>\$ 0.9</b>     | <b>\$(7.4 )</b> |          |
| Cat loss and ALAE ratio                      | <b>3.0</b>       | <b>% 9.3</b>   | <b>% 8.3</b>      | <b>% 5.6</b>    | <b>%</b> |
| Non-cat loss and ALAE ratio                  | <b>70.4</b>      | <b>% 44.1</b>  | <b>% 33.4</b>     | <b>% 59.2</b>   | <b>%</b> |
| <i>Total Loss and ALAE ratio</i>             | <b>73.4</b>      | <b>% 53.4</b>  | <b>% 41.7</b>     | <b>% 64.8</b>   | <b>%</b> |
| ULAE ratio                                   | <b>6.5</b>       | <b>% 5.8</b>   | <b>% 2.8</b>      | <b>% 6.1</b>    | <b>%</b> |
| <i>Total Loss and LAE ratio</i>              | <b>79.9</b>      | <b>% 59.2</b>  | <b>% 44.5</b>     | <b>% 70.9</b>   | <b>%</b> |
| Expense ratio                                | <b>27.7</b>      | <b>% 32.6</b>  | <b>% 35.8</b>     | <b>% 29.8</b>   | <b>%</b> |
| <i>Combined ratio</i>                        | <b>107.6</b>     | <b>% 91.8</b>  | <b>% 80.3</b>     | <b>% 100.7</b>  | <b>%</b> |





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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

Table 2

(\$ in millions)

| Three months ended September 30, 2016 | Personal<br>Auto | Homeowners    | Other<br>Personal | Total         |          |
|---------------------------------------|------------------|---------------|-------------------|---------------|----------|
| Net written premiums                  | \$86.9           | \$ 61.8       | \$ 5.3            | \$154.0       |          |
| Net earned premiums                   | 82.7             | 56.5          | 5.3               | 144.5         |          |
| Losses and LAE incurred:              |                  |               |                   |               |          |
| Cat loss and ALAE                     | 1.5              | 2.1           | 0.2               | 3.8           |          |
| Non-cat loss and ALAE                 | 63.0             | 23.0          | 1.6               | 87.6          |          |
| <i>Total Loss and ALAE</i>            | <i>64.5</i>      | <i>25.1</i>   | <i>1.8</i>        | <i>91.4</i>   |          |
| ULAE                                  | 3.4              | 3.4           | 0.3               | 7.1           |          |
| <i>Total Loss and LAE</i>             | <i>67.9</i>      | <i>28.5</i>   | <i>2.1</i>        | <i>98.5</i>   |          |
| Underwriting expenses                 | 23.5             | 18.7          | 1.9               | 44.1          |          |
| <i>Net underwriting (loss) gain</i>   | <i>\$(8.7 )</i>  | <i>\$ 9.3</i> | <i>\$ 1.3</i>     | <i>\$ 1.9</i> |          |
| Cat loss and ALAE ratio               | 1.8              | % 3.7         | % 3.9             | % 2.6         | %        |
| Non-cat loss and ALAE ratio           | 76.2             | % 40.8        | % 29.3            | % 60.6        | %        |
| <i>Total Loss and ALAE ratio</i>      | <i>78.0</i>      | <i>% 44.5</i> | <i>% 33.2</i>     | <i>% 63.2</i> | <i>%</i> |
| ULAE ratio                            | 4.2              | % 5.9         | % 6.9             | % 5.0         | %        |
| <i>Total Loss and LAE ratio</i>       | <i>82.2</i>      | <i>% 50.4</i> | <i>% 40.1</i>     | <i>% 68.2</i> | <i>%</i> |
| Expense ratio                         | 27.0             | % 30.3        | % 35.3            | % 28.6        | %        |
| <i>Combined ratio</i>                 | <i>109.2</i>     | <i>% 80.7</i> | <i>% 75.4</i>     | <i>% 96.8</i> | <i>%</i> |

Table 3

(\$ in millions)

| Nine months ended September 30, 2017 | Personal<br>Auto | Homeowners       | Other<br>Personal | Total            |          |
|--------------------------------------|------------------|------------------|-------------------|------------------|----------|
| Net written premiums                 | <b>\$265.0</b>   | <b>\$ 168.9</b>  | <b>\$13.7</b>     | <b>\$447.6</b>   |          |
| Net earned premiums                  | <b>251.5</b>     | <b>164.6</b>     | <b>14.2</b>       | <b>430.3</b>     |          |
| Losses and LAE incurred:             |                  |                  |                   |                  |          |
| Cat loss and ALAE                    | <b>8.4</b>       | <b>34.2</b>      | <b>1.1</b>        | <b>43.7</b>      |          |
| Non-cat loss and ALAE                | <b>176.6</b>     | <b>73.9</b>      | <b>6.8</b>        | <b>257.3</b>     |          |
| <i>Total Loss and ALAE</i>           | <i>185.0</i>     | <i>108.1</i>     | <i>7.9</i>        | <i>301.0</i>     |          |
| ULAE                                 | <b>15.8</b>      | <b>11.3</b>      | <b>0.9</b>        | <b>28.0</b>      |          |
| <i>Total Loss and LAE</i>            | <i>200.8</i>     | <i>119.4</i>     | <i>8.8</i>        | <i>329.0</i>     |          |
| Underwriting expenses                | <b>73.4</b>      | <b>54.7</b>      | <b>4.9</b>        | <b>133.0</b>     |          |
| <i>Net underwriting (loss) gain</i>  | <i>\$(22.7 )</i> | <i>\$ (9.5 )</i> | <i>\$ 0.5</i>     | <i>\$(31.7 )</i> |          |
| Cat loss and ALAE ratio              | <b>3.3</b>       | <b>% 20.8</b>    | <b>% 7.5</b>      | <b>% 10.2</b>    | <b>%</b> |
| Non-cat loss and ALAE ratio          | <b>70.3</b>      | <b>% 44.9</b>    | <b>% 48.2</b>     | <b>% 59.8</b>    | <b>%</b> |
| <i>Total Loss and ALAE ratio</i>     | <i>73.6</i>      | <i>% 65.7</i>    | <i>% 55.7</i>     | <i>% 70.0</i>    | <i>%</i> |
| ULAE ratio                           | <b>6.3</b>       | <b>% 6.8</b>     | <b>% 6.4</b>      | <b>% 6.5</b>     | <b>%</b> |
| <i>Total Loss and LAE ratio</i>      | <i>79.9</i>      | <i>% 72.5</i>    | <i>% 62.1</i>     | <i>% 76.5</i>    | <i>%</i> |
| Expense ratio                        | <b>27.7</b>      | <b>% 32.4</b>    | <b>% 36.5</b>     | <b>% 29.7</b>    | <b>%</b> |

*Combined ratio*

**107.6 % 104.9 % 98.6 % 106.2 %**

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

Table 4

(\$ in millions)

| Nine months ended September 30, 2016 | Personal<br>Auto | Homeowners | Other<br>Personal | Total     |   |
|--------------------------------------|------------------|------------|-------------------|-----------|---|
| Net written premiums                 | \$253.2          | \$ 172.3   | \$ 15.6           | \$441.1   |   |
| Net earned premiums                  | 247.3            | 170.5      | 16.0              | 433.8     |   |
| Losses and LAE incurred:             |                  |            |                   |           |   |
| Cat loss and ALAE                    | 7.1              | 36.5       | 0.8               | 44.4      |   |
| Non-cat loss and ALAE                | 180.7            | 66.7       | 7.4               | 254.8     |   |
| <i>Total Loss and ALAE</i>           | 187.8            | 103.2      | 8.2               | 299.2     |   |
| ULAE                                 | 14.9             | 11.8       | 1.2               | 27.9      |   |
| <i>Total Loss and LAE</i>            | 202.7            | 115.0      | 9.4               | 327.1     |   |
| Underwriting expenses                | 68.7             | 53.9       | 5.8               | 128.4     |   |
| <i>Net underwriting (loss) gain</i>  | \$(24.1 )        | \$ 1.6     | \$ 0.8            | \$(21.7 ) |   |
| Cat loss and ALAE ratio              | 2.9              | % 21.4     | % 5.1             | % 10.2    | % |
| Non-cat loss and ALAE ratio          | 73.0             | % 39.1     | % 46.6            | % 58.8    | % |
| <i>Total Loss and ALAE ratio</i>     | 75.9             | % 60.5     | % 51.7            | % 69.0    | % |
| ULAE ratio                           | 6.0              | % 6.9      | % 7.1             | % 6.4     | % |
| <i>Total Loss and LAE ratio</i>      | 81.9             | % 67.4     | % 58.8            | % 75.4    | % |
| Expense ratio                        | 27.1             | % 31.3     | % 36.8            | % 29.1    | % |
| <i>Combined ratio</i>                | 109.0            | % 98.7     | % 95.6            | % 104.5   | % |

The personal insurance segment's net written premiums for the three and nine months ended September 30, 2017 increased 7.5% and 1.5%, respectively, when compared to the same 2016 periods (Tables 1 - 4), driven by (i) rate increases for our personal auto product implemented beginning in 2016 and continuing throughout 2017 and (ii) new business growth in personal auto and homeowners. The third quarter 2017 new business growth in homeowners was not enough to offset business lost on renewal year to date 2017.

