

State Auto Financial CORP  
Form 10-Q  
November 06, 2013  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

ý Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended September 30, 2013

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 (I.R.S. Employer  
incorporation or organization) Identification No.)

518 East Broad Street, Columbus, Ohio 43215-3976  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (614) 464-5000

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ý No ¨

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ý No ¨

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated file ¨ Accelerated filer ý Non-accelerated filer ¨

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

Yes ¨ No ý

On November 1, 2013, the Registrant had 40,663,415 Common Shares outstanding.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

## PART I – FINANCIAL STATEMENTS

## Item 1. Condensed Consolidated Balance Sheets

(\$ and shares in millions, except per share amount)	September 30, 2013 (unaudited)	December 31, 2012
Assets		
Fixed maturities, available-for-sale, at fair value (amortized cost \$1,802.1 and \$1,776.2, respectively)	\$ 1,844.8	\$ 1,905.1
Equity securities, available-for-sale, at fair value (cost \$195.6 and \$196.2, respectively)	251.1	228.4
Other invested assets, available-for-sale, at fair value (cost \$49.3 and \$49.0, respectively)	76.3	64.4
Other invested assets	5.0	0.5
Notes receivable from affiliate	70.0	70.0
Total investments	2,247.2	2,268.4
Cash and cash equivalents	54.3	59.0
Accrued investment income and other assets	35.5	31.5
Deferred policy acquisition costs	98.6	91.7
Reinsurance recoverable on losses and loss expenses payable	10.8	13.5
Prepaid reinsurance premiums	4.7	3.9
Due from affiliate	12.6	—
Net deferred federal income taxes	10.0	1.0
Property and equipment, at cost	8.4	8.8
Total assets	\$ 2,482.1	\$ 2,477.8
Liabilities and Stockholders' Equity		
Losses and loss expenses payable (affiliates \$425.6 and \$435.1, respectively)	\$ 952.0	\$ 942.2
Unearned premiums (affiliates \$77.7 and \$81.9, respectively)	501.5	481.6
Notes payable (affiliates \$15.5 and \$15.5, respectively)	100.8	115.9
Postretirement and pension benefits	102.7	113.0
Due to affiliate	—	8.6
Current federal income taxes	0.1	—
Other liabilities	91.0	79.3
Total liabilities	1,748.1	1,740.6
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; 47.4 and 47.3 shares issued, respectively, at stated value of \$2.50 per share	118.6	118.1
Treasury stock, 6.8 and 6.8 shares, respectively, at cost	(115.9	) (115.8
Additional paid-in capital	135.4	131.6
Accumulated other comprehensive income	44.5	84.2
Retained earnings	551.4	519.1
Total stockholders' equity	734.0	737.2
Total liabilities and stockholders' equity	\$ 2,482.1	\$ 2,477.8

See accompanying notes to condensed consolidated financial statements.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

## Condensed Consolidated Statements of Income

(\$ in millions, except per share amounts) (unaudited)	Three months ended September 30	
	2013	2012
Earned premiums (ceded to affiliates \$215.2 and \$203.9, respectively)	\$ 266.0	\$ 261.4
Net investment income (affiliate \$1.3 and \$1.3, respectively)	18.8	17.2
Net realized gain on investments:		
Total other-than-temporary impairment losses	(0.3	) (0.7
Portion of loss recognized in other comprehensive income	—	—
Other net realized investment gains	7.8	7.7
Total net realized gain on investments	7.5	7.0
Other income from affiliates	0.4	0.8
Total revenues	292.7	286.4
Losses and loss expenses (ceded to affiliates \$137.9 and \$133.8, respectively)	178.8	201.4
Acquisition and operating expenses	90.9	86.4
Interest expense (affiliates \$0.1 and \$0.2, respectively)	1.6	1.8
Other expenses	2.7	2.4
Total expenses	274.0	292.0
Income (loss) before federal income taxes	18.7	(5.6
Federal income tax expense (benefit)	0.2	(0.1
Net income (loss)	\$ 18.5	\$(5.5
Earnings (loss) per common share:		
Basic	\$0.46	\$(0.14
Diluted	\$0.45	\$(0.14
Dividends paid per common share	\$0.10	\$0.15

See accompanying notes to condensed consolidated financial statements.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

## Condensed Consolidated Statements of Income

(\$ in millions, except per share amounts) (unaudited)	Nine months ended September 30	
	2013	2012
Earned premiums (ceded to affiliates \$639.0 and \$600.6, respectively)	\$ 790.8	\$ 774.7
Net investment income (affiliate \$3.7 and \$3.7, respectively)	55.4	55.2
Net realized gain on investments:		
Total other-than-temporary impairment losses	(2.6	) (2.4
Portion of loss recognized in other comprehensive income	—	—
Other net realized investment gains	18.3	23.2
Total net realized gain on investments	15.7	20.8
Other income from affiliates	1.4	2.7
Total revenues	863.3	853.4
Losses and loss expenses (ceded to affiliates \$434.0 and \$457.6, respectively)	537.9	594.4
Acquisition and operating expenses	266.7	257.6
Interest expense (affiliates \$0.5 and \$0.6, respectively)	7.1	5.3
Other expenses	6.6	6.4
Total expenses	818.3	863.7
Income (loss) before federal income taxes	45.0	(10.3
Federal income tax expense (benefit)	0.6	(0.1
Net income (loss)	\$ 44.4	\$ (10.2
Earnings (loss) per common share:		
Basic	\$ 1.09	\$ (0.25
Diluted	\$ 1.09	\$ (0.25
Dividends paid per common share	\$ 0.30	\$ 0.45

See accompanying notes to condensed consolidated financial statements.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

## Consolidated Statements of Comprehensive Income

(\$ in millions, except per share amounts) (unaudited)	Three months ended September 30	
	2013	2012
Net income (loss)	\$ 18.5	\$ (5.5 )
Other comprehensive income, net of tax:		
Net unrealized holding gain on investments:		
Unrealized holding gain arising during the period ended	12.1	36.7
Reclassification adjustments for gain realized in net income (loss)	(7.5 )	(7.0 )
Income tax benefit (expense)	1.4	(0.3 )
Total net unrealized holding gain on investments	6.0	29.4
Net unrecognized benefit plan obligations:		
Reclassification adjustments for amortization to statements of income:		
Negative prior service costs	(1.3 )	(1.3 )
Transition assets	—	0.1
Net loss	2.2	2.0
Total net unrecognized benefit plan obligations	0.9	0.8
Other comprehensive income, net of tax	6.9	30.2
Comprehensive income, net of tax	\$ 25.4	\$ 24.7

See accompanying notes to condensed consolidated financial statements.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

