

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

State Auto Financial CORP

Form 10-Q

November 05, 2018

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0000874977 us-gaap:OperatingSegmentsMember stfc:SpecialtyInsuranceSegmentMember 2018-07-01 2018-09-30  
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us-gaap:OperatingSegmentsMember stfc:InvestmentOperationsSegmentMember

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stfc:NetRealizedCapitalGainsMember 2017-01-01 2017-09-30 0000874977 us-gaap:OperatingSegmentsMember  
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stfc:SpecialtyInsuranceSegmentMember 2017-07-01 2017-09-30 0000874977  
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us-gaap:OperatingSegmentsMember stfc:SpecialtyInsuranceMember 2018-07-01 2018-09-30 0000874977  
stfc:CorporateAndReconcilingItemsMember 2018-07-01 2018-09-30 0000874977  
us-gaap:IntersegmentEliminationMember 2018-07-01 2018-09-30 0000874977 us-gaap:OperatingSegmentsMember  
stfc:PersonalInsuranceMember 2018-01-01 2018-09-30 0000874977 us-gaap:IntersegmentEliminationMember  
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2017-07-01 2017-09-30 0000874977 us-gaap:OperatingSegmentsMember stfc:SpecialtyInsuranceMember  
2017-01-01 2017-09-30 0000874977 us-gaap:OperatingSegmentsMember stfc:NetInvestmentIncomeMember  
2017-07-01 2017-09-30 0000874977 us-gaap:OperatingSegmentsMember stfc:BusinessInsuranceSegmentsMember  
2018-07-01 2018-09-30 xbrli:pure iso4217:USD xbrli:shares iso4217:USD xbrli:shares stfc:Agreement stfc:Segment  
[Table of Contents](#)

**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, 2018

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 ¨

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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  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

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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Table of Contents

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 30, 2018, the Registrant had 43,146,858 Common Shares outstanding.

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Table of Contents

## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

**PART I – FINANCIAL STATEMENTS****Item 1. Condensed Consolidated Balance Sheets**

	<b>September</b>	December
	<b>30, 2018</b>	31, 2017
<i>(\$ and shares in millions, except per share amounts)</i>		
<i>(unaudited)</i>		
<b>Assets</b>		
Fixed maturities, available-for-sale, at fair value (amortized cost \$2,185.2 and \$2,173.1, respectively)	<b>\$ 2,141.6</b>	\$2,192.8
Equity securities	<b>376.3</b>	365.3
Other invested assets	<b>54.5</b>	56.0
Other invested assets, at cost	<b>5.6</b>	5.6
Notes receivable from affiliate	<b>70.0</b>	70.0
<i>Total investments</i>	<b>2,648.0</b>	2,689.7
Cash and cash equivalents	<b>49.5</b>	91.5
Accrued investment income and other assets	<b>39.5</b>	36.5
Deferred policy acquisition costs (affiliated net assumed \$50.1 and \$57.2, respectively)	<b>104.5</b>	110.3
Reinsurance recoverable on losses and loss expenses payable	<b>5.0</b>	3.1
Prepaid reinsurance premiums	<b>6.8</b>	6.4
Due from affiliate	<b>10.6</b>	—
Current federal income taxes	<b>5.9</b>	4.8
Net deferred federal income taxes	<b>62.3</b>	58.8
Property and equipment, at cost	<b>7.1</b>	7.3
<b>Total assets</b>	<b>\$ 2,939.2</b>	\$3,008.4
<b>Liabilities and Stockholders' Equity</b>		
Losses and loss expenses payable (affiliated net assumed \$619.4 and \$711.4, respectively)	<b>\$ 1,198.7</b>	\$1,255.6
Unearned premiums (affiliated net assumed \$121.7 and \$187.9, respectively)	<b>595.6</b>	611.8
Notes payable (affiliates \$15.2 and \$15.2, respectively)	<b>122.0</b>	122.1
Pension and postretirement benefits (affiliated \$28.0 and \$34.8, respectively)	<b>52.1</b>	64.5
Due to affiliate	—	2.7
Other liabilities (affiliated net assumed \$70.0 and \$15.5, respectively)	<b>101.4</b>	76.7
<b>Total liabilities</b>	<b>2,069.8</b>	2,133.4
Stockholders' equity:		
Class A Preferred stock (nonvoting), without par value. Authorized 2.5 shares; none issued	—	—
Class B Preferred stock, without par value. Authorized 2.5 shares; none issued	—	—
Common stock, without par value. Authorized 100.0 shares; 49.8 and 49.2 shares issued, respectively, at stated value of \$2.50 per share	<b>124.5</b>	123.0
Treasury stock, 6.8 and 6.8 shares, respectively, at cost	<b>(117.0)</b>	(116.8)
Additional paid-in capital	<b>188.6</b>	171.8
Accumulated other comprehensive (loss) income (affiliated net ceded \$47.7 and \$50.7, respectively)	<b>(68.3)</b>	36.7
Retained earnings	<b>741.6</b>	660.3
<b>Total stockholders' equity</b>	<b>869.4</b>	875.0
<b>Total liabilities and stockholders' equity</b>	<b>\$ 2,939.2</b>	\$3,008.4