The personal insurance segment's SAP catastrophe loss ratios for the three and nine months ended September 30, 2017, were 5.6% and 10.2%, respectively, compared to 2.6% and 10.2%, respectively, for the same 2016 periods (Tables 1 - 4). The third quarter of 2017 was primarily impacted by hurricanes Harvey and Irma. The catastrophe loss ratio for the nine months ended September 30, 2017 also reflected the impact of widespread storms that affected the Ohio Valley region, South Carolina, Texas, Mississippi and Georgia during the first quarter of 2017. The catastrophe loss ratio for the nine months ended September 30, 2016 was impacted by storms in Texas, primarily wind and hail, which occurred during the second quarter of 2016.

The personal insurance segment's SAP non-catastrophe loss and ALAE ratios for the three and nine months ended September 30, 2017 decreased 1.4 points and increased 1.0 point, respectively, when compared to the same 2016 periods (Tables 1 - 4). The homeowners SAP non-catastrophe loss and ALAE ratios for the three and nine months ended September 30, 2017 increased 3.3 points and 5.8 points, respectively, when compared to the same 2016 periods, primarily driven by an increase in non-catastrophe weather-related losses.

The personal auto SAP non-catastrophe loss and ALAE ratios for the three and nine months ended September 30, 2017 improved 5.8 points and 2.7 points, respectively, when compared to the same 2016 periods, and include favorable development of prior accident year losses of \$0.5 million and \$2.3 million, respectively, compared to adverse development of \$0.6 million and \$8.5 million, respectively, for the same 2016 periods.



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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

*Commercial Insurance Segment*

The following tables set forth the SAP underwriting gain (loss) and SAP combined ratios by major product line for our commercial insurance segment for the three and nine months ended September 30, 2017 and 2016:

Table 5

(\$ in millions)

| <b>Three months ended September 30, 2017</b> | Commercial Auto | Small Commercial Package | Middle Market Commercial | Workers' Comp | Farm & Ranch  | Other Commercial | Total         |
|--|-----------------|--------------------------|--------------------------|---------------|---------------|------------------|---------------|
| Net written premiums                         | \$ 18.6         | \$ 31.4                  | \$ 28.8                  | \$ 25.1       | \$ 10.1       | 3.3              | \$ 117.3      |
| Net earned premiums                          | 18.8            | 33.3                     | 26.7                     | 22.0          | 10.1          | 3.4              | 114.3         |
| Losses and LAE incurred:                     |                 |                          |                          |               |               |                  |               |
| Cat loss and ALAE                            | 0.3             | 2.5                      | 0.4                      | —             | 1.2           | —                | 4.4           |
| Non-cat loss and ALAE                        | 10.6            | 17.4                     | 12.6                     | 11.9          | 4.9           | 0.3              | 57.8          |
| <i>Total Loss and ALAE</i>                   | <b>10.9</b>     | <b>19.9</b>              | <b>13.1</b>              | <b>11.9</b>   | <b>6.1</b>    | <b>0.3</b>       | <b>62.2</b>   |
| ULAE   | 1.2             | 1.7                      | 0.9                      | 1.5           | 0.2           | 0.1              | 5.6           |
| <i>Total Loss and LAE</i>                    | <b>12.1</b>     | <b>21.6</b>              | <b>14.0</b>              | <b>13.4</b>   | <b>6.3</b>    | <b>0.4</b>       | <b>67.8</b>   |
| Underwriting expenses                        | 7.8             | 14.1                     | 10.3                     | 7.4           | 3.7           | 1.9              | 45.2          |
| <i>Net underwriting (loss) gain</i>          | <b>\$(1.1 )</b> | <b>\$(2.4 )</b>          | <b>\$ 2.4</b>            | <b>\$ 1.2</b> | <b>\$ 0.1</b> | <b>1.1</b>       | <b>\$ 1.3</b> |
| Cat loss and ALAE ratio                      | 1.6             | % 7.6                    | % 1.4                    | % —           | % 11.7        | % —              | % 3.8         |
| Non-cat loss and ALAE ratio                  | 56.6            | % 52.4                   | % 47.4                   | % 54.3        | % 47.8        | % 6.8            | % 50.6        |
| <i>Total Loss and ALAE ratio</i>             | <b>58.2</b>     | <b>% 60.0</b>            | <b>% 48.8</b>            | <b>% 54.3</b> | <b>% 59.5</b> | <b>% 6.8</b>     | <b>% 54.4</b> |
| ULAE ratio                                   | 5.7             | % 5.1                    | % 3.3                    | % 6.6         | % 3.6         | % 7.8            | % 5.0         |
| <i>Total Loss and LAE ratio</i>              | <b>63.9</b>     | <b>% 65.1</b>            | <b>% 52.1</b>            | <b>% 60.9</b> | <b>% 63.1</b> | <b>% 14.6</b>    | <b>% 59.4</b> |
| Expense ratio                                | 42.1            | % 44.8                   | % 36.0                   | % 29.6        | % 36.8        | % 54.4           | % 38.5        |
| <i>Combined ratio</i>                        | <b>106.0</b>    | <b>% 109.9</b>           | <b>% 88.1</b>            | <b>% 90.5</b> | <b>% 99.9</b> | <b>% 69.0</b>    | <b>% 97.9</b> |



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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

Table 6

(\$ in millions)

| Three months ended September 30, 2016 | Commercial Auto | Small Commercial Package | Middle Market Commercial | Workers' Comp | Farm & Ranch | Other Commercial | Total      |
|---------------------------------------|-----------------|--------------------------|--------------------------|---------------|--------------|------------------|------------|
| Net written premiums                  | \$ 19.1         | \$ 31.8                  | \$ 27.4                  | \$24.0        | \$8.5        | \$ 4.3           | \$115.1    |
| Net earned premiums                   | 21.4            | 31.8                     | 27.3                     | 22.3          | 9.0          | 4.2              | 116.0      |
| Losses and LAE incurred:              |                 |                          |                          |               |              |                  |            |
| Cat loss and ALAE                     | —               | 2.3                      | 0.7                      | —             | 1.2          | —                | 4.2        |
| Non-cat loss and ALAE                 | 17.8            | 17.5                     | 23.5                     | 14.6          | 4.6          | 0.7              | 78.7       |
| <i>Total Loss and ALAE</i>            | 17.8            | 19.8                     | 24.2                     | 14.6          | 5.8          | 0.7              | 82.9       |
| ULAE                                  | 1.3             | 1.4                      | 1.8                      | 2.1           | 0.6          | 0.2              | 7.4        |
| <i>Total Loss and LAE</i>             | 19.1            | 21.2                     | 26.0                     | 16.7          | 6.4          | 0.9              | 90.3       |
| Underwriting expenses                 | 7.6             | 12.8                     | 10.6                     | 7.0           | 3.5          | 1.8              | 43.3       |
| <i>Net underwriting (loss) gain</i>   | \$ (5.3 )       | \$ (2.2 )                | \$ (9.3 )                | \$ (1.4 )     | \$ (0.9 )    | \$ 1.5           | \$ (17.6 ) |
| Cat loss and ALAE ratio               | 0.1 %           | 7.1 %                    | 2.7 %                    | — %           | 13.3 %       | — %              | 3.6 %      |
| Non-cat loss and ALAE ratio           | 83.3 %          | 55.2 %                   | 86.1 %                   | 65.4 %        | 51.6 %       | 15.4 %           | 67.9 %     |
| <i>Total Loss and ALAE ratio</i>      | 83.4 %          | 62.3 %                   | 88.8 %                   | 65.4 %        | 64.9 %       | 15.4 %           | 71.5 %     |
| ULAE ratio                            | 5.9 %           | 4.4 %                    | 6.3 %                    | 9.6 %         | 6.7 %        | 8.7 %            | 6.5 %      |
| <i>Total Loss and LAE ratio</i>       | 89.3 %          | 66.7 %                   | 95.1 %                   | 75.0 %        | 71.6 %       | 24.1 %           | 78.0 %     |
| Expense ratio                         | 39.7 %          | 40.2 %                   | 38.6 %                   | 29.1 %        | 41.5 %       | 41.8 %           | 37.6 %     |
| <i>Combined ratio</i>                 | 129.0 %         | 106.9 %                  | 133.7 %                  | 104.1 %       | 113.1 %      | 65.9 %           | 115.6 %    |