## Consolidated Statements of Comprehensive Income

(\$ in millions, except per share amounts) (unaudited)	Nine months ended September 30	
	2013	2012
Net income (loss)	\$44.4	\$ (10.2)
Other comprehensive income, net of tax:		
Net unrealized holding (loss) gain on investments:		
Unrealized holding (loss) gain arising during the period ended	(35.6	) 59.3
Reclassification adjustments for gain realized in net income (loss)	(15.7	) (20.8)
Income tax benefit	9.0	—
Total net unrealized holding (loss) gain on investments	(42.3	) 38.5
Amortization of gain on derivative used in cash flow hedge	(0.1	) (0.1)
Net unrecognized benefit plan obligations:		
Reclassification adjustments for amortization to statements of income:		
Negative prior service costs	(4.1	) (3.9)
Transition assets	0.2	0.2
Net loss	6.6	5.8
Total net unrecognized benefit plan obligations	2.7	2.1
Other comprehensive (loss) income, net of tax	(39.7	) 40.5
Comprehensive income, net of tax	\$4.7	\$30.3

See accompanying notes to condensed consolidated financial statements.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

## Condensed Consolidated Statements of Cash Flows

(\$ in millions) (unaudited)	Nine months ended September 30	
	2013	2012
Cash flows from operating activities:		
Net income (loss)	\$44.4	\$(10.2 )
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization, net	9.5	6.0
Share-based compensation	3.6	2.7
Net realized gain on investments	(15.7 )	(20.8 )
Changes in operating assets and liabilities:		
Deferred policy acquisition costs	(6.9 )	(2.2 )
Accrued investment income and other assets	(2.7 )	—
Postretirement and pension benefits	(7.4 )	(6.8 )
Other liabilities and due to/from affiliates, net	(18.8 )	(17.5 )
Reinsurance recoverable on losses and loss expenses payable and prepaid reinsurance premiums	1.9	10.7
Losses and loss expenses payable	9.8	38.8
Unearned premiums	19.9	21.3
Federal income taxes	0.1	6.4
Cash used in Homeowners' Quota Share initial net unearned premium transfer	—	(75.5 )
Cash used in pooling changes, December 31, 2011	—	(261.4 )
Net cash provided by (used in) operating activities	37.7	(308.5 )
Cash flows from investing activities:		
Purchases of fixed maturities – available-for-sale	(226.6 )	(429.3 )
Purchases of equity securities – available-for-sale	(60.5 )	(112.1 )
Purchases of other invested assets	(5.2 )	(0.7 )
Maturities, calls and pay downs of fixed maturities – available-for-sale	122.7	217.5
Sales of fixed maturities – available-for-sale	77.8	293.9
Sales of equity securities – available-for-sale	74.1	64.4
Sales of other invested assets	0.5	0.5
Net additions (reductions) of property and equipment	0.2	(0.2 )
Net cash (used in) provided by investing activities	(17.0 )	34.0
Cash flows from financing activities:		
Proceeds from issuance of common stock	2.3	0.8
Payments to acquire treasury stock	(0.1 )	—
Payment of dividends	(12.1 )	(18.1 )
Payment of credit facility issue costs	(0.5 )	—
Proceeds from long-term debt	85.0	—
Redemption of long-term debt	(100.0 )	—
Net cash used in financing activities	(25.4 )	(17.3 )
Net decrease in cash and cash equivalents	(4.7 )	(291.8 )
Cash and cash equivalents at beginning of period	59.0	356.0
Cash and cash equivalents at end of period	\$54.3	\$64.2
Supplemental disclosures:		

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Interest paid (affiliates \$0.5 and \$0.6, respectively)	\$7.3	\$3.7
Federal income taxes paid (refunds received)	\$0.6	\$(6.5 )

See accompanying notes to condensed consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of State Auto Financial Corporation and Subsidiaries (“State Auto Financial” or the “Company”) have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles (“GAAP”) for complete financial statements. In the opinion of the Company, all adjustments (consisting of normal, recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine month periods ended September 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. The balance sheet at December 31, 2012 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, 2012 (the “2012 Form 10-K”). Capitalized terms used herein and not otherwise defined shall have the meaning ascribed to them in the 2012 Form 10-K.

Adoption of Accounting Pronouncements

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income

The amendments in this guidance result in additional disclosure requirements under GAAP and do not change the current requirements for reporting net income or other comprehensive income in financial statements. The new guidance requires an entity to present, either in a single note, or, parenthetically on the face of the statement where net income is presented, the effects of significant amounts reclassified from each component of accumulated other comprehensive income by the respective line items of net income, only, if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period. If a component is not required to be reclassified to net income in its entirety, the entity would, instead, cross-reference it to the related disclosure required under GAAP. This guidance was effective prospectively for fiscal years and interim periods beginning after December 15, 2012. The Company adopted this guidance at January 1, 2013 and it did not have a material impact on the consolidated financial statements, see Note 8 - Other Comprehensive Income and Accumulated Other Comprehensive Income.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

## 2. Investments

The following tables set forth the cost or amortized cost and fair value of available-for-sale securities by lot at September 30, 2013 and December 31, 2012:

(\$ millions)

September 30, 2013	Cost or amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
Fixed maturities:				
U.S. treasury securities and obligations of U.S. government agencies	\$ 348.9	\$ 18.4	\$ (3.9)	) \$ 363.4
Obligations of states and political subdivisions	791.9	29.8	(16.7)	) 805.0
Corporate securities	326.7	11.6	(5.3)	) 333.0
U.S. government agencies residential mortgage-backed securities	334.6	11.4	(2.6)	) 343.4
Total fixed maturities	1,802.1	71.2	(28.5)	) 1,844.8
Equity securities:				
Large-cap securities	150.5	36.2	(2.1)	) 184.6
Small-cap securities	45.1	21.4	—	) 66.5
Total equity securities	195.6	57.6	(2.1)	) 251.1
Other invested assets	49.3	27.0	—	) 76.3
Total available-for-sale securities	\$ 2,047.0	\$ 155.8	\$ (30.6)	) \$ 2,172.2

(\$ millions)

December 31, 2012	Cost or amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
Fixed maturities:				
U.S. treasury securities and obligations of U.S. government agencies	\$ 328.2	\$ 38.3	\$ —	) \$ 366.5
Obligations of states and political subdivisions	750.4	50.3	(0.4)	) 800.3
Corporate securities	320.5	19.2	(1.1)	) 338.6
U.S. government agencies residential mortgage-backed securities	377.1	24.0	(1.4)	) 399.7
Total fixed maturities	1,776.2	131.8	(2.9)	) 1,905.1
Equity securities:				
Large-cap securities	152.6	25.0	(3.4)	) 174.2
Small-cap securities	43.6	10.6	—	) 54.2
Total equity securities	196.2	35.6	(3.4)	) 228.4
Other invested assets	49.0	15.4	—	) 64.4
Total available-for-sale securities	\$ 2,021.4	\$ 182.8	\$ (6.3)	) \$ 2,197.9

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

The following tables set forth the Company's gross unrealized losses and fair value on its investments by lot, aggregated by investment category and length of time for individual securities that have been in a continuous unrealized loss position at September 30, 2013 and December 31, 2012:

