State Auto Financial CORP
Form 10-Q
May 03, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

ýQuarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2019
or
¨Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission File Number 000-19289
STATE AUTO FINANCIAL CORPORATION
(Exact name of Registrant as specified in its charter)

Ohio	31-1324304
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
518 East Broad Street, Columbus, Ohio	43215-3976
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (614) 464-5000
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 every Interactive Data File required to be submitted 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 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. ¨
Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ¨ No ý
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading symbol	Name of each exchange on which registered
Common stock, without par value	STFC	The NASDAQ Global Select Market

On April 26, 2019, the Registrant had 43,403,270 Common Shares outstanding.

Table of Contents

Index to Form 10-Q Quarterly Report for the three month periods ended March 31, 2019

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

($ and shares in millions, except per share amounts)	March 31, 2019	December 31, 2018
(unaudited)		
Assets		
Fixed maturities, available-for-sale, at fair value (amortized cost $2,130.9 and $2,188.2, respectively)	$2,136.6	$ 2,159.5
Equity securities	363.9	315.0
Other invested assets	53.5	48.8
Other invested assets, at cost	5.6	5.6
Notes receivable from affiliate	70.0	70.0
Total investments	2,629.6	2,598.9
Cash and cash equivalents	72.3	59.8
Accrued investment income and other assets	36.6	32.4
Deferred policy acquisition costs (affiliated net assumed $48.6 and $48.3, respectively)	104.3	101.9
Reinsurance recoverable on losses and loss expenses payable	4.6	5.5
Prepaid reinsurance premiums	6.7	6.6
Current federal income taxes	6.3	5.9
Net deferred federal income taxes	57.7	77.8
Property and equipment, at cost	6.0	7.1
Total assets	$2,924.1	$ 2,895.9
Liabilities and Stockholders' Equity		
Losses and loss expenses payable (affiliated net assumed $583.7 and $593.6, respectively)	$1,128.9	$ 1,146.8
Unearned premiums (affiliated net assumed $103.7 and $112.4, respectively)	587.5	584.2
Notes payable (affiliates $15.2 and $15.2, respectively)	122.0	122.0
Pension and postretirement benefits	82.4	83.0
Due to affiliate	18.4	22.4
Other liabilities (affiliated net assumed $11.5 and $19.9, respectively)	89.6	119.0
Total liabilities	2,028.8	2,077.4
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; 50.1 and 50.0 shares issued, respectively, at stated value of $2.50 per share	125.3	125.0
Treasury stock, 6.8 and 6.8 shares, respectively, at cost	(117.5)	(117.0)
Additional paid-in capital	198.4	194.2
Accumulated other comprehensive (loss) income	(68.6)	(96.4)
Retained earnings	757.7	712.7
Total stockholders' equity	895.3	818.5
Total liabilities and stockholders' equity	$2,924.1	$ 2,895.9

See accompanying notes to condensed consolidated financial statements.
1

Table of Contents

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)	Three months ended March 31	
(unaudited)	2019	2018
Earned premiums (affiliated net assumed $59.7 and $98.0, respectively)	$302.7	$314.9
Net investment income (affiliates $1.2 and $1.2, respectively)	19.4	19.9
Net investment gain (loss)	44.9	(11.7)
Other income from affiliates	0.6	0.6
Total revenues	367.6	323.7
Losses and loss expenses (affiliated net assumed $56.4 and $46.2, respectively)	194.3	212.3
Acquisition and operating expenses (affiliated net assumed $24.2 and $43.6, respectively)	107.6	110.8
Interest expense (affiliates $0.2 and $0.2, respectively)	1.2	1.6
Other expenses	2.9	2.3
Total expenses	306.0	327.0
Income (loss) before federal income taxes	61.6	(3.3)
Federal income tax expense (benefit):		
Current	(0.4)	(1.0)
Deferred	12.6	(0.2)
Total federal income tax expense (benefit)	12.2	(1.2)
Net income (loss)	$49.4	$(2.1)
Earnings (loss) per common share:		
Basic	$1.14	$(0.05)
Diluted	$1.12	$(0.05)
Dividends paid per common share	$0.10	$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)