Table 7

(\$ in millions)

| Nine months ended September 30, 2017 | Commercial Auto | Small Commercial Package | Middle Market Commercial | Workers' Comp | Farm & Ranch | Other Commercial | Total     |
|--------------------------------------|-----------------|--------------------------|--------------------------|---------------|--------------|------------------|-----------|
| Net written premiums                 | \$ 56.9         | \$ 93.7                  | \$ 85.2                  | \$66.4        | \$31.5       | \$ 10.9          | \$344.6   |
| Net earned premiums                  | 57.6            | 96.5                     | 81.2                     | 66.3          | 29.1         | 11.1             | 341.8     |
| Losses and LAE incurred:             |                 |                          |                          |               |              |                  |           |
| Cat loss and ALAE                    | 0.9             | 12.0                     | 7.6                      | —             | 4.9          | —                | 25.4      |
| Non-cat loss and ALAE                | 34.0            | 47.0                     | 37.8                     | 37.6          | 15.2         | (0.1 )           | 171.5     |
| <i>Total Loss and ALAE</i>           | 34.9            | 59.0                     | 45.4                     | 37.6          | 20.1         | (0.1 )           | 196.9     |
| ULAE                                 | 3.3             | 4.3                      | 3.5                      | 5.1           | 1.6          | 0.6              | 18.4      |
| <i>Total Loss and LAE</i>            | 38.2            | 63.3                     | 48.9                     | 42.7          | 21.7         | 0.5              | 215.3     |
| Underwriting expenses                | 23.4            | 40.9                     | 31.0                     | 21.0          | 11.5         | 5.7              | 133.5     |
| <i>Net underwriting (loss) gain</i>  | \$ (4.0 )       | \$ (7.7 )                | \$ 1.3                   | \$2.6         | \$ (4.1 )    | \$ 4.9           | \$ (7.0 ) |
| Cat loss and ALAE ratio              | 1.6 %           | 12.4 %                   | 9.3 %                    | — %           | 16.9 %       | 0.1 %            | 7.4 %     |
| Non-cat loss and ALAE ratio          | 59.0 %          | 48.8 %                   | 46.6 %                   | 56.8 %        | 52.1 %       | (1.0 ) %         | 50.2 %    |
| <i>Total Loss and ALAE ratio</i>     | 60.6 %          | 61.2 %                   | 55.9 %                   | 56.8 %        | 69.0 %       | (0.9 ) %         | 57.6 %    |
| ULAE ratio                           | 5.6 %           | 4.4 %                    | 4.3 %                    | 7.6 %         | 5.7 %        | 5.6 %            | 5.4 %     |
| <i>Total Loss and LAE ratio</i>      | 66.2 %          | 65.6 %                   | 60.2 %                   | 64.4 %        | 74.7 %       | 4.7 %            | 63.0 %    |



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|                       |              |          |              |          |             |          |             |          |              |          |             |          |              |          |
|-----------------------|--------------|----------|--------------|----------|-------------|----------|-------------|----------|--------------|----------|-------------|----------|--------------|----------|
| Expense ratio         | <b>41.1</b>  | <b>%</b> | <b>43.6</b>  | <b>%</b> | <b>36.4</b> | <b>%</b> | <b>31.6</b> | <b>%</b> | <b>36.5</b>  | <b>%</b> | <b>52.2</b> | <b>%</b> | <b>38.7</b>  | <b>%</b> |
| <i>Combined ratio</i> | <b>107.3</b> | <b>%</b> | <b>109.2</b> | <b>%</b> | <b>96.6</b> | <b>%</b> | <b>96.0</b> | <b>%</b> | <b>111.2</b> | <b>%</b> | <b>56.9</b> | <b>%</b> | <b>101.7</b> | <b>%</b> |

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

Table 8

(\$ in millions)

| Nine months ended September 30, 2016 | Commercial Auto | Small Commercial Package | Middle Market Commercial | Workers' Comp | Farm & Ranch | Other Commercial | Total     |
|--------------------------------------|-----------------|--------------------------|--------------------------|---------------|--------------|------------------|-----------|
| Net written premiums                 | \$ 60.8         | \$ 95.1                  | \$ 82.5                  | \$ 70.2       | \$ 27.5      | \$ 12.8          | \$ 348.9  |
| Net earned premiums                  | 68.1            | 95.9                     | 83.2                     | 70.0          | 26.3         | 12.8             | 356.3     |
| Losses and LAE incurred:             |                 |                          |                          |               |              |                  |           |
| Cat loss and ALAE                    | 0.8             | 8.5                      | 7.3                      | —             | 3.8          | —                | 20.4      |
| Non-cat loss and ALAE                | 55.5            | 51.5                     | 52.0                     | 44.5          | 8.3          | 5.3              | 217.1     |
| <i>Total Loss and ALAE</i>           | 56.3            | 60.0                     | 59.3                     | 44.5          | 12.1         | 5.3              | 237.5     |
| ULAE                                 | 3.6             | 5.1                      | 4.7                      | 6.2           | 1.6          | 0.9              | 22.1      |
| <i>Total Loss and LAE</i>            | 59.9            | 65.1                     | 64.0                     | 50.7          | 13.7         | 6.2              | 259.6     |
| Underwriting expenses                | 23.0            | 38.5                     | 32.6                     | 20.5          | 10.4         | 5.4              | 130.4     |
| <i>Net underwriting (loss) gain</i>  | \$(14.8 )       | \$( 7.7 )                | \$(13.4 )                | \$(1.2 )      | \$2.2        | \$ 1.2           | \$(33.7 ) |
| Cat loss and ALAE ratio              | 1.3             | % 8.8                    | % 8.7                    | % —           | % 14.4       | % —              | % 5.7     |
| Non-cat loss and ALAE ratio          | 81.5            | % 53.7                   | % 62.5                   | % 63.5        | % 31.9       | % 41.5           | % 61.0    |
| <i>Total Loss and ALAE ratio</i>     | 82.8            | % 62.5                   | % 71.2                   | % 63.5        | % 46.3       | % 41.5           | % 66.7    |
| ULAE ratio                           | 5.4             | % 5.2                    | % 5.6                    | % 8.9         | % 6.0        | % 7.5            | % 6.2     |
| <i>Total Loss and LAE ratio</i>      | 88.2            | % 67.7                   | % 76.8                   | % 72.4        | % 52.3       | % 49.0           | % 72.9    |
| Expense ratio                        | 37.8            | % 40.5                   | % 39.4                   | % 29.3        | % 38.0       | % 42.1           | % 37.4    |
| <i>Combined ratio</i>                | 126.0           | % 108.2                  | % 116.2                  | % 101.7       | % 90.3       | % 91.1           | % 110.3   |

The commercial insurance segment's net written premiums for the three and nine months ended September 30, 2017 increased 1.8% and decreased 1.3%, respectively, compared to the same 2016 periods (Tables 5 - 8). Through the first nine months of 2017, we continue to be impacted by (i) rate actions to improve profitability in commercial auto, (ii) more competitive market conditions in workers' compensation, and (iii) our continued focus on underwriting discipline. During the third quarter of 2017, new business premiums for commercial auto, small commercial package and middle market commercial increased compared to the same 2016 period, due primarily to efforts undertaken in 2016 to (i) expand and strengthen our agency relationships, and (ii) reinforce and clarify our commercial underwriting appetite with our agency force. In addition, growth in farm & ranch continued, with increases in both net written premium and policies in force compared to the same 2016 periods.

The commercial insurance segment's SAP catastrophe loss and ALAE ratios for the three and nine months ended September 30, 2017 increased 0.2 points and 1.7 points, respectively, when compared to the same 2016 periods (Tables 5 - 8). Quarter and year to date 2017 and 2016, the commercial insurance segment's SAP catastrophe loss ratios were impacted by the same events described in the preceding personal insurance segment discussion.

The commercial insurance segment's SAP non-catastrophe loss and ALAE ratios for the three and nine months ended September 30, 2017 improved 17.3 points and 10.8 points, respectively, when compared to the same 2016 periods (Tables 5 - 8), primarily driven by (i) favorable development of prior accident year losses compared to adverse development in the same 2016 periods and (ii) pricing, underwriting and claims improvements implemented throughout the last two years, including improved risk classification, rate increases and reductions in claims leakage. The commercial auto ratios for the three and nine months ended September 30, 2017 improved 26.7 points and 22.5 points, respectively, when compared to the same 2016 periods, due primarily to favorable development of prior accident year losses of \$2.6 million and \$5.7 million, respectively, compared to adverse development of \$0.4 million

and \$5.1 million, respectively, for the same 2016 periods.

The small commercial package SAP non-catastrophe loss and ALAE ratio for the three and nine months ended September 30, 2017 improved 2.8 points and 4.9 points, respectively, when compared to the same 2016 periods, primarily driven by favorable development of prior accident year ultimate loss estimates of \$2.9 million and \$7.9 million, respectively, compared to adverse development of \$0.8 million and \$1.4 million, respectively, for the same 2016 periods.

The middle market commercial SAP non-catastrophe loss and ALAE ratios improved 38.7 points and 15.9 points, respectively, when compared to the same 2016 periods. For the three and nine months ended September 30, 2017, prior accident year loss estimates developed favorably by \$0.8 million and \$6.1 million, respectively, compared to adverse development of \$2.2 million

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

and \$1.1 million, respectively, for the same 2016 periods. In addition, for the three and nine months ended September 30, 2016, the current accident year loss and ALAE ratios were impacted by large fire losses.

The workers' compensation SAP non-catastrophe loss and ALAE ratios improved 11.1 points and 6.7 points, respectively, when compared to the same 2016 periods, due primarily to greater favorable development of prior accident year losses. In addition, for the three and nine months ended September 30, 2016, the current accident year loss and ALAE ratios were impacted by several large losses.