(\$ millions, except # of positions) September 30, 2013	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
Fixed maturities:									
U.S. treasury securities and obligations of U.S. government agencies	\$86.0	\$ (3.9 )	24	\$—	\$—	—	\$86.0	\$ (3.9 )	24
Obligations of states and political subdivisions	230.9	(16.7 )	81	—	—	—	230.9	(16.7 )	81
Corporate securities	102.0	(4.8 )	20	5.5	(0.5 )	1	107.5	(5.3 )	21
U.S. government agencies residential mortgage-backed securities	54.2	(1.6 )	16	27.6	(1.0 )	11	81.8	(2.6 )	27
Total fixed maturities	473.1	(27.0 )	141	33.1	(1.5 )	12	506.2	(28.5 )	153
Large-cap equity securities	16.2	(1.3 )	3	8.9	(0.8 )	3	25.1	(2.1 )	6
Total temporarily impaired securities	\$489.3	\$ (28.3 )	144	\$42.0	\$ (2.3 )	15	\$531.3	\$ (30.6 )	159

(\$ millions, except # of positions) December 31, 2012	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
Fixed maturities:									
U.S. treasury securities and obligations of U.S. government agencies	\$7.0	\$—	2	\$—	\$—	—	\$7.0	\$—	2
Obligations of states and political subdivisions	47.4	(0.4 )	12	—	—	—	47.4	(0.4 )	12
Corporate securities	80.4	(1.1 )	17	—	—	—	80.4	(1.1 )	17
U.S. government agencies residential mortgage-backed securities	23.3	(0.3 )	6	34.8	(1.1 )	13	58.1	(1.4 )	19
Total fixed maturities	158.1	(1.8 )	37	34.8	(1.1 )	13	192.9	(2.9 )	50
Large-cap equity securities	23.7	(2.1 )	4	8.9	(1.3 )	5	32.6	(3.4 )	9
Total temporarily impaired securities	\$181.8	\$ (3.9 )	41	\$43.7	\$ (2.4 )	18	\$225.5	\$ (6.3 )	59

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

The Company reviewed its investments at September 30, 2013, and determined no additional other-than-temporary impairment existed in the gross unrealized holding losses other than those listed in the table below. The following table sets forth the realized losses related to other-than-temporary impairments on the Company's investment portfolio recognized for the three and nine months ended September 30, 2013 and 2012:

(\$ millions)	Three months ended		Nine months ended	
	September 30		September 30	
	2013	2012	2013	2012
Equity securities:				
Large-cap securities	\$—	\$—	\$(1.3	) \$—
Small-cap securities	(0.3	) (0.7	) (1.3	) (2.2
Fixed maturities:	—	—	—	(0.2
Total other-than-temporary impairments	\$(0.3	) \$(0.7	) \$(2.6	) \$(2.4

The Company regularly monitors its investments that have fair values less than cost or amortized cost for signs of other-than-temporary impairment, an assessment that requires significant management judgment regarding the evidence known. Such judgments could change in the future as more information becomes known, which could negatively impact the amounts reported. Among the factors that management considers for fixed maturity securities are the financial condition of the issuer including receipt of scheduled principal and interest cash flows, and intent to sell including if it is more likely than not that the Company will be required to sell the investments before recovery. When a fixed maturity has been determined to have an other-than-temporary impairment, the impairment charge is separated into an amount representing the credit loss, which is recognized in earnings as a realized loss, and the amount related to non-credit factors, which is recognized in accumulated other comprehensive income. Future increases or decreases in fair value, if not other-than-temporary, are included in accumulated other comprehensive income.

Among the factors that management considers for equity securities and other invested assets are the length of time and/or the significance of decline below cost, the Company's ability and intent to hold these securities through their recovery periods, the current financial condition of the issuer and its future business prospects, and the ability of the market value to recover to cost in the near term. When an equity security or other invested asset has been determined to have a decline in fair value that is other-than-temporary, the cost basis of the security is adjusted to fair value. This results in a charge to earnings as a realized loss, which is not reversed for subsequent recoveries in fair value. Future increases or decreases in fair value, if not other-than-temporary, are included in accumulated other comprehensive income.

The following table sets forth the amortized cost and fair value of available-for-sale fixed maturities by contractual maturity at September 30, 2013:

(\$ millions)	Amortized cost	Fair value
Due in 1 year or less	\$57.2	\$57.9
Due after 1 year through 5 years	367.1	385.8
Due after 5 years through 10 years	374.6	391.6
Due after 10 years	668.6	666.1
U.S. government agencies residential mortgage-backed securities	334.6	343.4
Total	\$1,802.1	\$1,844.8

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, 2013, State Auto P&C had fixed maturity securities, with a carrying value of \$118.0 million, that were pledged as collateral in connection with an outstanding borrowing of \$85.0 million with the Federal Home Loan Bank of Cincinnati ("FHLB"). In accordance with the terms of the borrowing, State Auto P&C retains all rights regarding these securities, which are included in the "U.S. government agencies residential mortgage-backed securities" classification of the Company's fixed maturity securities portfolio.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

Fixed maturities with fair values of \$8.6 and \$10.0 million, respectively, were on deposit with insurance regulators as required by law at September 30, 2013 and December 31, 2012. 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, 2013 and 2012:

(\$ millions)	Three months ended		Nine months ended	
	September 30		September 30	
	2013	2012	2013	2012
Fixed maturities	\$ 16.2	\$ 14.7	\$ 48.2	\$ 49.1
Equity securities	1.9	1.5	4.7	3.5
Cash and cash equivalents, and other	1.3	1.4	4.1	4.1
Investment income	19.4	17.6	57.0	56.7
Investment expenses	0.6	0.4	1.6	1.5
Net investment income	\$ 18.8	\$ 17.2	\$ 55.4	\$ 55.2

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

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, 2013 and 2012:

(\$ millions)	Three months ended		Nine months ended	
	September 30		September 30	
	2013	2012	2013	2012
Realized gains:				
Fixed maturities	\$ 0.4	\$ 3.3	\$ 1.6	\$ 14.0
Equity securities	7.9	4.8	17.9	11.5
Other invested assets	0.1	—	0.1	—
Total realized gains	8.4	8.1	19.6	25.5
Realized losses:				
Equity securities:				
Sales	(0.3	) (0.4	) (1.0	) (2.3
OTTI	(0.3	) (0.7	) (2.6	) (2.2
Fixed maturities:				
Sales	(0.3	) —	(0.3	) —
OTTI	—	—	—	(0.2
Total realized losses	(0.9	) (1.1	) (3.9	) (4.7
Net realized gain on investments	\$ 7.5	\$ 7.0	\$ 15.7	\$ 20.8
Change in unrealized holding gains (losses), net of tax:				
Fixed maturities	\$ (7.7	) \$ 17.2	\$ (86.2	) \$ 20.7
Equity securities	5.3	8.5	23.3	13.4
Other invested assets	7.0	4.0	11.6	4.4
Deferred federal income tax (liability) benefit	(1.6	) (10.4	) 18.0	(13.5
Valuation allowance	3.0	10.1	(9.0	) 13.5
Change in net unrealized holding gains (losses), net of tax	\$ 6.0	\$ 29.4	\$ (42.3	) \$ 38.5

There was a deferred federal income tax liability, net of a valuation allowance, on the net unrealized holding gains at September 30, 2013 and December 31, 2012 of \$43.5 million and \$52.5 million, respectively.