See accompanying notes to condensed consolidated financial statements.



Table of Contents

## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

**Condensed Consolidated Statements of Income**

	Three months ended September 30	
<i>(\$ in millions, except per share amounts)</i>		
<i>(unaudited)</i>	<b>2018</b>	2017
Earned premiums (affiliated net assumed \$71.9 and \$115.3, respectively)	<b>\$306.8</b>	\$319.0
Net investment income (affiliates \$1.3 and \$1.3, respectively)	<b>20.8</b>	18.7
Net investment gain		
Total other-than-temporary impairment losses	—	(0.6 )
Other investment gain	<b>17.8</b>	20.8
Total net investment gain	<b>17.8</b>	20.2
Other income from affiliates	<b>0.6</b>	0.5
<b>Total revenues</b>	<b>346.0</b>	358.4
Losses and loss expenses (affiliated net assumed \$34.7 and \$128.9, respectively)	<b>191.0</b>	253.5
Acquisition and operating expenses (affiliated net ceded \$26.8 and affiliated net assumed \$78.9, respectively)	<b>110.9</b>	112.7
Interest expense (affiliates \$0.2 and \$0.2, respectively)	<b>1.2</b>	1.5
Other expenses	<b>1.9</b>	1.9
<b>Total expenses</b>	<b>305.0</b>	369.6
<b>Income (loss) before federal income taxes</b>	<b>41.0</b>	(11.2 )
Federal income tax expense (benefit):		
Current	<b>(0.1 )</b>	(0.1 )
Deferred	<b>7.7</b>	(1.6 )
<b>Total federal income tax expense (benefit)</b>	<b>7.6</b>	(1.7 )
<b>Net income (loss)</b>	<b>\$33.4</b>	\$(9.5 )
Earnings (loss) per common share:		
Basic	<b>\$0.78</b>	\$(0.23 )
Diluted	<b>\$0.76</b>	\$(0.23 )
Dividends paid per common share	<b>\$0.10</b>	\$0.10

See accompanying notes to condensed consolidated financial statements.