The farm & ranch SAP non-catastrophe loss and ALAE ratios for the three and nine months ended September 30, 2017 improved 3.8 points and increased 20.2 points, respectively, when compared to the same 2016 periods. The loss ratio for the three months ended September 30, 2016 reflected revised loss estimates for current accident year losses during the second quarter of 2016. The 2017 year to date increase was primarily driven by large fire losses.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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*Specialty Insurance Segment*

The following tables set forth the SAP underwriting gain (loss) and SAP combined ratios by major product line for our specialty insurance segment for the three and nine months ended September 30, 2017 and 2016:

Table 9

(\$ in millions)

| <b>Three months ended September 30, 2017</b> | <b>E&amp;S<br/>Property</b> | <b>E&amp;S<br/>Casualty</b> | <b>Programs</b> | <b>Total</b>    |
|--|-----------------------------|-----------------------------|-----------------|-----------------|
| Net written premiums                         | <b>\$4.9</b>                | <b>\$26.3</b>               | <b>\$7.3</b>    | <b>\$38.5</b>   |
| Net earned premiums                          | <b>10.0</b>                 | <b>27.0</b>                 | <b>23.6</b>     | <b>60.6</b>     |
| Losses and LAE incurred:                     |                             |                             |                 |                 |
| Cat loss and ALAE                            | <b>42.9</b>                 | <b>0.3</b>                  | <b>0.5</b>      | <b>43.7</b>     |
| Non-cat loss and ALAE                        | <b>4.0</b>                  | <b>17.3</b>                 | <b>17.1</b>     | <b>38.4</b>     |
| <i>Total Loss and ALAE</i>                   | <b>46.9</b>                 | <b>17.6</b>                 | <b>17.6</b>     | <b>82.1</b>     |
| ULAE   | <b>—</b>                    | <b>0.7</b>                  | <b>1.2</b>      | <b>1.9</b>      |
| <i>Total Loss and LAE</i>                    | <b>46.9</b>                 | <b>18.3</b>                 | <b>18.8</b>     | <b>84.0</b>     |
| Underwriting expenses                        | <b>3.7</b>                  | <b>9.4</b>                  | <b>2.6</b>      | <b>15.7</b>     |
| <i>Net underwriting (loss) gain</i>          | <b>\$(40.6)</b>             | <b>\$(0.7)</b>              | <b>\$2.2</b>    | <b>\$(39.1)</b> |
| Cat loss and ALAE ratio                      | <b>430.9</b>                | <b>% 1.2</b>                | <b>% 2.1</b>    | <b>% 72.2</b>   |
| Non-cat loss and ALAE ratio                  | <b>38.6</b>                 | <b>% 63.9</b>               | <b>% 72.8</b>   | <b>% 63.2</b>   |
| <i>Total Loss and ALAE ratio</i>             | <b>469.5</b>                | <b>% 65.1</b>               | <b>% 74.9</b>   | <b>% 135.4</b>  |
| ULAE ratio                                   | <b>1.0</b>                  | <b>% 2.5</b>                | <b>% 4.9</b>    | <b>% 3.2</b>    |
| <i>Total Loss and LAE ratio</i>              | <b>470.5</b>                | <b>% 67.6</b>               | <b>% 79.8</b>   | <b>% 138.6</b>  |
| Expense ratio                                | <b>75.1</b>                 | <b>% 35.8</b>               | <b>% 35.5</b>   | <b>% 40.8</b>   |
| <i>Combined ratio</i>                        | <b>545.6</b>                | <b>% 103.4</b>              | <b>% 115.3</b>  | <b>% 179.4</b>  |



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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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Table 10

(\$ in millions)

| Three months ended September 30, 2016 | E&S<br>Property | E&S<br>Casualty | Programs  | Total     |
|---------------------------------------|-----------------|-----------------|-----------|-----------|
| Net written premiums                  | 7.8             | \$ 31.6         | \$ 27.3   | \$ 66.7   |
| Net earned premiums                   | 10.2            | 25.6            | 29.5      | 65.3      |
| Losses and LAE incurred:              |                 |                 |           |           |
| Cat loss and ALAE                     | —               | —               | 0.1       | 0.1       |
| Non-cat loss and ALAE                 | 2.6             | 17.5            | 21.2      | 41.3      |
| <i>Total Loss and ALAE</i>            | 2.6             | 17.5            | 21.3      | 41.4      |
| ULAE                                  | (0.8 )          | 1.4             | 1.9       | 2.5       |
| <i>Total Loss and LAE</i>             | 1.8             | 18.9            | 23.2      | 43.9      |
| Underwriting expenses                 | 3.7             | 11.7            | 9.3       | 24.7      |
| <i>Net underwriting gain (loss)</i>   | \$ 4.7          | \$ (5.0 )       | \$ (3.0 ) | \$ (3.3 ) |
| Cat loss and ALAE ratio               | — %             | — %             | 0.4 %     | 0.2 %     |
| Non-cat loss and ALAE ratio           | 25.2 %          | 68.4 %          | 72.1 %    | 63.2 %    |
| <i>Total Loss and ALAE ratio</i>      | 25.2 %          | 68.4 %          | 72.5 %    | 63.4 %    |
| ULAE ratio                            | (6.9 )%         | 5.2 %           | 6.1 %     | 3.7 %     |
| <i>Total Loss and LAE ratio</i>       | 18.3 %          | 73.6 %          | 78.6 %    | 67.1 %    |
| Expense ratio                         | 47.1 %          | 37.2 %          | 34.2 %    | 37.1 %    |
| <i>Combined ratio</i>                 | 65.4 %          | 110.8 %         | 112.8 %   | 104.2 %   |

Table 11

(\$ in millions)

| Nine months ended September 30, 2017 | E&S<br>Property | E&S<br>Casualty | Programs        | Total            |
|--------------------------------------|-----------------|-----------------|-----------------|------------------|
| Net written premiums                 | <b>\$31.4</b>   | <b>\$ 83.6</b>  | <b>\$ 61.4</b>  | <b>\$ 176.4</b>  |
| Net earned premiums                  | <b>31.4</b>     | <b>76.1</b>     | <b>76.8</b>     | <b>184.3</b>     |
| Losses and LAE incurred:             |                 |                 |                 |                  |
| Cat loss and ALAE                    | <b>45.3</b>     | <b>0.3</b>      | <b>1.0</b>      | <b>46.6</b>      |
| Non-cat loss and ALAE                | <b>11.4</b>     | <b>52.3</b>     | <b>57.7</b>     | <b>121.4</b>     |
| <i>Total Loss and ALAE</i>           | <b>56.7</b>     | <b>52.6</b>     | <b>58.7</b>     | <b>168.0</b>     |
| ULAE                                 | <b>(0.2 )</b>   | <b>2.9</b>      | <b>4.2</b>      | <b>6.9</b>       |
| <i>Total Loss and LAE</i>            | <b>56.5</b>     | <b>55.5</b>     | <b>62.9</b>     | <b>174.9</b>     |
| Underwriting expenses                | <b>15.0</b>     | <b>29.5</b>     | <b>17.4</b>     | <b>61.9</b>      |
| <i>Net underwriting loss</i>         | <b>\$(40.1)</b> | <b>\$(8.9 )</b> | <b>\$(3.5 )</b> | <b>\$(52.5 )</b> |
| Cat loss and ALAE ratio              | <b>144.4 %</b>  | <b>0.4 %</b>    | <b>1.3 %</b>    | <b>25.3 %</b>    |
| Non-cat loss and ALAE ratio          | <b>36.2 %</b>   | <b>68.6 %</b>   | <b>75.2 %</b>   | <b>65.8 %</b>    |
| <i>Total Loss and ALAE ratio</i>     | <b>180.6 %</b>  | <b>69.0 %</b>   | <b>76.5 %</b>   | <b>91.1 %</b>    |
| ULAE ratio                           | <b>(0.5 )%</b>  | <b>3.9 %</b>    | <b>5.4 %</b>    | <b>3.8 %</b>     |
| <i>Total Loss and LAE ratio</i>      | <b>180.1 %</b>  | <b>72.9 %</b>   | <b>81.9 %</b>   | <b>94.9 %</b>    |
| Expense ratio                        | <b>47.9 %</b>   | <b>35.2 %</b>   | <b>28.4 %</b>   | <b>35.1 %</b>    |

*Combined ratio*

**228.0 % 108.1 % 110.3 % 130.0 %**

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

Table 12

(\$ in millions)

| Nine months ended September 30, 2016 | E&S<br>Property | E&S<br>Casualty | Programs  | Total     |   |
|--------------------------------------|-----------------|-----------------|-----------|-----------|---|
| Net written premiums                 | \$31.6          | \$75.9          | \$88.7    | \$196.2   |   |
| Net earned premiums                  | 29.9            | 66.7            | 81.4      | 178.0     |   |
| Losses and LAE incurred:             |                 |                 |           |           |   |
| Cat loss and ALAE                    | 0.4             | —               | 0.2       | 0.6       |   |
| Non-cat loss and ALAE                | 9.4             | 44.1            | 72.4      | 125.9     |   |
| <i>Total Loss and ALAE</i>           | 9.8             | 44.1            | 72.6      | 126.5     |   |
| ULAE                                 | (0.3 )          | 3.9             | 4.7       | 8.3       |   |
| <i>Total Loss and LAE</i>            | 9.5             | 48.0            | 77.3      | 134.8     |   |
| Underwriting expenses                | 14.9            | 26.9            | 29.7      | 71.5      |   |
| <i>Net underwriting gain (loss)</i>  | \$5.5           | \$(8.2 )        | \$(25.6 ) | \$(28.3 ) |   |
| Cat loss and ALAE ratio              | 1.3             | % —             | % 0.2     | % 0.3     | % |
| Non-cat loss and ALAE ratio          | 31.5            | % 66.1          | % 89.0    | % 70.7    | % |
| <i>Total Loss and ALAE ratio</i>     | 32.8            | % 66.1          | % 89.2    | % 71.0    | % |
| ULAE ratio                           | (0.7 )          | % 5.7           | % 5.9     | % 4.8     | % |
| <i>Total Loss and LAE ratio</i>      | 32.1            | % 71.8          | % 95.1    | % 75.8    | % |
| Expense ratio                        | 47.2            | % 35.5          | % 33.5    | % 36.5    | % |
| <i>Combined ratio</i>                | 79.3            | % 107.3         | % 128.6   | % 112.3   | % |

The specialty insurance segment's net written premiums for the three and nine months ended September 30, 2017 decreased 42.3% and 10.1%, respectively, compared to the same 2016 periods (Tables 9 - 12), primarily driven by (i) our decision to exit program business and (ii) continued competitiveness of the catastrophe-exposed property market. In addition, the third quarter of 2016 was impacted by a change in the structure of the reinsurance treaty covering casualty risks within the specialty insurance segment, resulting in the return to us of ceded unearned premium from the reinsurers. Partially offsetting the year to date decrease was new business growth in E&S casualty, primarily due to increased production from our umbrella and gas & propane distribution underwriting teams.