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Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

3. Fair Value of Financial Instruments

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

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

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

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

The Company utilizes one nationally recognized pricing service to estimate the majority of its available-for-sale investment portfolio's fair value. The Company obtains one price per security and the processes and control procedures employed by the Company are designed to ensure the value is accurately recorded on an unadjusted basis. Through discussions with the pricing service, the Company gains an understanding of the methodologies used to price the different types of securities, that the data and the valuation methods utilized are appropriate and consistently applied, and that the assumptions are reasonable and representative of fair value. To validate the reasonableness of the valuations obtained from the pricing service, the Company compares to other fair value pricing information gathered from other independent pricing sources. At September 30, 2013 and December 31, 2012, the Company did not adjust any of the prices received from the pricing service.

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

Transfers in and out of level categorizations are reported as having occurred at the beginning of the quarter in which the transfer occurred. There were no transfers between level categorizations during the three and nine months ended September 30, 2013 and 2012.

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

Fixed Maturities

The Company utilizes a third party pricing service to estimate fair value measurements for the majority of its fixed maturities. The fair value estimate of the Company's fixed maturity investments are determined by evaluations that are based on observable market information rather than market quotes. Inputs to the evaluations include, but are not limited to, market prices from recently completed transactions and transactions of comparable securities, interest rate yield curves, credit spreads, and other market-observable information. The fixed maturity portfolio pricing obtained from the pricing service is reviewed for reasonableness. Regularly, a sample of security prices are referred back to the pricing service for more detailed explanation as to how the pricing service arrived at that particular price. The explanations are reviewed for reasonableness by the portfolio manager and investment officer. Additionally, the prices and assumptions are verified against an alternative pricing source for reasonableness and accuracy. 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 one security discussed below), and U.S. government agencies residential mortgage-backed securities. All unadjusted estimates of fair value for fixed maturities priced by the pricing service are included in the amounts disclosed in Level 2 of the hierarchy. If market inputs are unavailable, then no fair value is provided by the pricing service. For these securities, fair value is determined either by requesting brokers who are knowledgeable about these securities to provide a quote; or the Company internally determines the fair values by employing widely accepted pricing valuation models, and depending on the level of observable market inputs, renders the fair value estimate as Level 2 or Level 3. The Company holds two fixed maturity corporate securities included in Level 3. The Company estimates the fair value of

one security using the present value of the future cash flows and the Company obtains a broker quote of the other security's fair value. Due to the limited amount of observable market information for both of these securities, the Company includes the fair value estimates in Level 3.

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Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

Equities

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

Other Invested Assets

Included in other invested assets are two international funds (“the funds”) that invest in equity securities of foreign issuers and are managed by third party investment managers. The funds had a fair value of \$70.0 million and \$59.0 million at September 30, 2013 and December 31, 2012, respectively, which was determined using each fund’s net asset value. The Company employs procedures to assess the reasonableness of the fair value of the funds including obtaining and reviewing each fund’s audited financial statements. There are no unfunded commitments related to the funds. The Company may not sell its investment in the funds; however, the Company may redeem all or a portion of its investment in the funds at net asset value per share with the appropriate prior written notice. Due to the Company’s ability to redeem its investment in the funds at net asset value per share at the measurement date, the funds have been disclosed in Level 2.

The remainder of the Company’s other invested assets consist primarily of holdings in publicly-traded mutual funds. The Company believes that its prices for these publicly-traded mutual funds based on an observable market price for an identical asset in an active market reflect their fair values and consequently these securities have been disclosed in Level 1.

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The following tables set forth the Company's available-for-sale investments within the fair value hierarchy at September 30, 2013 and December 31, 2012:

(\$ millions)

	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
September 30, 2013				
Fixed maturities:				
U.S. treasury securities and obligations of U.S. government agencies	\$ 363.4	\$ —	\$ 363.4	\$ —
Obligations of states and political subdivisions	805.0	—	805.0	—
Corporate securities	333.0	—	324.1	8.9
U.S. government agencies residential mortgage-backed securities	343.4	—	343.4	—
Total fixed maturities	1,844.8	—	1,835.9	8.9
Equity securities:				
Large-cap securities	184.6	184.6	—	—
Small-cap securities	66.5	66.5	—	—
Total equity securities	251.1	251.1	—	—
Other invested assets	76.3	6.3	70.0	—
Total available-for-sale investments	\$ 2,172.2	\$ 257.4	\$ 1,905.9	\$ 8.9

(\$ millions)

	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
December 31, 2012				
Fixed maturities:				
U.S. treasury securities and obligations of U.S. government agencies	\$ 366.5	\$ —	\$ 366.5	\$ —
Obligations of states and political subdivisions	800.3	—	800.3	—
Corporate securities	338.6	—	330.1	8.5
U.S. government agencies residential mortgage-backed securities	399.7	—	399.7	—
Total fixed maturities	1,905.1	—	1,896.6	8.5
Equity securities:				
Large-cap securities	174.2	174.2	—	—
Small-cap securities	54.2	54.2	—	—
Total equity securities	228.4	228.4	—	—
Other invested assets	64.4	5.4	59.0	—
Total available-for-sale investments	\$ 2,197.9	\$ 233.8	\$ 1,955.6	\$ 8.5

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For assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3), the following tables set forth a reconciliation of the beginning and ending balances for the three and nine months ended September 30, 2013 and the year ended December 31, 2012, separately for each major category of assets:

(\$ millions)	Fixed maturities
Balance at January 1, 2013	\$ 8.5
Total realized gains (losses) – included in earnings	—
Total unrealized gains (losses) – included in other comprehensive income	—
Purchases	0.1
Sales	—
Transfers into Level 3	—
Transfers out of Level 3	—
Balance at March 31, 2013	\$ 8.6
Total realized gains (losses) – included in earnings	—
Total unrealized gains (losses) – included in other comprehensive income	0.1
Purchases	0.1
Sales	—
Transfers into Level 3	—
Transfers out of Level 3	—
Balance at June 30, 2013	\$ 8.8
Total realized gains (losses) – included in earnings	—
Total unrealized gains (losses) – included in other comprehensive income	—
Purchases	0.1
Sales	—
Transfers into Level 3	—
Transfers out of Level 3	—
Balance at September 30, 2013	\$ 8.9

(\$ millions)	Fixed maturities
Balance at January 1, 2012	\$ 2.9
Total realized (losses) gains – included in earnings	(0.2 )
Total unrealized gains (losses) – included in other comprehensive income	—
Purchases	5.8
Sales	—
Transfers into Level 3	—
Transfers out of Level 3	—
Balance at December 31, 2012	\$ 8.5

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

Included in other invested assets are the Federal Home Loan Bank of Cincinnati (“FHLB”) common stock and the Trust securities. The Trust securities and FHLB common stock are carried at cost, which approximates fair value. The fair value of the FHLB common stock at September 30, 2013 was \$4.5 million and the fair value of the Trust common

securities was \$0.5 million. Both investments have been placed in Level 3 of the fair value hierarchy.