Consolidated Statements of Comprehensive Income

($ in millions, except per share amounts)	Three months ended March 31	
(unaudited)	2019	2018
Net income (loss)	$49.4	$(2.1)
Other comprehensive income (loss), net of tax:		
Net unrealized holding gains (losses) on fixed maturities:		
Unrealized holding gains (losses)	34.5	(36.7)
Reclassification adjustments for gains realized in net income	(0.1)	(0.4)
Income tax (expense) benefit	(7.2)	7.8
Total net unrealized holding gains (losses) on available-for-sale investments	27.2	(29.3)
Net unrecognized benefit plan obligations:		
Reclassification adjustments for amortization to statements of income:		
Negative prior service cost	(1.6)	(1.6)
Net actuarial loss	2.4	3.3
Income tax expense	(0.2)	(0.4)
Total net unrecognized benefit plan obligations	0.6	1.3
Other comprehensive income (loss)	27.8	(28.0)
Comprehensive income (loss)	$77.2	$(30.1)

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 Stockholders' Equity

(in millions)	Three months ended March 31	
	2019	2018
Common shares:		
Balance at beginning of year	50.0	49.2
Issuance of shares	0.1	0.3
Balance at end of year	50.1	49.5
Treasury shares:		
Balance at beginning of year	(6.8)	(6.8)
Balance at end of year	(6.8)	(6.8)
Common stock:		
Balance at beginning of year	$125.0	$123.0
Issuance of shares	0.3	0.8
Balance at end of year	$125.3	$123.8
Treasury stock:		
Balance at beginning of year	$(117.0)	$(116.8)
Shares acquired on stock award exercises and vested restricted shares	(0.5)	(0.1)
Balance at end of year	$(117.5)	$(116.9)
Additional paid-in capital:		
Balance at beginning of year	$194.2	$171.8
Issuance of common stock	0.7	6.2
Stock awards granted	3.5	2.3
Balance at end of year	$198.4	$180.3
Accumulated other comprehensive (loss) income:		
Balance at beginning of year	$(96.4)	$3.8
Cumulative effect of change in accounting for equity securities and other invested assets and reclassification of stranded tax effects as of January 1, 2018	—	(63.9)
Change in unrealized holding gain (loss) on investments, net of tax	27.2	(29.3)
Change in unrecognized benefit plan obligations, net of tax	0.6	1.3
Balance at end of year	$(68.6)	$(88.1)
Retained earnings:		
Balance at beginning of year	$712.7	$653.2
Cumulative effect of change in accounting for equity securities and other invested assets and reclassification of stranded tax effects as of January 1, 2018	—	63.9
Net income	49.4	(2.1)
Dividends declared (affiliates $2.6 and $2.6, respectively)	$(4.4)	$(4.3)
Balance at end of year	757.7	710.7
Total stockholders' equity at end of year	$895.3	$809.8

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 Cash Flows

($ in millions)	Three months ended March 31	
(unaudited)	2019	2018
Cash flows from operating activities:		
Net income (loss)	$49.4	$(2.1)
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization, net	3.1	2.9
Share-based compensation	3.8	2.3
Net investment (gain) loss	(44.9)	11.7
Changes in operating assets and liabilities:		
Deferred policy acquisition costs	(2.4)	5.2
Accrued investment income and other assets	(4.1)	(3.8)
Postretirement and pension benefits	(0.1)	(0.3)
Other liabilities and due to/from affiliates, net	(33.6)	4.2
Reinsurance recoverable on losses and loss expenses payable and prepaid reinsurance premiums	0.8	1.0
Losses and loss expenses payable	(17.9)	(8.0)
Unearned premiums	3.3	(22.6)
Deferred tax expense on share-based awards	0.2	—
Federal income taxes	12.0	(1.2)
Net cash used in operating activities	(30.4)	(10.7)
Cash flows from investing activities:		
Purchases of fixed maturities available-for-sale	(137.2)	(99.0)
Purchases of equity securities	(19.5)	(61.5)
Purchases of other invested assets	(1.0)	(0.5)
Maturities, calls and pay downs of fixed maturities available-for-sale	125.9	55.5
Sales of fixed maturities available-for-sale	65.6	15.3
Sales of equity securities	12.7	65.1
Sales of other invested assets	0.3	0.3
Net cash provided by (used in) investing activities	46.8	(24.8)
Cash flows from financing activities:		
Proceeds from issuance of common stock	1.0	9.3
Payments to acquire treasury stock	(0.5)	(0.1)
Payment of dividends	(4.4)	(4.3)
Net cash (used in) provided by financing activities	(3.9)	4.9
Net increase (decrease) in cash and cash equivalents	12.5	(30.6)
Cash and cash equivalents at beginning of period	59.8	91.5
Cash and cash equivalents at end of period	$72.3	$60.9
Supplemental disclosures:		
Interest paid (affiliates $0.2 and $0.2, respectively)	$1.7	$1.6

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 months ended March 31, 2019, are not necessarily indicative of the results that may be expected for the year ending December 31, 2019. The balance sheet at December 31, 2018, 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, 2018 (the “2018 Form 10-K”). Capitalized terms used herein and not otherwise defined shall have the meaning ascribed to them in the 2018 Form 10-K.