The specialty insurance segment's SAP catastrophe loss and ALAE ratio for the three and nine months ended September 30, 2017, increased 72.0 points and 25.0 points, respectively, when compared to the same 2016 periods (Tables 9 - 12), primarily driven by hurricanes Harvey and Irma, which impacted the quarter and year to date 2017 cat loss and ALAE ratios by 71.8 points and 23.6 points, respectively.

The specialty insurance segment's SAP non-catastrophe loss and ALAE ratio for the three and nine months ended September 30, 2017 was flat and improved 4.9 points, respectively, when compared to the same 2016 periods (Tables 9 - 12). During the first nine months of 2017, ultimate loss estimates for prior accident years increased \$2.6 million compared to \$17.9 million for the same 2016 period. The third quarter and year to date 2016 loss ratios were impacted by (i) higher current accident year losses in programs, and (ii) adverse development of prior accident year losses resulting from increased severity in programs with commercial auto exposures.

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

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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*Losses and LAE Development*

Losses and loss expenses represent the combined estimated ultimate liability for claims occurring in a period, along with any change in the estimated ultimate liability for claims occurring in prior periods.

The following table sets forth a tabular presentation of the development of the prior accident years ultimate liability by product for the three and nine months ended September 30, 2017 and 2016:

| (\$ millions)                             | Three months ended<br>September 30 |         |              | Nine months ended<br>September 30 |          |              |
|---|------------------------------------|---------|--------------|-----------------------------------|----------|--------------|
|   | 2017                               | 2016    | \$<br>Change | 2017                              | 2016     | \$<br>Change |
|   | <i>Redundancy /(Deficiency)</i>    |         |              | <i>Redundancy /(Deficiency)</i>   |          |              |
| Non-cat loss and ALAE:                    |                                    |         |              |                                   |          |              |
| <u>Personal Insurance Segment:</u>        |                                    |         |              |                                   |          |              |
| Personal Auto                             | <b>\$0.5</b>                       | \$(0.6) | \$ 1.1       | <b>\$2.3</b>                      | \$(8.5)  | \$ 10.8      |
| Homeowners                                | —                                  | (0.2)   | 0.2          | <b>(1.9)</b>                      | (0.1)    | (1.8)        |
| Other Personal                            | <b>(0.4)</b>                       | —       | (0.4)        | <b>(2.5)</b>                      | (0.8)    | (1.7)        |
| <i>Total Personal Insurance Segment</i>   | <b>0.1</b>                         | (0.8)   | 0.9          | <b>(2.1)</b>                      | (9.4)    | 7.3          |
| <u>Commercial Insurance Segment:</u>      |                                    |         |              |                                   |          |              |
| Commercial Auto                           | <b>2.6</b>                         | (0.4)   | 3.0          | <b>5.7</b>                        | (5.1)    | 10.8         |
| Small Commercial Package                  | <b>2.9</b>                         | (0.8)   | 3.1          | <b>7.9</b>                        | (1.4)    | 9.3          |
| Middle Market Commercial                  | <b>0.8</b>                         | (2.2)   | 3.0          | <b>6.1</b>                        | (1.1)    | 7.2          |
| Workers' Compensation                     | <b>2.2</b>                         | 1.4     | 0.8          | <b>6.9</b>                        | 2.0      | 4.9          |
| Farm & Ranch                              | <b>0.2</b>                         | 0.4     | (0.2)        | <b>1.0</b>                        | 1.1      | (0.1)        |
| Other Commercial                          | <b>1.2</b>                         | 1.4     | (0.2)        | <b>5.5</b>                        | 0.9      | 4.6          |
| <i>Total Commercial Insurance Segment</i> | <b>9.9</b>                         | (0.2)   | 10.1         | <b>33.1</b>                       | (3.6)    | 36.7         |
| <u>Specialty Insurance Segment:</u>       |                                    |         |              |                                   |          |              |
| E&S Property                              | <b>(1.4)</b>                       | 0.1     | (1.5)        | <b>(3.0)</b>                      | (1.1)    | (1.9)        |
| E&S Casualty                              | <b>0.8</b>                         | (1.1)   | 1.9          | <b>1.1</b>                        | (3.4)    | 4.5          |
| Programs                                  | <b>(0.6)</b>                       | (0.8)   | 0.2          | <b>(0.7)</b>                      | (13.4)   | 12.7         |
| <i>Total Specialty Insurance Segment</i>  | <b>(1.2)</b>                       | (1.8)   | 0.6          | <b>(2.6)</b>                      | (17.9)   | 15.3         |
| Cat Loss and ALAE                         | <b>0.2</b>                         | 0.3     | (0.1)        | <b>1.8</b>                        | 1.3      | 0.5          |
| ULAE                                      | <b>0.2</b>                         | (0.7)   | 0.9          | <b>4.4</b>                        | (3.8)    | 8.2          |
| <i>Total</i>                              | <b>\$9.2</b>                       | \$(3.2) | \$ 12.4      | <b>\$34.6</b>                     | \$(33.4) | \$ 68.0      |

For further information, see the "Personal Insurance Segment", "Commercial Insurance Segment" and "Specialty Insurance Segment" discussions included in this Item 2.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

*Losses and loss expenses payable*

The following table sets forth losses and loss expenses payable by major product at September 30, 2017 and December 31, 2016:

| <i>(\$ millions)</i>  | <b>September</b>  | December \$ |         |
|---|-------------------|-------------|---------|
|   | <b>30, 2017</b>   | 31, 2016    | Change  |
| <b><u>Personal Insurance Segment:</u></b>   |                   |             |         |
| Personal Auto   | <b>\$ 197.3</b>   | \$ 192.7    | \$ 4.6  |
| Homeowners  | <b>60.6</b>       | 50.0        | 10.6    |
| Other Personal  | <b>13.9</b>       | 8.8         | 5.1     |
| <i>Total Personal Insurance Segment</i>   | <b>271.8</b>      | 251.5       | 20.3    |
| <b><u>Commercial Insurance Segment:</u></b>   |                   |             |         |
| Commercial Auto   | <b>96.0</b>       | 98.3        | (2.3 )  |
| Small Commercial Package  | <b>126.5</b>      | 126.2       | 0.3     |
| Middle Market Commercial  | <b>151.9</b>      | 157.7       | (5.8 )  |
| Workers' Compensation   | <b>192.6</b>      | 185.6       | 7.0     |
| Farm & Ranch  | <b>15.7</b>       | 14.3        | 1.4     |
| Other Commercial  | <b>23.8</b>       | 23.4        | 0.4     |
| <i>Total Commercial Insurance Segment</i>   | <b>606.5</b>      | 605.5       | 1.0     |
| <b><u>Specialty Insurance Segment:</u></b>  |                   |             |         |
| E&S Property  | <b>72.0</b>       | 29.8        | 42.2    |
| E&S Casualty  | <b>167.6</b>      | 137.4       | 30.2    |
| Programs  | <b>157.7</b>      | 153.8       | 3.9     |
| <i>Total Specialty Insurance Segment</i>  | <b>397.3</b>      | 321.0       | 76.3    |
| <i>Total losses and loss expenses payable, net of reinsurance recoverable on losses and loss expenses payable</i> | <b>\$ 1,275.6</b> | \$ 1,178.0  | \$ 97.6 |

Losses and loss expenses payable increased \$97.6 million since December 31, 2016 primarily due to exposure growth and higher current accident year loss estimates in E&S casualty and a higher level of current accident year weather-related losses, predominantly in E&S property and homeowners, driven by hurricanes Harvey and Irma.

We conduct quarterly reviews of loss development and make judgments in determining the reserves for losses and loss expenses. Several factors are considered by us when estimating ultimate liabilities, including consistency in relative case reserve adequacy, consistency in claims settlement practices, recent legal developments, historical data, actuarial projections, accounting projections, exposure changes, anticipated inflation, current business conditions, catastrophe development, late reported claims, and other reasonableness tests.

The risks and uncertainties inherent in our estimates include, but are not limited to, actual settlement experience different from historical data, trends, changes in business and economic conditions, court decisions creating unanticipated liabilities, ongoing interpretation of policy provisions by the courts, inconsistent decisions in lawsuits regarding coverage and additional information discovered before settlement of claims. Our results of operations and financial condition could be impacted, perhaps significantly, in the future if the ultimate payments required for claims settlement vary from the liability currently recorded. For a discussion of our reserving methodologies, see "Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies – Losses and Loss Expenses Payable" in Item 7 of 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)

*Acquisition and Operating Expenses*

Our GAAP acquisition and operating expense ratios for the three and nine months ended September 30, 2017 were 35.3% and 35.0%, respectively, compared to 33.7% and 33.5%, respectively, for the same 2016 periods. The third quarter and year to date 2017 increases were primarily due to (i) the impact of our technology investments, including amortization and system and infrastructure support, and (ii) a decrease in the deferral rate of certain underwriting expenses.