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Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

## Notes Receivable from Affiliates

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

(\$ millions, except interest rates)	September 30, 2013			December 31, 2012		
	Carrying value	Fair value	Interest rate	Carrying value	Fair value	Interest rate
Notes receivable from affiliate	\$ 70.0	\$ 75.7	7.00 %	\$ 70.0	\$ 78.3	7.00 %

## Notes Payable

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

(\$ millions, except interest rates)	September 30, 2013			December 31, 2012		
	Carrying value	Fair Value	Interest rate	Carrying value	Fair value	Interest rate
FHLB Loan due 2033:, issued \$85.0, July 2013 with fixed interest	\$ 85.3	\$ 91.1	4.59 %	N/A	N/A	N/A
Senior Notes due 2013: issued \$100.0, November 2003 with fixed interest	N/A	N/A	N/A	100.4	100.3	6.25 %
Affiliate Subordinated Debentures due 2033: issued \$15.5, May 2003 with variable interest	15.5	15.5	4.46 %	15.5	15.5	4.51 %
Total notes payable	\$ 100.8	\$ 106.6		\$ 115.9	\$ 115.8	

## 4. Reinsurance

The insurance subsidiaries of State Auto Financial, including State Auto Property & Casualty Insurance Company (“State Auto P&C”), Milbank Insurance Company and State Auto Insurance Company of Ohio (collectively referred to as the “STFC Pooled Companies”) participate in a quota share reinsurance pooling arrangement (“the Pooling Arrangement”) with State Automobile Mutual Insurance Company (“State Auto Mutual”) and its subsidiaries and affiliates, State Auto Insurance Company of Wisconsin, Meridian Citizens Mutual Insurance Company, Meridian Security Insurance Company, Patrons Mutual Insurance Company of Connecticut (which includes Litchfield Mutual Fire Insurance Company as it was merged with Patrons Mutual at the close of business March 31, 2013), Rockhill Insurance Company (“RIC”), Plaza Insurance Company (“Plaza”), American Compensation Insurance Company (“American Compensation”) and Bloomington Compensation Insurance Company (“Bloomington Compensation”), (collectively referred to as the “Mutual Pooled Companies”).



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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

The following table sets forth a summary of the Company's external reinsurance transactions, as well as reinsurance transactions with State Auto Mutual under the Pooling Arrangement, for the three and nine months ended September 30, 2013 and 2012:

(\$ millions)	Three months ended		Nine months ended	
	September 30		September 30	
	2013	2012	2013	2012
Premiums earned:				
Assumed from external insurers and reinsurers	\$ 1.2	\$ 1.1	\$ 2.7	\$ 3.1
Assumed under Pooling Arrangement	266.0	261.4	790.8	774.7
Ceded to external insurers and reinsurers	(5.4	) (6.6	) (17.6	) (22.1
Ceded under Pooling Arrangement	(215.2	) (203.9	) (639.0	) (600.6
Net assumed premiums earned	\$ 46.6	\$ 52.0	\$ 136.9	\$ 155.1
Losses and loss expenses incurred:				
Assumed from external insurers and reinsurers	\$ 0.9	\$ 1.2	\$ 1.3	\$ 3.1
Assumed under Pooling Arrangement	179.5	201.7	540.1	595.3
Ceded to external insurers and reinsurers	(0.8	) (4.5	) (4.9	) (9.1
Ceded under Pooling Arrangement	(137.8	) (133.8	) (434.0	) (457.6
Net assumed losses and loss expenses incurred	\$ 41.8	\$ 64.6	\$ 102.5	\$ 131.7

## 5. Notes Payable and Credit Facility

## FHLB Loan

On July 11, 2013, State Auto Financial's subsidiary, State Auto P&C, borrowed \$85.0 million (the "FHLB Loan") from the Federal Home Loan Bank of Cincinnati (the "FHLB"). The FHLB Loan is a 20-year term loan and is callable after three years with no prepayment penalty thereafter. The FHLB Loan provides for interest-only payments during its term, with principal due in full at maturity. The interest rate is fixed over the term of the loan at 5.03%. The FHLB Loan is fully secured by a pledge of specific investment securities of State Auto P&C. The total loan interest incurred through September 30, 2013 was \$0.9 million.

## Senior Note Redemption

On July 15, 2013, the Company redeemed all \$100.0 million of its outstanding Senior Notes. The redemption price of \$103.0 million was calculated in accordance with the terms of the Senior Notes and included principal plus a make-whole amount. The redemption price was funded by proceeds from the FHLB Loan and cash on hand.

## Credit Facility

On July 26, 2013, State Auto Financial terminated its then-current credit agreement with a syndicate of lenders, as further described below. Concurrent with the termination of this credit agreement, State Auto P&C entered into a new credit facility (the "SPC Credit Facility") with a syndicate of lenders. The SPC Credit Facility provides State Auto P&C with a \$100.0 million five-year revolving credit facility maturing in July 2018. During the term of the SPC Credit Facility, State Auto P&C has the right to increase the total facility to a maximum amount of \$150.0 million, provided that no event of default has occurred and is continuing. The SPC Credit Facility is available for general corporate purposes and provides for interest-only payments during its term, with principal and interest due in full at maturity.

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Interest is based on the London Interbank Offered Rate ("LIBOR") or a base rate plus a calculated margin amount. All advances under the SPC Credit Facility are to be fully secured by a pledge of specific investment securities of State Auto P&C. The SPC Credit Facility includes certain requirements, including financial requirements that State Auto Financial maintain a minimum net worth and a certain debt to capitalization ratio.