Table of Contents

## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

**Condensed Consolidated Statements of Income**

	Nine months ended September 30	
	<b>2018</b>	2017
<i>(\$ in millions, except per share amounts)</i>		
<i>(unaudited)</i>		
Earned premiums (affiliated net assumed \$251.1 and \$349.0, respectively)	<b>\$929.2</b>	\$957.2
Net investment income (affiliates \$3.7 and \$3.7, respectively)	<b>62.2</b>	56.5
Net investment gain		
Total other-than-temporary impairment losses	—	(3.5 )
Other investment gain	<b>18.2</b>	47.3
Total net investment gain	<b>18.2</b>	43.8
Other income from affiliates	<b>1.8</b>	1.7
<b>Total revenues</b>	<b>1,011.4</b>	1,059.2
Losses and loss expenses (affiliated net assumed \$105.4 and \$298.8, respectively)	<b>621.1</b>	718.2
Acquisition and operating expenses (affiliated net assumed \$52.3 and \$231.0, respectively)	<b>333.0</b>	334.1
Interest expense (affiliates \$0.7 and \$0.6, respectively)	<b>4.5</b>	4.4
Other expenses	<b>7.4</b>	5.8
<b>Total expenses</b>	<b>966.0</b>	1,062.5
<b>Income (loss) before federal income taxes</b>	<b>45.4</b>	(3.3 )
Federal income tax expense (benefit):		
Current	(1.1 )	—
Deferred	<b>9.2</b>	0.8
<b>Total federal income tax expense</b>	<b>8.1</b>	0.8
<b>Net income (loss)</b>	<b>\$37.3</b>	\$(4.1 )
Earnings (loss) per common share:		
Basic	<b>\$0.87</b>	\$(0.10 )
Diluted	<b>\$0.86</b>	\$(0.10 )
Dividends paid per common share	<b>\$0.30</b>	\$0.30

See accompanying notes to condensed consolidated financial statements.

Table of Contents

## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

**Consolidated Statements of Comprehensive Income**

	Three months ended September 30 <b>2018</b>
<i>(\$ in millions, except per share amounts)</i>	
<i>(unaudited)</i>	
Net income	<b>\$ 33.4</b>
Other comprehensive income, net of tax:	
Net unrealized holding losses on fixed maturities:	
Unrealized holding losses	<b>(14.7 )</b>
Reclassification adjustments for gains realized in net income	<b>—</b>
Income tax benefit	<b>3.1</b>
<i>Total net unrealized holding losses on fixed maturities</i>	<b>(11.6 )</b>
Net unrecognized benefit plan obligations:	
Reclassification adjustments for amortization to statements of income:	
Negative prior service cost	<b>(1.4 )</b>
Net actuarial loss	<b>2.2</b>
Income tax expense	<b>(0.2 )</b>
<i>Total net unrecognized benefit plan obligations</i>	<b>0.6</b>
<i>Other comprehensive loss</i>	<b>(11.0 )</b>
<b>Comprehensive income</b>	<b>\$ 22.5</b>

	Three months ended September 30 <b>2017</b>
<i>(\$ in millions, except per share amounts)</i>	
<i>(unaudited)</i>	
Net loss	<b>\$ (9.5 )</b>
Other comprehensive income, net of tax:	
Net unrealized holding losses on investments:	
Unrealized holding gains	<b>11.0</b>
Reclassification adjustments for gains realized in net income	<b>(20.2 )</b>
Income tax benefit	<b>3.2</b>
<i>Total net unrealized holding losses on investments</i>	<b>(6.0 )</b>
Net unrecognized benefit plan obligations:	
Reclassification adjustments for amortization to statements of income:	
Negative prior service cost	<b>(1.3 )</b>
Net actuarial loss	<b>2.1</b>
Income tax expense	<b>(0.3 )</b>
<i>Total net unrecognized benefit plan obligations</i>	<b>0.5</b>
<i>Other comprehensive loss</i>	<b>(5.5 )</b>
<b>Comprehensive loss</b>	<b>\$ (15.0 )</b>

See accompanying notes to condensed consolidated financial statements.