**Investment Operations Segment**

Our investments in fixed maturities, equity securities and certain other invested assets are reported as available-for-sale and carried at fair value. The unrealized holding gains or losses, net of applicable deferred taxes, are included as a separate component of stockholders' equity as accumulated other comprehensive income and as such are not included in the determination of net income.

We have investment policy guidelines with respect to purchasing fixed maturity investments for our insurance subsidiaries which preclude investments in bonds that are rated below investment grade by a recognized rating service at the time of purchase. Our fixed maturity portfolio is composed of high quality, investment grade issues, consisting primarily of debt issues rated AAA, AA or A. We obtain investment ratings from major rating services. If there is a split rating, we assign the lowest rating obtained. At September 30, 2017, there was one fixed maturity investments rated below investment grade in our available-for-sale investment portfolio.

For further discussion regarding the management of our investment portfolio, see "Management's Discussion and Analysis of Financial Condition and Results of Operations – Results of Operations – Investment Operations Segment" in Item 7 of the 2016 Form 10-K.

*Composition of Investment Portfolio*

The following table sets forth the composition of our investment portfolio at carrying value at September 30, 2017 and December 31, 2016:

| <i>(\$ million)</i>                     | <b>September 30,<br/>2017</b> | <b>% of Total</b> | December 31,<br>2016 | <b>% of Total</b> |
|---|-------------------------------|-------------------|----------------------|-------------------|
| Cash and cash equivalents               | <b>\$ 111.1</b>               | <b>4.0</b>        | \$ 51.1              | 1.9               |
| Fixed maturities, at fair value:        |                               |                   |                      |                   |
| Fixed maturities                        | <b>2,025.2</b>                | <b>73.0</b>       | 1,947.5              | 73.1              |
| Treasury inflation-protected securities | <b>153.5</b>                  | <b>5.6</b>        | 161.8                | 6.1               |
| <i>Total fixed maturities</i>           | <b>2,178.7</b>                | <b>78.6</b>       | 2,109.3              | 79.2              |
| Not receivable from                     | <b>70.0</b>                   | <b>2.5</b>        | 70.0                 | 2.6               |

|  |                   |            |       |
|--|-------------------|------------|-------|
| affiliate<br>(a)                                 |                   |            |       |
| Equity securities,<br>at fair value:             |                   |            |       |
| Large-cap securities                             | <b>3.6</b>        | 139.0      | 5.2   |
| Small-cap securities                             | <b>2.4</b>        | 79.1       | 3.0   |
| Mutual and exchange traded funds                 | <b>6.8</b>        | 164.7      | 6.2   |
| <i>Total equity securities</i>                   | <b>12.8</b>       | 382.8      | 14.4  |
| Other invested assets,<br>at fair value:         |                   |            |       |
| International funds                              | <b>1.5</b>        | 35.7       | 1.3   |
| Other invested assets                            | <b>0.4</b>        | 9.4        | 0.4   |
| <i>Total other invested assets at fair value</i> | <b>1.9</b>        | 45.1       | 1.7   |
| Other invested assets,<br>at cost                | <b>0.2</b>        | 5.4        | 0.2   |
| <i>Total portfolio</i>                           | <b>\$ 2,773.4</b> | \$ 2,663.7 | 100.0 |

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





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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

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

Expected maturities may differ from contractual maturities as the issuers may have the right to call or prepay the obligations with or without call or prepayment penalties. The duration of the fixed maturity portfolio was approximately 4.37 and 4.45 as of September 30, 2017, and December 31, 2016, respectively.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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*Investment Operations Revenue*

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 |           | Nine months ended |           |
|--|--------------------|-----------|-------------------|-----------|
|  | September 30       |           | September 30      |           |
|  | 2017               | 2016      | 2017              | 2016      |
| Gross investment income:               |                    |           |                   |           |
| Fixed maturities                       | <b>\$15.4</b>      | \$15.4    | <b>\$47.1</b>     | \$47.0    |
| Equity securities                      | <b>2.0</b>         | 1.3       | <b>5.7</b>        | 4.3       |
| Other                                  | <b>1.6</b>         | 1.4       | <b>4.6</b>        | 4.1       |
| <i>Total gross investment income</i>   | <b>19.0</b>        | 18.1      | <b>57.4</b>       | 55.4      |
| Less: Investment expenses              | <b>0.3</b>         | 0.5       | <b>0.9</b>        | 1.3       |
| <i>Net investment income</i>           | <b>\$18.7</b>      | \$17.6    | <b>\$56.5</b>     | \$54.1    |
| <br>                                   |                    |           |                   |           |
| Average invested assets (at cost)      | <b>\$2,554.5</b>   | \$2,427.3 | <b>\$2,545.3</b>  | \$2,405.7 |
| Annualized investment yield            | <b>2.9</b>         | % 2.9     | <b>% 3.0</b>      | % 3.0     |
| Annualized investment yield, after tax | <b>2.1</b>         | % 2.2     | <b>% 2.1</b>      | % 2.3     |
| Net investment income, after tax       | <b>\$13.4</b>      | \$13.1    | <b>41.0</b>       | \$40.7    |
| Effective tax rate                     | <b>27.8</b>        | % 25.5    | <b>% 27.3</b>     | % 24.8    |

The following table sets forth realized gains (losses) and the proceeds received from the sale of our investment portfolio for the three and nine months ended September 30, 2017 and 2016:

| (\$ in millions)                         | Three months ended      |                           |                         |                           | Nine months ended September |                           |                         |                           |
|--|-------------------------|---------------------------|-------------------------|---------------------------|-----------------------------|---------------------------|-------------------------|---------------------------|
|  | September 30            |                           |                         |                           | 30                          |                           |                         |                           |
|  | 2017                    |                           | 2016                    |                           | 2017                        |                           | 2016                    |                           |
|  | Realized gains (losses) | Proceeds received on sale | Realized gains (losses) | Proceeds received on sale | Realized gains (losses)     | Proceeds received on sale | Realized gains (losses) | Proceeds received on sale |
| Realized gains:                          |                         |                           |                         |                           |                             |                           |                         |                           |
| Fixed maturities                         | <b>\$0.4</b>            | <b>\$48.1</b>             | \$—                     | \$11.6                    | <b>\$2.7</b>                | <b>\$156.3</b>            | \$2.1                   | \$138.0                   |
| Equity securities                        | <b>20.9</b>             | <b>76.9</b>               | 9.9                     | 49.0                      | <b>45.2</b>                 | <b>164.1</b>              | 20.6                    | 109.5                     |
| Other invested assets                    | <b>—</b>                | <b>0.3</b>                | —                       | 0.3                       | <b>0.1</b>                  | <b>0.8</b>                | 0.1                     | 0.7                       |
| <i>Total realized gains</i>              | <b>21.3</b>             | <b>125.3</b>              | 9.9                     | 60.9                      | <b>48.0</b>                 | <b>321.2</b>              | 22.8                    | 248.2                     |
| Realized losses:                         |                         |                           |                         |                           |                             |                           |                         |                           |
| Equity securities:                       |                         |                           |                         |                           |                             |                           |                         |                           |
| Sales                                    | <b>(0.5 )</b>           | —                         | —                       | (0.1 )                    | <b>(0.7 )</b>               | <b>4.7</b>                | (0.8 )                  | 4.4                       |
| OTTI                                     | <b>(0.6 )</b>           | —                         | (1.1 )                  | —                         | <b>(3.5 )</b>               | —                         | (3.1 )                  | —                         |
| Fixed maturities:                        |                         |                           |                         |                           |                             |                           |                         |                           |
| OTTI                                     | <b>—</b>                | —                         | —                       | —                         | <b>—</b>                    | —                         | (2.3 )                  | —                         |
| Total realized losses                    | <b>(1.1 )</b>           | —                         | (1.1 )                  | (0.1 )                    | <b>(4.2 )</b>               | <b>4.7</b>                | (6.2 )                  | 4.4                       |
| <i>Net realized gains on investments</i> | <b>\$20.2</b>           | <b>\$125.3</b>            | \$8.8                   | \$60.8                    | <b>\$43.8</b>               | <b>\$325.9</b>            | \$16.6                  | \$252.6                   |

Net realized gains increased \$11.4 million and \$27.2 million, respectively, for the three and nine months ended September 30, 2017, when compared to the same 2016 periods, driven by sales in the U.S. large-cap portfolio. When a fixed maturity security has been determined to have an other-than-temporary decline in fair value, the impairment charge is separated into an amount representing the credit loss, which is recognized in earnings, and the

amount related to non-credit factors, which is recognized in accumulated other comprehensive income. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies – Investments” included in Item 7 of the 2016 Form 10-K for other-than-temporary impairment (“OTTI”) indicators. Future increases or decreases in fair value, if not other-than-temporary, are included in accumulated other comprehensive income. We did not recognize any OTTI on our fixed maturity

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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portfolio for the nine months ended September 30, 2017, and we recognized \$2.3 million of OTTI on our fixed maturity portfolio for the nine months ended September 30, 2016.

When an equity security or other invested asset has been determined to have a decline in fair value that is other-than-temporary, we adjust the cost basis of the security to fair value. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies – Investments” included in Item 7 of the 2016 Form 10-K for OTTI impairment indicators. This results in a charge to earnings as a realized loss, which is not reversed for subsequent recoveries in fair value. Future increases or decreases in fair value, if not other-than-temporary, are included in accumulated other comprehensive income.