As of September 30, 2013, State Auto P&C had not made any borrowings and both State Auto P&C and the Company were in compliance with all covenants and requirements of the SPC Credit Facility.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

## 6. Income Taxes

The following table sets forth the reconciliation between actual federal income tax expense and the amount computed at the indicated statutory rate for the three and nine months ended September 30, 2013 and 2012:

(\$ millions)	Three months ended				Nine months ended			
	September 30		September 30		September 30		September 30	
	2013	2012	2013	2012	2013	2012	2013	2012
		%		%		%		%
Amount at statutory rate	\$ 6.6	35	\$ (1.9 )	35	\$ 15.8	35	\$ (3.6 )	35
Tax-exempt interest and dividends received deduction	(2.5 )	(13 )	(2.3 )	41	(7.2 )	(16 )	(6.7 )	65
Other, net	(0.3 )	(1 )	(0.1 )	2	—	—	0.3	(3 )
Valuation allowance	(3.6 )	(19 )	4.2	(75 )	(8.0 )	(18 )	9.9	(96 )
Federal income tax expense (benefit) and effective rate	\$ 0.2	2	\$ (0.1 )	3	\$ 0.6	1	\$ (0.1 )	1

The following table sets forth the tax effects of temporary differences that give rise to significant portions of deferred tax assets and deferred tax liabilities at September 30, 2013 and December 31, 2012:

(\$ millions)	September 30, 2013	December 31, 2012
Deferred tax assets:		
Unearned premiums not currently deductible	\$ 34.8	\$ 33.4
Losses and loss expenses payable discounting	25.5	25.2
Postretirement and pension benefits	35.8	39.4
Realized loss on other-than-temporary impairment	9.3	7.5
Other liabilities	17.1	14.5
Net operating loss carryforward	56.9	66.5
Tax credit carryforward	1.8	0.9
Other	7.6	7.9
Total deferred tax assets	188.8	195.3
Deferred tax liabilities:		
Deferral of policy acquisition costs	34.5	32.1
Net unrealized holding gains on investments	43.8	61.7
Total deferred tax liabilities	78.3	93.8
Total net deferred tax assets before valuation allowance	110.5	101.5
Less valuation allowance	100.5	100.5
Net deferred federal income taxes	\$ 10.0	\$ 1.0

Deferred income tax assets and liabilities represent the tax effect of the differences between the financial statement carrying value of existing assets and liabilities and their respective tax bases. In accordance with the Financial Accounting Standards Board's Accounting Standards Codification 740, Income Taxes (ASC 740), the Company periodically evaluates its deferred tax assets, which requires significant judgment, to determine if they are realizable based upon weighing all available evidence, both positive and negative, including loss carryback potential, past operating results, existence of cumulative losses in the most recent years, projected performance of the business, future taxable income, including the ability to generate capital gains, and prudent and feasible tax planning strategies. In making such judgments, significant weight is given to evidence that can be objectively verified. At both September 30, 2013 and December 31, 2012, the Company recorded a valuation allowance of \$100.5 million, respectively. The deferred income tax asset remaining after recognition of the valuation allowance represents a

deferred tax asset on the gross unrealized fixed maturity losses where management determined this portion of the asset to be realizable due to management's assertion that it has both the ability and intent to hold these securities through recovery or maturity.

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Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

Based on ASC 740 intraperiod tax allocation guidelines, the following sets forth the change in valuation allowance attributable to continuing operations and other comprehensive income for the three and nine months ended September 30, 2013 is as follows:

(\$ millions)	Three months ended		Nine months ended	
	September 30, 2013		September 30, 2013	
Continuing operations	\$ (3.6	)	\$ (8.0	)
Other comprehensive income	(3.4	)	8.0	
Change in valuation allowance	\$ (7.0	)	\$ —	

In future periods the Company will re-assess its judgments and assumptions regarding the realization of its net deferred tax assets, but until such time the positive evidence exceeds the negative evidence the Company will maintain a valuation allowance against its net deferred tax assets.

**7. Pension and Postretirement Benefit Plans**

The following table sets forth the components of net periodic cost for the Company's pension and postretirement benefit plans for the three and nine months ended September 30, 2013 and 2012:

(\$ millions)	Pension				Postretirement			
	Three months ended				Nine months ended			
	September 30		September 30		September 30		September 30	
	2013	2012	2013	2012	2013	2012	2013	2012
Service cost	\$ 1.7	\$ 2.0	\$ 0.1	\$ —	\$ 4.7	\$ 5.8	\$ 0.2	\$ —
Interest cost	2.4	2.5	0.3	0.3	7.2	7.5	0.9	0.9
Expected return on plan assets	(3.2 )	(3.0 )	0.4	—	(9.2 )	(8.8 )	0.4	(0.2 )
Amortization of:								
Prior service (benefits) costs	—	0.1	(1.3 )	(1.4 )	—	0.2	(4.1 )	(4.1 )
Transition assets	—	0.1	—	—	—	—	0.2	0.2
Net loss	2.0	1.8	0.2	0.2	6.0	5.2	0.6	0.6
Net periodic cost	\$ 2.9	\$ 3.5	\$ (0.3 )	\$ (0.9 )	\$ 8.7	\$ 9.9	\$ (1.8 )	\$ (2.6 )

The Company contributed \$13.0 million for the nine months ended September 30, 2013 to its pension plan.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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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 income component (AOCI), net of tax, for the three and nine months ended September 30, 2013 and 2012:

(\$ millions)

	Unrealized Gains and Losses on Available-for-Sale Securities	Gains and Losses on Cash Flow Hedges	Benefit Plan Items	Total
The three months ended September 30, 2013 and 2012:				
Beginning balance at July 1, 2013	\$ 75.7	\$—	\$(38.1)	) \$37.6
Other comprehensive income before reclassifications	13.6	—	—	13.6
Amounts reclassified from AOCI <sup>(a)</sup>	(7.6)	) —	0.9	(6.7)
Net current period other comprehensive income	6.0	—	0.9	6.9
Ending balance at September 30, 2013	\$ 81.7	\$—	\$(37.2)	) \$44.5
Beginning balance at July 1, 2012	\$ 107.8	\$0.1	\$(33.8)	) \$74.1
Other comprehensive income before reclassifications	36.4	—	—	36.4
Amounts reclassified from AOCI <sup>(a)</sup>	(7.0)	) —	0.8	(6.2)
Net current period other comprehensive income	29.4	—	0.8	30.2
Ending balance at September 30, 2012	\$ 137.2	\$0.1	\$(33.0)	) \$104.3

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

(\$ millions)

	Unrealized Gains and Losses on Available-for-Sale Securities	Gains and Losses on Cash Flow Hedges	Benefit Plan Items	Total
The nine months ended September 30, 2013 and 2012:				
Beginning balance at January 1, 2013	\$ 124.0	\$0.1	\$(39.9)	) \$84.2
Other comprehensive income before reclassifications	(26.5)	) —	—	(26.5)
Amounts reclassified from AOCI <sup>(a)</sup>	(15.8)	) (0.1)	) 2.7	(13.2)
Net current period other comprehensive income	(42.3)	) (0.1)	) 2.7	(39.7)
Ending balance at September 30, 2013	\$ 81.7	\$—	\$(37.2)	) \$44.5
Beginning balance at January 1, 2012	\$ 98.7	\$0.2	\$(35.1)	) \$63.8
Other comprehensive income before reclassifications	59.3	—	—	59.3
Amounts reclassified from AOCI <sup>(a)</sup>	(20.8)	) (0.1)	) 2.1	(18.8)
Net current period other comprehensive income	38.5	(0.1)	) 2.1	40.5
Ending balance at September 30, 2012	\$ 137.2	\$0.1	\$(33.0)	) \$104.3