Revisions of Previously Issued Financial Statements

Revisions to certain line items in the consolidated statements of comprehensive income and consolidated statements of cash flows for the three months ended March 31, 2018, were affected by revisions of previously issued financial statements. All such changes to the consolidated statements of cash flows were included within cash flows from operating activities and all related changes in the consolidated statements of comprehensive income were isolated to unrecognized benefit plan obligations. The basis of these revisions were described in Note 2 to our Consolidated Financial Statements set forth in Part II, Item 8, "Financial Statements and Supplementary Data" included in our most recent Annual Report disclosures on Form 10-K for the year ended December 31, 2018.

Adoption of Recent Accounting Pronouncements

Leases

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)" 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 became effective beginning January 1, 2019 and it did not have a material impact on the Company’s results of operations, consolidated financial position or cash flows. The Company has elected the practical expedients contained in ASC 842-10-65-1(f) and therefore did not reassess the lease classification of its existing leases.

Pending Adoption of Recent Accounting Pronouncements

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 2018 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 March 31, 2019 and December 31, 2018:

($ millions) March 31, 2019	Cost or amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
Available-for-sale fixed maturities:				
U.S. treasury securities and obligations of U.S. government agencies	$ 399.9	$ 6.7	$ (5.0)	$401.6
Obligations of states and political subdivisions	458.1	14.0	(0.1)	472.0
Corporate securities	515.2	4.2	(3.3)	516.1
U.S. government agencies mortgage-backed securities	757.7	4.9	(15.7)	746.9
Total available-for-sale fixed maturities	$ 2,130.9	$ 29.8	$ (24.1)	$2,136.6

($ millions) December 31, 2018	Cost or amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
Available-for-sale fixed maturities:				
U.S. treasury securities and obligations of U.S. government agencies	$ 438.4	$ 3.2	$ (9.2)	$432.4
Obligations of states and political subdivisions	408.2	7.3	(0.9)	414.6
Corporate securities	551.7	0.6	(11.7)	540.6
U.S. government agencies mortgage-backed securities	789.9	3.3	(21.3)	771.9
Total available-for-sale fixed maturities	$ 2,188.2	$ 14.4	$ (43.1)	$2,159.5

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 March 31, 2019 and December 31, 2018:

($ millions, except # of positions)	Less than 12 months			12 months or more			Total		
March 31, 2019	Fair value	Unrealized losses	Number of positions	Fair value	Unrealized losses	Number of positions	Fair value	Unrealized losses	Number of positions
Fixed maturities:									
U.S. treasury securities and obligations of U.S. government agencies	$9.2	$ (0.1)	1	$235.4	$ (4.9)	30	$244.6	$ (5.0)	31
Obligations of states and political subdivisions	—	—	—	42.5	(0.1)	7	42.5	(0.1)	7
Corporate securities	9.1	—	1	234.2	$ (3.3)	32	243.3	$ (3.3)	33
U.S. government agencies mortgage-backed securities	54.1	(1.6)	8	430.4	(14.1)	68	484.5	(15.7)	76
Total temporarily impaired securities	$72.4	$ (1.7)	10	$942.5	$ (22.4)	137	$1,014.9	$ (24.1)	147

($ millions, except # of positions)	Less than 12 months			12 months or more			Total		
December 31, 2018	Fair value	Unrealized losses	Number of positions	Fair value	Unrealized losses	Number of positions	Fair value	Unrealized losses	Number of positions
Fixed maturities:									
U.S. treasury securities and obligations of U.S. government agencies	$83.1	$ (1.8)	7	$259.6	$ (7.4)	35	$342.7	$ (9.2)	42
Obligations of states and political subdivisions	63.6	(0.5)	7	39.6	(0.4)	8	103.2	(0.9)	15
Corporate securities	244.0	(3.0)	31	189.5	(8.7)	30	433.5	(11.7)	61
U.S. government agencies mortgage-backed securities	169.5	(2.8)	18	385.5	(18.5)	70	555.0	(21.3)	88
Total fixed maturities	$560.2	$ (8.1)	63	$874.2	$ (35.0)	143	$1,434.4	$ (43.1)	206