The following table sets forth the realized losses related to OTTI on our investment portfolio recognized 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                         |
|   | Number of positions impaired | Number of positions impaired | Number of positions impaired | Number of positions impaired |
| Equity securities:                            |                              |                              |                              |                              |
| Large-cap securities                          | —                            | —                            | 1                            | 1                            |
| Small-cap securities                          | 4                            | 8                            | 22                           | 22                           |
| Fixed maturities                              | —                            | —                            | —                            | 1                            |
| <i>Total other-than-temporary impairments</i> | <b>4</b>                     | <b>8</b>                     | <b>23</b>                    | <b>24</b>                    |

*Gross Unrealized Investment Gains and Losses*

Based upon our review of our investment portfolio at September 30, 2017, we determined that there were no individual investments with an unrealized holding loss that had a fair value significantly below cost continually for more than one year. The following table sets forth detailed information on our available-for-sale investment portfolio by lot at fair value for our gross unrealized holding gains (losses) at September 30, 2017:

|  | Cost or amortized cost | Gross unrealized holding gains | Number of positions | Gross unrealized holding losses | Number of loss positions | Fair value       |
|--|------------------------|--------------------------------|---------------------|---------------------------------|--------------------------|------------------|
| Fixed maturities:  |                        |                                |                     |                                 |                          |                  |
| U.S. treasury securities and obligations of U.S. government agencies | \$418.6                | \$8.3                          | 20                  | \$(4.5)                         | 32                       | \$422.4          |
| Obligations of states and political subdivisions                     | 553.7                  | 19.9                           | 132                 | (0.4)                           | 8                        | 573.2            |
| Corporate securities   | 534.9                  | 6.9                            | 65                  | (1.4)                           | 23                       | 540.4            |
| U.S. government agencies mortgage-backed securities                  | 642.3                  | 8.9                            | 46                  | (8.5)                           | 60                       | 642.7            |
| <i>Total fixed maturities</i>  | <b>2,149.5</b>         | <b>44.0</b>                    | <b>263</b>          | <b>(14.8)</b>                   | <b>123</b>               | <b>2,178.7</b>   |
| Equity securities:   |                        |                                |                     |                                 |                          |                  |
| Large-cap securities   | 71.5                   | 29.9                           | 38                  | (0.7)                           | 6                        | 100.7            |
| Small-cap securities   | 48.3                   | 17.1                           | 72                  | —                               | —                        | 65.4             |
| Mutual and exchange traded funds                                     | 177.3                  | 18.3                           | 11                  | (6.8)                           | 1                        | 188.8            |
| <i>Total equity securities</i>                                       | <b>297.1</b>           | <b>65.3</b>                    | <b>121</b>          | <b>(7.5)</b>                    | <b>7</b>                 | <b>354.9</b>     |
| Other invested assets  | 25.6                   | 27.5                           | 2                   | —                               | —                        | 53.1             |
| <i>Total available-for-sale investments</i>                          | <b>\$2,472.2</b>       | <b>\$136.8</b>                 | <b>386</b>          | <b>\$(22.3)</b>                 | <b>130</b>               | <b>\$2,586.7</b> |



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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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The following table sets forth our unrealized holding gains by investment type, net of deferred tax that was included as a component of accumulated other comprehensive income at September 30, 2017, and December 31, 2016, and the change in unrealized holding gains, net of deferred tax, for the nine months ended September 30, 2017:

| <i>(\$ millions)</i>                      | <b>September<br/>30, 2017</b> | December<br>31, 2016 | \$<br>Change |
|---|-------------------------------|----------------------|--------------|
| Available-for-sale investments:           |                               |                      |              |
| Unrealized holding gains:                 |                               |                      |              |
| Fixed maturities                          | <b>\$ 29.2</b>                | \$ 13.4              | \$ 15.8      |
| Equity securities                         | <b>57.8</b>                   | 59.7                 | (1.9 )       |
| Other invested assets                     | <b>27.5</b>                   | 19.6                 | 7.9          |
| <i>Unrealized gains</i>                   | <b>114.5</b>                  | 92.7                 | 21.8         |
| Net deferred federal income tax liability | <b>(37.5 )</b>                | (29.9 )              | (7.6 )       |
| <i>Unrealized gains, net of tax</i>       | <b>\$ 77.0</b>                | \$ 62.8              | \$ 14.2      |

**Fair Value Measurements**

We primarily use one independent nationally recognized pricing service in developing fair value estimates. We obtain one price per security, and our processes and control procedures are designed to ensure the value is accurately recorded on an unadjusted basis. Through discussions with the pricing service, we gain an understanding of the methodologies used to price the different types of securities, that the data and the valuation methods utilized are appropriate and consistently applied, and that the assumptions are reasonable and representative of fair value. To validate the reasonableness of the valuations obtained from the pricing service, we compare to other fair value pricing information gathered from other independent pricing sources. See Note 3, "Fair Value of Financial Instruments" to our condensed consolidated financial statements included in Item 1 of this Form 10-Q for a presentation of our available-for-sale investments within the fair value hierarchy at September 30, 2017, and December 31, 2016. As of September 30, 2017, we no longer hold any Level 3 assets.

**Other Items***Income Taxes*

The following table sets forth the components of our federal income tax expense for the three and nine months ended September 30, 2017 and 2016, respectively.

| <i>(\$ millions)</i>                       | Three months<br>ended<br>September 30<br><b>2017</b> |        | Nine months<br>ended<br>September 30<br><b>2017</b> |          |
|--|--|--------|---|----------|
|  | 2017   | 2016   | 2017  | 2016     |
| (Loss) income before federal income taxes  | <b>\$(11.2)</b>                                      | \$7.4  | <b>\$(4.5)</b>                                      | \$(13.9) |
| Federal income tax (benefit) expense:      |  |        |   |          |
| Current                                    | <b>(0.1)</b>   | (1.5 ) | —   | (1.5 )   |
| Deferred                                   | <b>(1.6 )</b>  | (1.2 ) | <b>0.4</b>  | (0.9 )   |
| Total federal income tax (benefit) expense | <b>(1.7 )</b>  | (2.7 ) | <b>0.4</b>  | (2.4 )   |
| <i>Net (loss) income</i>                   | <b>\$(9.5 )</b>                                      | \$10.1 | <b>\$(4.9)</b>                                      | \$(11.5) |

The effective tax rates for the three and nine months ended September 30, 2017 were 14.8% and (8.7)%, respectively, compared to (36.2)% and 17.0%, respectively, for the same 2016 periods. Federal income tax expense for the nine months ended September 30, 2017 included \$1.3 million of deferred income tax expense as a result of the expiration of unexercised stock options.

For additional information, see Note 6 of our condensed consolidated financial statements included in Item 1 of this Form 10-Q.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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**LIQUIDITY AND CAPITAL RESOURCES**

**General**

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

**Liquidity**

Our insurance subsidiaries must have adequate liquidity to ensure that their cash obligations are met. However, as discussed below, the STFC Pooled Companies do not have the day-to-day liquidity concerns normally associated with an insurance company due to their participation in, and the terms of, the Pooling Arrangement. In addition, State Auto P&C's \$100.0 million credit facility is available for general corporate purposes such as funding liquidity needs. See "Borrowing Arrangements - Credit Facility" included in this Item 2.

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

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

We generally manage our cash flows through current operational activity and maturing investments, without a need to liquidate any of our other investments; however, should our written premiums decline or paid losses increase significantly, or a combination thereof, we may need to liquidate investments at losses in order to meet our cash obligations. This action was not necessary for the three and nine months ended September 30, 2017.

We maintain a portion of our investment portfolio in relatively short-term and highly liquid investments to ensure the immediate availability of funds to pay claims and expenses. At September 30, 2017, and December 31, 2016, we had \$111.1 million and \$51.1 million, respectively, in cash and cash equivalents, and \$2,586.7 million and \$2,537.2 million, respectively, of total available-for-sale investments. Our fixed maturities available-for-sale included \$9.3 million and \$9.2 million of securities on deposit with insurance regulators as required by law at September 30, 2017, and December 31, 2016; in addition, substantially all of our fixed maturity and equity securities are traded on public markets. For a further discussion regarding investments, see "Investments Operations Segment" included in this Item 2.



Cash provided by operating activities was \$60.7 million and \$62.0 million for the nine months ended September 30, 2017, and 2016, respectively. Net cash from operations will vary from period to period if there are significant changes in underwriting results, primarily a combination of the level of premiums written and loss and loss expenses paid, changes in cash flows from investment income or federal income tax activity.

Cash provided by investing activities was \$6.2 million and cash used in was \$63.8 million for the nine months ended September 30, 2017, and 2016, respectively. The change was primarily driven by an increase in proceeds from sales of equity

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

securities

Cash used in financing activities was \$6.9 million and cash provided by was \$13.2 million for the nine months ended September 30, 2017, and 2016 respectively. The decrease year over year was primarily driven by proceeds from the Federal Home Loan Bank of Cincinnati ("the "FHLB") loan in the principal amount of \$21.5 million in 2016.