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

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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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 consolidated statement of income for the three and nine months ended September 30, 2013 and 2012: (\$ millions)

Details about Accumulated Other Comprehensive Income Components	Three months ended September 30		Affected line item in the Condensed Consolidated Statements of Income
	2013	2012	
Unrealized gains (losses) on available for sale securities	7.5	7.0	Realized gain (loss) on sale of securities
	7.5	7.0	Total before tax
	0.1	—	Tax benefit (expense)
	7.6	7.0	Net of tax
Amortization of benefit plan items			
Negative prior service costs	1.3	1.3	(a)
Transition assets	—	(0.1)	) (a)
Net loss	(2.2)	) (2.0)	) (a)
	(0.9)	) (0.8)	) Total before tax
	—	—	Tax benefit (expense)
	(0.9)	) (0.8)	) Net of tax
Total reclassifications for the period	6.7	6.2	

(a) 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	Nine months ended September 30		Affected line item in the Condensed Consolidated Statements of Income
	2013	2012	
Unrealized gains (losses) on available for sale securities	\$ 15.7	\$ 20.8	Realized gain (loss) on sale of securities
	15.7	20.8	Total before tax
	0.1	—	Tax benefit (expense)
	15.8	20.8	Net of tax
Amortization of gain on derivative used in cash flow hedge	0.1	0.1	Realized gain (loss) on sale of securities
	0.1	0.1	Total before tax
	—	—	Tax benefit (expense)
	0.1	0.1	Net of tax
Amortization of benefit plan items			
Negative prior service costs	4.1	3.9	(a)
Transition assets	(0.2)	) (0.2)	) (a)
Net loss	(6.6)	) (5.8)	) (a)
	(2.7)	) (2.1)	) Total before tax
	—	—	Tax benefit (expense)
	(2.7)	) (2.1)	) Net of tax
Total reclassifications for the period	\$ 13.2	\$ 18.8	

(a) 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).





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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

## 9. Earnings (Loss) per Common Share

The following table sets forth the compilation of basic and diluted earnings (loss) per common share for the three and nine months ended September 30, 2013 and 2012:

(\$ and shares in millions, except per share amounts)	Three months ended		Nine months ended	
	September 30		September 30	
	2013	2012	2013	2012
Numerator:				
Net income (loss) for basic earnings (loss) per common share	\$ 18.5	\$(5.5 )	\$ 44.4	\$(10.2 )
Denominator:				
Weighted average shares for basic net earnings (loss) per common share	40.6	40.4	40.5	40.4
Effect of dilutive share-based awards	0.3	—	0.2	—
Adjusted weighted average shares for diluted net earnings (loss) per common share	40.9	40.4	40.7	40.4
Basic net earnings (loss) per common share	\$ 0.46	\$(0.14 )	\$ 1.09	\$(0.25 )
Diluted net earnings (loss) per common share	\$ 0.45	\$(0.14 )	\$ 1.09	\$(0.25 )

The following table sets forth the options to purchase shares of common stock and the restricted share units ("RSU award") provided to each outside director of the Company, that were not included in the computation of diluted earnings per common share because the exercise price of the options, or awards, was greater than the average market price or their inclusion would have been antidilutive for the three and nine months ended September 30, 2013 and 2012.

(number of options and awards in millions)	Three months ended		Nine months ended	
	September 30		September 30	
	2013	2012	2013	2012
Number of options	2.1	3.7	2.7	3.7
Number of RSU awards	0.2	—	0.1	—
Total number of antidilutive shares and awards	2.3	3.7	2.8	3.7

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

10. Segment Information

The Company has four reportable segments: personal insurance, business insurance, specialty insurance and investment operations. The reportable insurance segments are business units managed separately because of the differences in the type of customers they serve, the products they provide or services they offer. The insurance segments market a broad line of property and casualty insurance products throughout the United States through independent insurance agencies, which include retail agents and wholesale brokers. The personal insurance segment provides primarily personal automobile and homeowners to the personal insurance market. The business insurance segment provides primarily commercial automobile, commercial multi-peril, fire & allied and general liability insurance covering small-to-medium sized commercial exposures in the business insurance market. The specialty insurance segment provides commercial coverages, including workers' compensation for both legacy State Auto Group and RTW, Inc.'s insurance subsidiaries, that require specialized product underwriting, claims handling or risk management services through a distribution channel of retail agents and wholesale brokers, which may include program administrators and other specialty sources. 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 accounting for pension benefits also contributes to the difference between our GAAP loss and expense ratios and our SAP loss and expense ratios. At January 1, 2013, we adopted new SAP pension guidance, which required the recognition of service costs for non-vested participants. In accordance with GAAP, service costs related to non-vested participants was recognized over the vesting period.

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.

As of January 1, 2013 our units within the specialty insurance segment changed from RED, Rockhill and Workers' Compensation to Excess & Surplus Property, Excess & Surplus Casualty, Programs and Workers' Compensation. This change did not have any impact on segment reporting.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

The following table sets forth financial information regarding the Company's reportable segments for the three and nine months ended September 30, 2013 and 2012:

(\$ millions)	Three months ended		Nine months ended	
	September 30		September 30	
	2013	2012	2013	2012
Revenues from external sources:				
Insurance segments				
Personal insurance	\$ 116.4	\$ 117.4	\$ 348.3	\$ 352.1
Business insurance	92.9	83.4	271.0	240.1
Specialty insurance	56.7	60.6	171.5	182.5
Total insurance segments	266.0	261.4	790.8	774.7
Investment operations segment				
Net investment income	18.8	17.2	55.4	55.2
Net realized capital gains	7.5	7.0	15.7	20.8
Total investment operations segment	26.3	24.2	71.1	76.0
All other	0.4	0.8	1.4	2.7
Total revenues from external sources	292.7	286.4	863.3	853.4
Intersegment revenues:	1.4	5.6	4.0	10.3
Total revenues	294.1	292.0	867.3	863.7
Reconciling items:				
Eliminate intersegment revenues	(1.4	) (5.6	) (4.0	) (10.3
Total consolidated revenues	\$ 292.7	\$ 286.4	\$ 863.3	\$ 853.4
Segment (loss) income before federal income tax:				
Insurance segments SAP underwriting (loss) income				
Personal insurance	\$ (6.0	) \$ 2.9	\$ (11.5	) \$ (8.8
Business insurance	(1.1	) (7.4	) (11.0	) (40.8
Specialty insurance	3.1	(25.1	) (4.6	) (37.4
Total insurance segments	(4.0	) (29.6	) (27.1	) (87.0
Investment operations segment				
Net investment income	18.8	17.2	55.4	55.2
Net realized capital gains	7.5	7.0	15.7	20.8
Total investment operations segment	26.3	24.2	71.1	76.0
All other	—	0.3	0.8	1.4
Total segment income (loss) before tax expense (benefit)	22.3	(5.1	) 44.8	(9.6
Reconciling items:				
GAAP expense adjustments	(0.4	) 2.4	11.4	7.7
Interest expense on corporate debt	(1.6	) (1.8	) (7.1	) (5.3
Corporate expenses	(1.6	) (1.1	) (4.1	) (3.1
Total reconciling items	(3.6	) (0.5	) 0.2	(0.7
Total consolidated income (loss) before federal income tax expense (benefit)	\$ 18.7	\$ (5.6	) \$ 45.0	\$ (10.3

Investable assets attributable to the Company's investment operations segment totaled \$2,301.5 million and \$2,327.4 million at September 30, 2013 and December 31, 2012, respectively.