The Company reviewed its investments at March 31, 2019, 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 March 31, 2019:

($ millions)	Amortized cost	Fair value
Due in 1 year or less	$ 101.5	$ 101.5
Due after 1 year through 5 years	631.8	629.4
Due after 5 years through 10 years	208.5	214.4
Due after 10 years	431.4	444.4
U.S. government agencies mortgage-backed securities	757.7	746.9
Total	$ 2,130.9	$ 2,136.6

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 March 31, 2019, 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.

At March 31, 2019, State Auto P&C had fixed maturities with fair values of approximately $21.6 million pledged as collateral for the performance obligations under its reinsurance agreement with Home State County Mutual Insurance Company. In accordance with the terms of the trust agreement, State Auto P&C retains all rights regarding these securities, which are included in the "U.S. government agencies mortgage-backed securities" classification of the Company's fixed maturity securities portfolio.

Fixed maturities with fair values of $9.1 million and $8.9 million were on deposit with insurance regulators as required by law at March 31, 2019, and December 31, 2018, respectively. The Company retains all rights regarding these securities.

The following table sets forth the components of net investment income for the three months ended March 31, 2019 and 2018:

($ millions)	Three months ended March 31	
	2019	2018
Fixed maturities	$ 15.1	$ 16.1
Equity securities	2.8	2.5
Cash and cash equivalents, and other	1.7	1.7
Investment income	19.6	20.3
Investment expenses	0.2	0.4
Net investment income	$ 19.4	$ 19.9

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

Proceeds on sales of investments were $78.6 million and $80.7 million for the three months ended March 31, 2019, and 2018, 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 months ended March 31, 2019 and 2018:

($ millions)	Three months ended March 31	
	2019	2018
Realized gains on sales of securities:		
Fixed maturities	$0.1	$0.4
Equity securities	0.3	3.3
Other invested assets	—	0.1
Total realized gains	0.4	3.8
Realized losses on sales of securities:		
Sales of equity securities	(2.2)	(0.2)
Total realized losses	(2.2)	(0.2)
Net realized (loss) gain on investments	$(1.8)	$3.6
Net unrealized gain (loss) on investments[1]		
Equity securities	$44.1	$(14.6)
Other invested assets	3.9	(0.7)
Net unrealized gain (loss) on investments	48.0	(15.3)
Other net realized loss	$(1.3)	$—
Net investment gain (loss)	$44.9	$(11.7)
Change in unrealized holding gains (losses), net of tax:		
Fixed maturities	$34.4	$(37.1)
Deferred federal income tax (liability) benefit	(7.2)	7.8
Change in net unrealized holding gains (losses), net of tax	$27.2	$(29.3)

[1]Unrealized holding gains (losses) recognized during the period on securities still held at the reporting date

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 a nationally recognized pricing service to estimate the majority of its 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 March 31, 2019, and December 31, 2018, the Company did not adjust any of the prices received from the pricing service.

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)

Fixed Maturities

The Company utilizes a nationally recognized 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 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.

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.

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 $41.2 million and $38.5 million at March 31, 2019, and December 31, 2018, 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.

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 investments within the fair value hierarchy at March 31, 2019 and December 31, 2018:

($ millions) March 31, 2019	Total	Level 1	Level 2
Available-for-sale fixed maturities:			
U.S. treasury securities and obligations of U.S. government agencies	$401.6	$—	$401.6
Obligations of states and political subdivisions	472.0	—	472.0
Corporate securities	516.1	—	516.1
U.S. government agencies mortgage-backed securities	746.9	—	746.9
Total available-for-sale fixed maturities	2,136.6	—	2,136.6
Equity securities:			
Large-cap securities	88.9	88.9	—
Mutual and exchange traded funds	275.0	275.0	—
Total equity securities	363.9	363.9	—
Other invested assets	12.3	12.3	—
Total investments	$2,512.8	$376.2	$2,136.6