**Borrowing Arrangements***Credit Facility*

State Auto P&C has a \$100.0 million five-year revolving credit facility (the "Credit Facility") maturing in July 2018 with a syndicate of lenders. During the term of the Credit Facility, State Auto P&C has the right to increase the total facility to a maximum amount of \$150.0 million, provided that no event of default has occurred and is continuing. The Credit Facility is available for general corporate purposes and provides for interest-only payments during its term, with principal and interest due in full at maturity. Interest is based on LIBOR or a base rate plus a calculated margin amount. All advances under the Credit Facility are to be fully secured by a pledge of specific investment securities of State Auto P&C. The Credit Facility includes certain covenants and requirements, including financial requirements that State Auto Financial maintain a minimum net worth and a certain debt to capitalization ratio. As of September 30, 2017, State Auto P&C had not made any borrowings under the Credit Facility and State Auto P&C and State Auto Financial were in compliance with all covenants and requirements of the Credit Facility.

*FHLB Loans*

State Auto P&C has outstanding two term loans with the FHLB in the principal amounts of \$21.5 million and \$85.0 million, respectively (the "2016 FHLB Loan" and "2013 FHLB Loan", respectively). The 2016 FHLB Loan is a five-year term loan and may be called (prepaid) after three years with no prepayment penalty. The 2016 FHLB Loan provides for interest-only payments during its term, with principal due in full at maturity. The interest rate is fixed over the term of the loan at 1.73%. The 2013 FHLB Loan is a 20-year term loan that may be currently called (prepaid) at any time with no prepayment penalty. The interest rate is fixed over the term of the loan at 5.03%. The 2013 and 2016 FHLB Loans are fully secured by a pledge of specific investment securities of State Auto P&C.

*Subordinated Debentures*

State Auto Financial's Delaware business trust subsidiary (the "Capital Trust") has outstanding \$15.0 million liquidation amount of capital securities, due 2033. In connection with the Capital Trust's issuance of the capital securities and the related purchase by State Auto Financial of all of the Capital Trust's common securities (liquidation amount of \$0.5 million), State Auto Financial has issued to the Capital Trust \$15.5 million aggregate principal amount of unsecured Floating Rate Junior Subordinated Debt Securities due 2033 (the "Subordinated Debentures"). The sole assets of the Capital Trust are the Subordinated Debentures and any interest accrued thereon. Interest on the Capital Trust's capital and common securities is payable quarterly at a rate equal to the three-month LIBOR rate plus 4.20%, adjusted quarterly. The applicable interest rates for September 30, 2017, and 2016 were 5.52% and 5.04%, respectively.

**Reinsurance Arrangements**

Members of the State Auto Group follow the customary industry practice of reinsuring a portion of their exposures and paying to the reinsurers a portion of the premiums received. Insurance is ceded principally to reduce net liability on individual risks or for individual loss occurrences, including catastrophic losses. Although reinsurance does not legally discharge the individual members of the State Auto Group from primary liability for the full amount of limits applicable under their policies, it does make the assuming reinsurer liable to the extent of the reinsurance ceded. To minimize the risk of reinsurer default, the State Auto Group cedes only to third-party reinsurers who are rated A- or better by A.M. Best or Standard & Poor's and also utilizes both domestic and international markets to diversify its credit risk. We utilize reinsurance to limit our loss exposure and contribute to our liquidity and capital resources. 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. We have also secured other reinsurance to limit the net cost of large loss events for certain types of coverage. The State Auto Group also makes

use of facultative reinsurance for unique risk situations. The State Auto Group also participates in state insurance pools and associations. In general, these pools and associations are state sponsored and/or operated, impose mandatory participation by insurers doing business in that state, and offer

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

*Property Catastrophe Treaty*

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. This property catastrophe reinsurance agreement renewed as of July 1, 2017. Under this reinsurance agreement, we retain the first \$75.0 million of catastrophe loss, each occurrence, with a 5.0% co-participation on the next \$325.0 million of covered loss, each occurrence. The reinsurers are responsible for 95.0% of the excess over \$75.0 million up to \$400.0 million of covered losses, each occurrence. The State Auto Group is responsible for catastrophe losses above \$400.0 million.

*Property Per Risk Treaty*

As of July 1, 2017, the State Auto Group renewed the property per risk excess of loss reinsurance agreement. This reinsurance agreement provides individual property risk coverage for the State Auto Group for losses exceeding \$3.0 million, subject to an additional \$2 million annual aggregate retention (AAD). Claims arising from named storms and earthquake for E&S property are excluded from this treaty. The reinsurers are responsible for 100.0% of the loss excess of the \$3.0 million retention and \$2.0 million AAD for property business up to \$20.0 million of covered loss.

*Casualty and Workers' Compensation Treaties*

As of July 1, 2017, the State Auto Group renewed our casualty excess of loss reinsurance agreement. Under this reinsurance agreement, the State Auto Group is responsible for the first \$2.0 million of losses that involve workers' compensation, auto liability, other liability and umbrella liability policies, subject to an additional \$2.0 million AAD. This reinsurance agreement provides coverage up to \$10.0 million, except for commercial umbrella policies which are covered for limits up to \$15.0 million. E&S casualty and programs units risks are not subject to this casualty excess of loss reinsurance agreement.

Also, certain unusual claim situations involving extra contractual obligations, excess of policy limits, LAE coverage and multiple policy or coverage loss occurrences arising from bodily injury liability, property damage, uninsured motorist and personal injury protection are covered by a Clash reinsurance agreement that provides for \$30.0 million of coverage in excess of \$10.0 million retention for each loss occurrence. This Clash reinsurance coverage sits above the \$8.0 million excess of \$2.0 million arrangement. Policies underwritten by the E&S casualty and programs units are not subject to this casualty excess of loss reinsurance agreement.

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

As of July 1, 2017, the State Auto Group renewed its reinsurance coverage for E&S casualty and programs casualty risks. Under this reinsurance agreement, the State Auto Group is responsible for the first \$2.0 million of losses. This reinsurance agreement provides 95.0% coverage up to \$9.0 million excess of \$2.0 million for any one insured, all policies, and 100.0% of \$14.0 million excess of \$11.0 million clash only coverage.

The rates for all of our treaty reinsurance agreements are negotiated annually.

**Regulatory Considerations**

At September 30, 2017, all of our insurance subsidiaries were in compliance with statutory requirements relating to capital adequacy.



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**ADOPTION OF RECENT ACCOUNTING PRONOUNCEMENTS**

*Improvements to 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. We adopted this guidance prospectively at January 1, 2017 and prior periods were not adjusted. For the nine months ended September 30, 2017, we recognized \$1.3 million of income tax expense as a result of adopting this guidance.

**CREDIT AND FINANCIAL STRENGTH RATINGS**

On June 6, 2017, A.M. Best reaffirmed the State Auto Group's financial strength rating of A- (Excellent) with a stable outlook.

**MARKET RISK**

With respect to Market Risk, see the discussion regarding this subject at "Management's Discussion and Analysis of Financial Condition and Results of Operations – Investment Operations Segment – Market Risk" in Item 7 of the 2016 Form 10-K. There have been no material changes from the information reported regarding Market Risk in the 2016 Form 10-K.

**Item 3. Quantitative and Qualitative Disclosure of Market Risk**

The information called for by this item is provided in this Form 10-Q under the caption "Market Risk" under Item 2 – Management's Discussion and Analysis of Financial Condition and Results of Operations.

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**Item 4. Controls and Procedures**

**Disclosure Controls and Procedures**

With the participation of our principal executive officer and principal financial officer, our management has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)), as of the end of the period covered by this report. Based upon that evaluation, our principal executive officer and principal financial officer have concluded that, as of the end of the period covered by this report:

- Information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded,
1. processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission;
  2. accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure; and
  3. Our disclosure controls and procedures are effective in timely making known to them material information required to be included in our periodic filings with the Securities and Exchange Commission.

**Changes in Internal Control over Financial Reporting**

There has been no change in our internal controls over financial reporting that occurred during the most recent fiscal quarter that has materially affected, nor is it likely to materially affect, our internal control over financial reporting.

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**PART II – OTHER INFORMATION**

**Item 1. Legal Proceedings**

None.

**Item 1A. Risk Factors**

There have been no material changes in our risk factors from those disclosed in the 2016 Form 10-K under Part I, Item 1A – Risk Factors.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None.

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**Item 6. Exhibits**

| Exhibit No. | Description of Exhibits   |
|-------------|---|
| 31.01       | <u>CEO certification required by Section 302 of Sarbanes Oxley Act of 2002</u>  |
| 31.02       | <u>CFO certification required by Section 302 of Sarbanes Oxley Act of 2002</u>  |
| 32.01       | <u>CEO certification required by Section 906 of Sarbanes Oxley Act of 2002</u>  |
| 32.02       | <u>CFO certification required by Section 906 of Sarbanes Oxley Act of 2002</u>  |
| 101.INS     | The instance document does not appear in the interactive data file because its XBRL tags are embedded within the inline XBRL document |
| 101.SCH     | XBRL Taxonomy Extension Schema Document   |
| 101.CAL     | XBRL Taxonomy Extension Calculation Linkbase Document   |
| 101.DEF     | XBRL Taxonomy Definition Linkbase Document  |
| 101.LAB     | XBRL Taxonomy Extension Label Linkbase Document   |
| 101.PRE     | XBRL Taxonomy Extension Presentation Linkbase Document  |

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

**State Auto Financial Corporation**

Date: November 6, 2017 /s/ Steven E. English

Steven E. English

Chief Financial Officer

(Duly Authorized Officer and

Principal Financial Officer)