4

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Table of Contents

## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

**Consolidated Statements of Comprehensive Income**

	Nine months ended September 30 <b>2018</b>
<i>(\$ in millions, except per share amounts)</i>	
<i>(unaudited)</i>	
Net income	<b>\$ 37.3</b>
Other comprehensive income, net of tax:	
Net unrealized holding losses on fixed maturities:	
Unrealized holding losses	<b>(61.6 )</b>
Reclassification adjustments for gains realized in net income	<b>(1.7 )</b>
Income tax benefit	<b>13.3</b>
<i>Total net unrealized holding losses on fixed maturities</i>	<b>(50.0 )</b>
Net unrecognized benefit plan obligations:	
Reclassification adjustments for amortization to statements of income:	
Negative prior service cost	<b>(4.1 )</b>
Net actuarial loss	<b>6.4</b>
Income tax expense	<b>(0.5 )</b>
<i>Total net unrecognized benefit plan obligations</i>	<b>1.8</b>
<i>Other comprehensive loss</i>	<b>(48.2 )</b>
<b>Comprehensive loss</b>	<b>\$ (10.9 )</b>

	Nine months ended September 30 <b>2017</b>
<i>(\$ in millions, except per share amounts)</i>	
<i>(unaudited)</i>	
Net loss	<b>\$ (4.1 )</b>
Other comprehensive income, net of tax:	
Net unrealized holding gains on investments:	
Unrealized holding gains	65.6
Reclassification adjustments for gains realized in net income	(43.8 )
Income tax expense	(7.6 )
<i>Total net unrealized holding gains on investments</i>	14.2
Net unrecognized benefit plan obligations:	
Reclassification adjustments for amortization to statements of income:	
Negative prior service cost	(4.1 )
Net actuarial loss	6.1
Income tax expense	(0.8 )
<i>Total net unrecognized benefit plan obligations</i>	1.2
<i>Other comprehensive income</i>	15.4
<b>Comprehensive income</b>	<b>\$ 11.3</b>

See accompanying notes to condensed consolidated financial statements.

5

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Table of Contents

## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

**Condensed Consolidated Statements of Cash Flows**

	Nine months ended September 30	
	2018	2017
<i>(\$ in millions)</i>		
<i>(unaudited)</i>		
<b>Cash flows from operating activities:</b>		
Net income (loss)	<b>\$37.3</b>	\$(4.1 )
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization, net	<b>6.7</b>	9.9
Share-based compensation	<b>6.7</b>	3.0
Net investment gain	<b>(18.2)</b>	(43.8 )
Changes in operating assets and liabilities:		
Deferred policy acquisition costs	<b>5.8</b>	7.2
Accrued investment income and other assets	<b>(3.0)</b>	2.0
Postretirement and pension benefits	<b>(10.6)</b>	(9.1 )
Other liabilities and due to/from affiliates, net	<b>11.8</b>	(15.1 )
Reinsurance recoverable on losses and loss expenses payable and prepaid reinsurance premiums	<b>(2.3)</b>	(1.9 )
Losses and loss expenses payable	<b>(56.9)</b>	98.9
Unearned premiums	<b>(16.2)</b>	12.7
Deferred tax expense on share-based awards	<b>—</b>	1.3
Federal income taxes	<b>8.6</b>	(0.3 )
<b>Net cash (used in) provided by operating activities</b>	<b>(30.3)</b>	60.7
<b>Cash flows from investing activities:</b>		
Purchases of fixed maturities available-for-sale	<b>(267.0)</b>	(409.2 )
Purchases of equity securities	<b>(82.2)</b>	(104.1 )
Purchases of other invested assets	<b>(1.1)</b>	(1.0 )
Maturities, calls and pay downs of fixed maturities available-for-sale	<b>180.4</b>	192.1
Sales of fixed maturities available-for-sale	<b>69.7</b>	156.3
Sales of equity securities	<b>89.3</b>	171.3
Sales of other invested assets	<b>0.9</b>	0.8
<b>Net cash (used in) provided by investing activities</b>	<b>(10.0)</b>	6.2
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of common stock	<b>11.7</b>	6.0
Payments to acquire treasury stock	<b>(0.2)</b>	(0.2 )
Payment of dividends	<b>(12.8)</b>	(12.7 )
Payment of prepayment fee	<b>(0.4)</b>	—
<b>Net cash used in financing activities</b>	<b>(1.7)</b>	(6.9 )
Net (decrease) increase in cash and cash equivalents	<b>(42.0)</b>	60.0
Cash and cash equivalents at beginning of period	<b>91.5</b>	51.1
<b>Cash and cash equivalents at end of period</b>	<b>\$49.5</b>	\$111.1
<u>Supplemental disclosures:</u>		
Interest paid (affiliates \$0.7 and \$0.6, respectively)	<b>\$4.5</b>	\$4.3

See accompanying notes to condensed consolidated financial statements.