($ millions) December 31, 2018	Total	Level 1	Level 2
Fixed maturities:			
U.S. treasury securities and obligations of U.S. government agencies	$432.4	$—	$432.4
Obligations of states and political subdivisions	414.6	—	414.6
Corporate securities	540.6	—	540.6
U.S. government agencies mortgage-backed securities	771.9	—	771.9
Total fixed maturities	2,159.5	—	2,159.5
Equity securities:			
Large-cap securities	77.2	77.2	—
Mutual and exchange traded funds	237.8	237.8	—
Total equity securities	315.0	315.0	—
Other invested assets	10.3	10.3	—
Total available-for-sale investments	$2,484.8	$325.3	$2,159.5

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, at Cost

Included in other invested assets, at cost 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 March 31, 2019, 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.

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)

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)	March 31, 2019			December 31, 2018		
	Carrying value	Fair value	Interest rate	Carrying value	Fair value	Interest rate
Notes receivable from affiliate	$70.0	$72.1	7.00 %	$70.0	$71.1	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)	March 31, 2019			December 31, 2018		
	Carrying value	Fair Value	Interest rate	Carrying value	Fair value	Interest rate
FHLB Loan due 2021: issued $21.5, September 2016 with fixed interest	$21.5	$21.1	1.73 %	$21.5	$20.9	1.73 %
FHLB Loan due 2033: issued $85.0, May 2018 with fixed interest	85.3	92.8	3.96 %	85.3	89.0	3.96 %
Affiliate Subordinated Debentures due 2033: issued $15.5, May 2003 with variable interest	15.2	15.2	6.83 %	15.2	15.2	6.94 %
Total notes payable	$122.0	$129.1		$122.0	$125.1	

4. Losses and Loss Expenses Payable

The following table sets forth the activity in the liability for losses and loss expenses for the three months ended March 31, 2019 and 2018:

($ millions)	2019	2018
Losses and loss expenses payable, at beginning of period	$1,146.8	$1,255.6
Less: reinsurance recoverable on losses and loss expenses payable	5.5	3.1
Net balance at beginning of period	1,141.3	1,252.5
Incurred related to:		
Current year	215.7	232.7
Prior years	(21.4)	(20.4)
Total incurred	194.3	212.3
Paid related to:		
Current year	59.3	63.0
Prior years	152.0	156.3
Total paid	211.3	219.3
Net balance at end of period	1,124.3	1,245.5
Plus: reinsurance recoverable on losses and loss expenses payable	4.6	2.1
Losses and loss expenses payable, at end of period	$1,128.9	$1,247.6

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 Company recorded favorable development related to prior years' loss and loss expense reserves for the three months ended March 31, 2019, of $21.4 million compared to favorable development of $20.4 million for the same 2018 period. Favorable development of prior accident years' non-catastrophe loss and ALAE reserves for the three months ended March 31, 2019 was $20.9 million. In the personal insurance segment, personal auto contributed $6.8 million of favorable development, primarily attributable to lower than anticipated severity from the 2018 accident year partially offset by $0.6 million of adverse development in homeowners, primarily from the 2018 accident year. In the commercial insurance segment, all products developed favorably, with small commercial package, workers' compensation, and middle market commercial contributing $4.8 million, $4.5 million, and $3.1 million, respectively. Slightly offsetting the favorable development was adverse development in the specialty run-off business of $1.3 million, primarily driven by large fire losses in the fourth quarter of 2018 in E&S property.

Favorable development of prior accident years' non-catastrophe loss and ALAE reserves for the three months ended March 31, 2018 was primarily due to $16.3 million of favorable development in the commercial and personal insurance segments. In the personal insurance segment, personal auto contributed $4.0 million of favorable development, primarily attributable to the 2016 and 2017 accident years, and homeowners' contributed $2.8 million of favorable development, spread across several accident years. In the commercial insurance segment, commercial auto, middle market commercial and workers' compensation contributed $3.5 million, $2.5 million and $2.3 million, respectively, of favorable development. Slightly offsetting the favorable development was adverse development in the specialty insurance segment of $0.3 million. The specialty insurance segment was impacted by $1.9 million of adverse development in E&S casualty, due primarily to development within our general liability and healthcare books of business. Favorable development of prior years' unallocated loss adjustment expenses was approximately $3.8 million.

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 months ended March 31, 2019 and 2018:

($ millions)	Three months ended March 31	
	2019	2018
Premiums earned:		
Assumed from external insurers and reinsurers	$18.2	$10.4
Assumed under Pooling Arrangement	302.7	314.9
Ceded to external insurers and reinsurers	(5.9)	(5.4)
Ceded under Pooling Arrangement	(243.0)	(216.9)
Net assumed premiums earned	$72.0	$103.0
Losses and loss expenses incurred:		
Assumed from external insurers and reinsurers	$14.2	$10.9
Assumed under Pooling Arrangement	200.2	202.7
Ceded to external insurers and reinsurers	(0.6)	(1.3)
Ceded under Pooling Arrangement	(143.8)	(156.5)
Net assumed losses and loss expenses incurred	$70.0	$55.8

14

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)

6. Income Taxes
The following table sets forth the reconciliation between actual federal income tax expense and the amount computed at the indicated statutory rate for the three months ended March 31, 2019 and 2018:

($ millions)	Three months ended March 31			
	2019		2018	
Amount at statutory rate	$12.9	21.0 %	$(0.7)	21.0 %
Tax-exempt interest and dividends received deduction	(0.7)	(1.1)	(0.7)	20.8
Other, net	—	—	0.2	(5.7)
Federal income tax expense (benefit)	12.2	19.9 %	$(1.2)	36.1 %

7. Pension and Postretirement Benefit Plans
The following table sets forth information regarding the Company’s share of pension and postretirement benefit plans’ components of net periodic cost for the three months ended March 31, 2019 and 2018:

($ millions)	Pension		Postretirement	
	Three months ended March 31			
	2019	2018	2019	2018
Service cost	$1.0	$1.3	$—	$—
Interest cost	2.9	2.7	0.2	0.2
Expected return on plan assets	(4.2)	(4.5)	—	—
Amortization of:				
Negative prior service cost	—	—	(1.4)	(1.4)
Net actuarial loss	1.5	2.1	0.1	0.1
Net periodic cost (benefit)	$1.2	$1.6	$(1.1)	$(1.1)

The Company expects to contribute $15.0 million to its pension plan in 2019.

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)

8. Other Comprehensive Income and Accumulated Other Comprehensive Income
The following tables set forth the changes in the Company's accumulated other comprehensive (loss) income ("AOC(L)I"), net of tax, for the three months ended March 31, 2019 and 2018:

($ millions)	Unrealized Gains and Losses on Available-for-Sale Securities	Benefit Plan Items	Total
Beginning balance at January 1, 2019	$ (20.2)	$ (76.2)	$ (96.4)
Other comprehensive income before reclassifications	27.3	—	27.3
Amounts reclassified from AOCI (a)	(0.1)	0.6	0.5
Net current period other comprehensive income	27.2	0.6	27.8
Ending balance at March 31, 2019	$ 7.0	$ (75.6)	$ (68.6)
Beginning balance at January 1, 2018	$ 66.0	$ (62.2)	$ 3.8
Cumulative effect	(47.9)	(16.0)	(63.9)

of change in accounting for equity securities and other invested assets and reclassification of stranded tax effects as of January 1, 2018			
Other comprehensive loss before reclassifications	(29.0)	—	(29.0)
Amounts reclassified from AOCI (a)	(0.3)	1.3	1.0
Net current period other comprehensive (loss) income	(29.3)	1.3	(28.0)
Ending balance at March 31, 2018	$ (11.2)	$ (76.9)	$ (88.1)

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

16

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 reclassifications out of accumulated other comprehensive income, by component, to the Company's condensed consolidated statement of income for the three months ended March 31, 2019 and 2018:

($ millions) Details about Accumulated Other Comprehensive Income Components	Three months ended March 31 2019	Affected line item in the Condensed Consolidated Statements of Income
Unrealized gains on available-for-sale fixed maturity investments	$ 0.1	Realized gains on sale of securities
	0.1	Total before tax
	—	Tax expense
	0.1	Net of tax
Amortization of benefit plan items		
Negative prior service cost	1.6	(b)
Net actuarial loss	(2.4)	(b)
	(0.8)	Total before tax
	0.2	Tax benefit
	(0.6)	Net of tax
Total reclassifications for the period	$ (0.5)	