Table of Contents

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, 2018, are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. The balance sheet at December 31, 2017, 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, 2017, (the “2017 Form 10-K”). Capitalized terms used herein and not otherwise defined shall have the meaning ascribed to them in the 2017 Form 10-K.

**Adoption of Recent Accounting Pronouncements**

*Financial Instruments - Overall: Recognition and Measurement of Financial Assets and Financial Liabilities*

In January 2016, the FASB issued ASU-2016-01 to improve certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Specifically the guidance (i) requires equity investments, including equity securities and limited partnership interests, that are not accounted for under the equity method of accounting or result in consolidation to be measured at fair value with changes in fair value recognized in earnings, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost, (iv) requires the use of the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option, (vi) requires separate presentation of financial assets and liabilities by measurement category and form on the balance sheet or the notes to the financial statements, and (vii) clarifies that the need for a valuation allowance on a deferred tax asset related to an available for sale security should be evaluated with other deferred tax assets. The guidance was effective beginning January 1, 2018. The adoption of this guidance resulted in the recognition of \$60.8 million of net unrealized gains (net of tax) as a cumulative effect adjustment that increased retained earnings as of January 1, 2018 and decreased accumulated other comprehensive income (“AOCI”) by the same amount. Changes in the fair value of equity securities and other invested assets previously identified as available-for-sale are reported in "net investment (loss) gain" in the condensed consolidated statements of income. At December 31, 2017, equity securities and other invested assets were classified as available-for-sale on the Company's balance sheet; however, upon adoption, the guidance eliminated the available-for-sale balance sheet classification for equity securities and other invested assets.

*Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*

In February 2018, the FASB issued ASU 2018-02 that addresses certain stranded income tax effects in AOCI resulting from the Tax Cuts and Jobs Act of 2017 (“TCJA”). Current guidance requires the effect of a change in tax laws or rates on deferred tax balances to be reported in income from continuing operations in the accounting period that includes the period of enactment, even if the related income tax effects were originally charged or credited directly to AOCI. The amount of the reclassification would include the effect of the change in the U.S. federal corporate income tax rate on the gross deferred tax amounts and related valuation allowances, if any, at the date of the enactment of TCJA related to items in AOCI. The updated guidance is effective for reporting periods beginning after December 15, 2018

and is to be applied retrospectively to each period in which the effect of the TCJA related to items remaining in AOCI are recognized or at the beginning of the period of adoption. Early adoption is permitted. The Company adopted the updated guidance effective January 1, 2018 and elected to reclassify the income tax effects of the TCJA from AOCI to retained earnings as of January 1, 2018. This reclassification resulted in a decrease in retained earnings of \$4.0 million as of January 1, 2018 and an increase in AOCI by the same amount.

7

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Table of Contents

STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

*Revenue from Contracts with Customers*

In May 2014, the FASB issued ASU 2014-09 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 was effective for annual reporting periods beginning after December 15, 2017, with early adoption permitted. The Company adopted this guidance effective January 1, 2018. The adoption of the guidance did not impact how the Company recognizes revenue; thus, there was no impact to its results of operations or consolidated financial position.

*Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments*

In August 2016, the FASB issued 2016-15 that addresses eight specific cash flow issues with the objective of reducing existing diversity in practice. The new guidance is effective beginning January 1, 2018. The Company adopted this guidance effective January 1, 2018 and it did not impact the Company's cash flows.

*Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*

In March 2017, the FASB issued ASU 2017-07 on how to present the components of net periodic benefit costs in the income statement for pension plans and other post-retirement benefit plans. The new guidance is effective for interim and annual reporting periods beginning after December 15, 2017. The Company adopted this guidance effective beginning January 1, 2018 and it did not have a material impact on the Company's results of operations, consolidated financial position, or cash flows.

**Pending Adoption of Recent Accounting Pronouncements**

*Leases*

In February 2016, the FASB issued guidance that amended previous guidance on lease accounting. The new guidance requires the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. The guidance is effective beginning January 1, 2019 and it is not expected to have a material impact on the Company's results of operations, consolidated financial position or cash flows.

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 2017 Form 10-K.

Table of Contents

## 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 investments by lot at September 30, 2018 and December 31, 2017:

(\$ millions)

**September 30, 2018**

Available-for-sale fixed maturities:

	Cost or amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
U.S. treasury securities and obligations of U.S. government agencies	\$409.4	\$4.3	\$(11.7)	\$402.0
Obligations of states and political subdivisions	434.8	6.0	(2.0)	438.8
Corporate securities	535.6	1.7	(11.4)	525.9
U.S. government agencies mortgage-backed securities	805.4	1.7	(32.2)	774.9
<i>Total available-for-sale fixed maturities</i>	<b>\$2,185.2</b>	<b>\$13.7</b>	<b>\$(57.3)</b>	<b>\$2,141.6</b>

(\$ millions)

## December 31, 2017

Fixed maturities:

	Cost or amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
U.S. treasury securities and obligations of U.S. government agencies	\$433.8	\$9.3	\$(6.2)	\$436.9
Obligations of states and political subdivisions	507.1	19.1	(0.4)	525.8
Corporate securities	527.5	4.5	(2.3)	529.7
U.S. government agencies mortgage-backed securities	704.7	7.1	(11.4)	700.4
<i>Total fixed maturities</i>	2,173.1	40.0	(20.3)	2,192.8
Equity securities:				
Large-cap securities	62.4	35.1	(0.7)	96.8
Mutual and exchange traded funds	256.2	21.6	(9.3)	268.5
<i>Total equity securities</i>	318.6	56.7	(10.0)	365.3
Other invested assets	25.8	30.2	—	56.0
<i>Total available-for-sale securities</i>	<b>\$2,517.5</b>	<b>\$126.9</b>	<b>\$(30.3)</b>	<b>\$2,614.1</b>

Table of Contents

## 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, 2018 and December 31, 2017:

(\$ 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, 2018</b>									
Fixed maturities:									
U.S. treasury securities and obligations of U.S. government agencies	\$106.1	\$(2.1)	15	\$221.6	\$(9.6)	29	\$327.7	\$(11.7)	44
Obligations of states and political subdivisions	130.7	(1.8)	19	23.3	(0.2)	3	154.0	(2.0)	22
Corporate securities	352.9	(5.7)	46	114.3	\$(5.7)	19	467.2	\$(11.4)	65
U.S. government agencies mortgage-backed securities	390.1	(11.8)	54	303.1	(20.4)	52	693.2	(32.2)	106
<i>Total temporarily impaired securities</i>	<b>\$979.8</b>	<b>\$(21.4)</b>	<b>134</b>	<b>\$662.3</b>	<b>\$(35.9)</b>	<b>103</b>	<b>\$1,642.1</b>	<b>\$(57.3)</b>	<b>237</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, 2017</b>									
Fixed maturities:									
U.S. treasury securities and obligations of U.S. government agencies	\$102.4	\$(0.6)	18	\$196.1	\$(5.6)	22	\$298.5	\$(6.2)	40
Obligations of states and political subdivisions	58.6	(0.4)	10	—	—	—	58.6	(0.4)	10
Corporate securities	153.2	(1.3)	23	67.3	(1.0)	10	220.5	(2.3)	33
U.S. government agencies mortgage-backed securities	188.6	(2.9)	31	252.2	(8.5)	41	440.8	(11.4)	72
<i>Total fixed maturities</i>	<b>502.8</b>	<b>(5.2)</b>	<b>82</b>	<b>515.6</b>	<b>(15.1)</b>	<b>73</b>	<b>1,018.4</b>	<b>(20.3)</b>	<b>155</b>
Equity securities:									
Large-cap equity securities	4.4	(0.7)	4	—	—	—	4.4	(0.7)	4
Mutual and exchange traded funds	66.9	(9.3)	1	—	—	—	66.9	(9.3)	1
<i>Total equity securities</i>	<b>71.3</b>	<b>(10.0)</b>	<b>5</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>71.3</b>	<b>(10.0)</b>	<b>5</b>
<i>Total temporarily impaired securities</i>	<b>\$574.1</b>	<b>\$(15.2)</b>	<b>87</b>	<b>\$515.6</b>	<b>\$(15.1)</b>	<b>73</b>	<b>\$1,089.7</b>	<b>\$(30.3)</b>	<b>160</b>