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

($ millions) Details about Accumulated Other Comprehensive Income Components	Three months ended March 31 2018	Affected line item in the Condensed Consolidated Statements of Income
Unrealized gains on available for sale securities	$0.4	Realized gain on sale of securities
	0.4	Total before tax
	(0.1)	Tax expense
	0.3	Net of tax
Amortization of benefit plan items		
Negative prior service cost	1.6	(b)
Net actuarial loss	(3.3)	(b)
	(1.7)	Total before tax
	0.4	Tax benefit
	(1.3)	Net of tax
Total reclassifications for the period	$ (1.0)	

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

17

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)

9. Net Earnings (Loss) per Common Share

The following table sets forth the compilation of basic and diluted earnings per common share for the three months ended March 31, 2019 and 2018:

($ and shares in millions, except per share amounts)	Three months ended March 31	
	2019	2018
Numerator:		
Net income (loss) for basic earnings per common share	$49.4	$(2.1)
Denominator:		
Weighted average shares for basic earnings (loss) per common share	43.3	42.6
Effect of dilutive share-based awards	0.6	—
Adjusted weighted average shares for diluted net earnings (loss) per common share	43.9	42.6
Basic net earnings (loss) per common share	$1.14	$(0.05)
Diluted net earnings (loss) per common share	$1.12	$(0.05)

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 months ended March 31, 2019 and 2018:

(shares in millions)	Three months ended March 31	
	2019	2018
Total number of antidilutive options and awards	—	0.7

10. Segment Information

The Company changed its reportable segments from four to three effective January 1, 2019. The exit from the specialty insurance business resulted in the elimination of specialty insurance as a reportable segment as it no longer is material to the Company's results and is disclosed as "specialty run-off." The three remaining reportable segments are: personal insurance, commercial 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.

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.

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 financial information regarding the Company's reportable segments and specialty run-off for the three months ended March 31, 2019 and 2018:

($ millions)	Three months ended March 31	
	2019	2018
Revenue from external sources:		
Insurance operations		
Personal insurance	$181.5	$156.3
Commercial insurance	116.4	114.9
Specialty run-off	4.8	43.7
Total insurance operations	302.7	314.9
Investment operations		
Net investment income	19.4	19.9
Net investment gain	44.9	(11.7)
Total investment operations	64.3	8.2
All other	0.6	0.6
Total revenue from external sources	367.6	323.7
Intersegment revenue	1.6	1.6
Total revenue	369.2	325.3
Reconciling items:		
Eliminate intersegment revenue	(1.6)	(1.6)
Total consolidated revenues	$367.6	$323.7
Segment income before federal income tax:		
Insurance operations SAP underwriting gain (loss)		
Personal insurance	$4.2	$1.7
Commercial insurance	(5.9)	(8.3)
Specialty run-off	(1.4)	1.6
Total insurance operations	(3.1)	(5.0)
Investment operations		
Net investment income	19.4	19.9
Net investment gain (loss)	44.9	(11.7)
Total investment operations	64.3	8.2
All other	0.1	0.1
Total segment income before reconciling items	61.3	3.3
Reconciling items:		
GAAP expense adjustments	4.1	(4.0)
Interest expense on corporate debt	1.2	1.6
Corporate expenses	(5.0)	(4.2)
Total reconciling items	0.3	(6.6)
Total consolidated income (loss) before federal income tax expense	$61.6	$(3.3)

Investable assets attributable to the Company's investment operations segment totaled $2,701.9 million and $2,658.7 million at March 31, 2019, and December 31, 2018, respectively.

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 a loss 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.

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 “first quarter” as used below refers to the three months ended March 31 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, 2018 (the “2018 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 March 31, 2019 and December 31, 2018, and for the consolidated statements of income for the three month period ended March 31, 2019 and 2018. This discussion and analysis should be read together with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in the 2018 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 2018 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 2018 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 three reportable segments: personal insurance, commercial insurance, and investment operations. 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 Commercial Insurance” in Item 1 of the 2018 Form 10-K for more information about our insurance segments. As previously disclosed, we stopped writing our specialty insurance business on a net basis in 2018. As a result, effective January 1, 2019, the specialty insurance business is no longer a reportable segment as it no longer is material to our results and is disclosed as "specialty run-off." Financial information about our reportable segments for 2019 is set forth in Note 10 of our condensed consolidated financial statements included in Item 1 of this Form 10-Q.