The Company reviewed its investments at September 30, 2018, and determined that no other-than-temporary impairment ("OTTI") existed in the gross unrealized holding losses.

The Company regularly monitors its available-for-sale 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.





Table of Contents

## 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 amortized cost and fair value of available-for-sale fixed maturities by contractual maturity at September 30, 2018:

(\$ millions)	Amortized Fair	
	cost	value
Due in 1 year or less	<b>\$ 28.1</b>	<b>\$28.0</b>
Due after 1 year through 5 years	<b>587.1</b>	<b>576.4</b>
Due after 5 years through 10 years	<b>369.9</b>	<b>364.2</b>
Due after 10 years	<b>394.7</b>	<b>398.1</b>
U.S. government agencies mortgage-backed securities	<b>805.4</b>	<b>774.9</b>
<i>Total</i>	<b>\$ 2,185.2</b>	<b>\$2,141.6</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, 2018, 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 \$8.9 million and \$9.3 million were on deposit with insurance regulators as required by law at September 30, 2018, and December 31, 2017, respectively. The Company retains all rights regarding these securities.

The following table sets forth the components of net investment income for the three and nine months ended September 30, 2018 and 2017:

(\$ millions)	Three months ended		Nine months ended	
	September 30	2017	September 30	2017
Fixed maturities	<b>\$16.4</b>	\$15.4	<b>\$49.4</b>	\$47.1
Equity securities	<b>3.0</b>	2.0	<b>8.6</b>	5.7
Cash and cash equivalents, and other	<b>1.7</b>	1.6	<b>5.2</b>	4.6
<i>Investment income</i>	<b>21.1</b>	19.0	<b>63.2</b>	57.4
Investment expenses	<b>0.3</b>	0.3	<b>1.0</b>	0.9
<i>Net investment income</i>	<b>\$20.8</b>	\$18.7	<b>\$62.2</b>	\$56.5

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

Proceeds on sales of investments were \$159.9 million and \$328.4 million for the nine months ended September 30, 2018, and 2017, respectively.

Table of Contents

## 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 realized and unrealized holding gains (losses) on the Company's investment portfolio for the three and nine months ended September 30, 2018 and 2017:

<i>(\$ millions)</i>	Three months ended September 30 <b>2018</b>	Nine months ended September 30 <b>2018</b>	2017
Realized gains:			
Fixed maturities	\$ —	\$ <b>1.7</b>	\$ 2.7
Equity securities	<b>1.0</b>	<b>6.0</b>	45.2
Other invested assets	—	—	0.1
<i>Total realized gains</i>	<b>1.0</b>	<b>7.7</b>	48.0
Realized losses on securities:			
Sales of equity securities	— (0.5 )	<b>(0.6 )</b>	(0.7 )
OTTI	— (0.6 )		