Table of Contents

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

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 P&C	51.0	%
Milbank	14.0	
SA Ohio	—	
Total STFC Pooled Companies	65.0	%
State Auto Mutual Pooled Companies:		
State Auto Mutual	34.5	%
SA Wisconsin	—	
Meridian Security	—	
Patrons Mutual	0.5	
RIC	—	
Plaza	—	
American Compensation	—	
Bloomington Compensation	—	
Total State Auto Mutual Pooled Companies	35.0	%

Table of Contents
STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES
(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

RESULTS OF OPERATIONS
The following table sets forth certain key performance indicators we use to monitor our operations for the three months ended March 31, 2019 and 2018:

($ millions, except per share amounts)	Three months ended March 31	
	2019	2018
GAAP Basis:		
Total revenues	$367.6	$323.7
Income (loss) before federal income taxes	$61.6	$(3.3)
Net income (loss)	$49.4	$(2.1)
Basic earnings (loss) per share	$1.14	$(0.05)
Diluted earnings (loss) per share	$1.12	$(0.05)
Stockholders' equity	$895.3	$809.8
Return on average equity (LTM)	7.5 %	(1.1)%
Book value per share	$20.67	$18.97
Debt to capital ratio	12.0 %	13.1 %
Cat loss and ALAE ratio	5.9 %	3.1 %
Non-cat loss and LAE ratio	58.3 %	64.3 %
Loss and LAE ratio	64.2 %	67.4 %
Expense ratio	35.5 %	35.2 %
Combined ratio	99.7 %	102.6 %
Premium written growth	4.7 %	(4.8)%
Investment yield	2.9 %	3.1 %
SAP Basis:		
Cat loss and ALAE ratio	5.9 %	3.1 %
Non-cat loss and ALAE ratio	52.1 %	58.7 %
ULAE ratio	6.3 %	5.8 %
Loss and LAE ratio	64.3 %	67.6 %
Expense ratio	36.4 %	36.7 %
Combined ratio	100.7 %	104.3 %

	Twelve months ended March 31	
	2019	2018
Net premiums written to surplus	1.4	1.6

Our pre-tax income for the three months ended March 31, 2019 was $61.6 million, an increase of $64.9 million compared to the same 2018 period primarily driven by net investment gains of $44.9 million compared to a net investment loss of $11.7 million in 2018. In addition, the personal and commercial insurance segments' net underwriting results improved compared to the same 2018 period due primarily to new business growth, rate increases, and greater favorable development of prior accident year losses and loss adjustment expenses. Partially offsetting these improvements were weather events classified as catastrophes, which in 2019 were more severe than those experienced in 2018.

Insurance Segments

We measure our top-line growth for our insurance segments based on net written premiums, which provides 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 2018 Form 10-K.

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

Table of Contents
STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES
(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

The following tables set forth certain key performance indicators for our insurance segments for the three months ended March 31, 2019 and 2018:
SAP Insurance Segment Results
($ in millions)
(unaudited)

Three months ended March 31, 2019	Personal & Commercial	Specialty run-off	Total
Net written premiums	$ 305.6	$ 0.4	$ 306.0
Net earned premiums	297.9	4.8	302.7
Losses and LAE incurred:			
Cat loss and ALAE	17.2	0.5	17.7
Non-cat loss and ALAE			
Prior accident years non-cat loss and ALAE	(22.2)	1.3	(20.9)
Current accident year non-cat loss and ALAE	174.7	4.0	178.7
Total non-cat loss and ALAE	152.5	5.3	157.8
Total Loss and ALAE	169.7	5.8	175.5
ULAE	19.5	(0.4)	19.1
Total Loss and LAE	189.2	5.4	194.6
Underwriting expenses	110.4	0.8	111.2
Net underwriting loss	$ (1.7)	$ (1.4)	$ (3.1)
Cat loss and ALAE ratio	5.8 %	N/M[1]	5.9 %
Non-cat loss and ALAE ratio			
Prior accident years non-cat loss and ALAE ratio	(7.4)%	N/M	(6.9)%
Current accident year non-cat loss and ALAE ratio	58.6 %	N/M	59.0 %
Total non-cat loss and ALAE ratio	51.2 %	N/M	52.1 %
Total Loss and ALAE ratio	57.0 %	N/M	58.0 %
ULAE ratio	6.6 %	N/M	6.3 %
Total Loss and LAE ratio	63.6 %	N/M	64.3 %
Expense ratio	36.1 %	N/M	36.4 %
Combined ratio	99.7 %	N/M	100.7 %