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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

11. Contingencies and Litigation

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

The following describes a pending legal proceeding, other than routine litigation incidental to our business, to which State Auto Financial or any of its subsidiaries is a party or to which any of its or their property is subject:

In April 2013, a putative class action lawsuit (Schumacher vs. State Automobile Mutual Insurance Company, et al.) was filed against State Auto Mutual, State Auto Financial and State Auto P&C in Federal District Court in Ohio. Plaintiffs claim that in connection with the homeowners policies of various State Auto companies, the coverage limits and premiums were improperly increased as a result of an insurance to value ("ITV") program and Plaintiffs allege that they purchased coverage in excess of that which was necessary to insure them in the event of loss. Plaintiffs' claims include breach of good faith and fair dealing, negligent misrepresentation and fraud, violation of the Ohio Deceptive Trade Practices Act, and fraudulent inducement. Plaintiffs are seeking class certification and compensatory and punitive damages to be determined by the court. The Company intends to deny any and all liability to plaintiffs or the alleged class and to vigorously defend this lawsuit.

The Company is involved in other lawsuits arising in the ordinary course of our business operations arising out of or otherwise related to our insurance policies. Additionally, from time to time the Company may be involved in lawsuits arising 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 or cash flow positions.

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 financial or cash flow position.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation

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

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

For a glossary of terms for State Auto Financial Corporation and its subsidiaries and affiliates and a glossary of selected insurance and accounting terms, see the section entitled "Important Defined Terms Used in this Form 10-K" included in our Annual Report on Form 10-K for the year ended December 31, 2012 (the "2012 Form 10-K").

The discussion and analysis presented below relates to the material changes in financial condition and results of operations for our consolidated balance sheets as of September 30, 2013 and December 31, 2012, and for the consolidated statements of income for the three and nine month periods ended September 30, 2013 and 2012. This discussion and analysis should be read together with "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in the 2012 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 2012 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. 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 2012 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.

The Company has four reportable segments: personal insurance, business insurance, specialty insurance and investment operations. The reportable insurance segments are business units managed separately because of the differences in the type of customers they serve 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 personal insurance segment provides primarily personal automobile and homeowners to the personal insurance market. The business insurance segment provides primarily commercial automobile, commercial multi-peril, fire & allied and general liability insurance covering small-to-medium sized commercial exposures in the business insurance market. Effective January 1, 2013, the units within the specialty insurance segment changed from the three units of RED, Rockhill and Workers' Compensation to the four units of Excess & Surplus property, Excess & Surplus casualty, Programs and Workers' compensation. The specialty insurance segment provides commercial coverages that require specialized product underwriting, claims handling or risk management services through a distribution channel of retail agents and wholesale brokers, which may include program administrators and other specialty sources. The investment operations segment, managed by Stateco, provides investment services. See "Personal and Business Insurance" and "Specialty Insurance" in Item 1 of the 2012 Form 10-K for more information about our insurance segments. Financial information about our reportable segments for 2013 is set forth in Note 10 of our condensed consolidated financial statements included in Item 1 of this Form 10-Q.

POOLING ARRANGEMENT

The STFC Pooled Companies and the Mutual Pooled Companies participate in a quota share reinsurance pooling arrangement referred to as the "Pooling Arrangement." Under the Pooling Arrangement, State Auto Mutual assumes premiums, losses and expenses from each of the Pooled Companies and in turn cedes to each of the Pooled Companies a specified portion of premiums, losses and expenses based on each of the Pooled Companies' respective pooling percentages. State Auto Mutual then retains the balance of the pooled business.

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

The following table sets forth the participants and their participation percentages in the Pooling Arrangement since January 1, 2012:

## 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	34.0	%
SA Wisconsin	—	
Meridian Security	—	
Meridian Citizens Mutual	0.5	
Patrons Mutual <sup>(1)</sup>	0.5	
RIC	—	
Plaza	—	
American Compensation	—	
Bloomington Compensation	—	
Total State Auto Mutual Pooled Companies	35.0	

Includes the pooling participation percentage of Litchfield which was merged into Patrons Mutual as of the close (1) of business on March 31, 2013. Litchfield's pooling participation percentage was 0.1% from January 1, 2012 to March 31, 2013

## RESULTS OF OPERATIONS

Our net income for the three and nine months ended September 30, 2013 was \$18.5 million and \$44.4 million, respectively, compared to net losses of \$5.5 million and \$10.2 million, respectively, for the same 2012 periods. The improvement for the three and nine months ended September 30, 2013 was primarily due to improved loss experience, both catastrophe and non-catastrophe, when compared to the same 2012 periods. Year over year results have also been favorably impacted by the termination of business previously written through the former RED unit in our specialty insurance segment.



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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

The following table sets forth certain key performance indicators we use to monitor our operations for the three and nine months ended September 30, 2013 and 2012:

(\$ millions, except per share amounts)	Three months ended September 30		Nine months ended September 30	
	2013	2012	2013	2012
GAAP Basis:				
Total revenues	\$292.7	286.4	\$863.3	853.4
Net income (loss)	\$18.5	(5.5 )	\$44.4	(10.2 )
Basic earnings (loss) per share	\$0.46	(0.14 )	\$1.09	(0.25 )
Diluted earnings (loss) per share	\$0.45	(0.14 )	\$1.09	(0.25 )
Stockholders' equity	\$734.0	739.1		
Return on average equity (LTM)	8.9	% 13.6		
Book value per share	\$18.07	18.30		
Debt to capital ratio	12.1	13.6		
Cat loss and ALAE ratio	2.4	2.8	4.1	7.9
Non-cat loss and LAE ratio	64.8	74.3	63.9	68.8
Loss and LAE ratio	67.2	77.1	68.0	76.7
Expense ratio	34.2	33.1	33.7	33.3
Combined ratio	101.4	110.2	101.7	110.0
Premium written growth	(2.3 )	% (29.1 )	1.3	% (29.9 )
Investment yield	3.5	% 3.2	3.5	% 3.4
	Three months ended September 30		Nine months ended September 30	
SAP Basis :	2013	2012	2013	2012
Cat loss and ALAE points	2.4	2.8	4.1	7.9
Non-cat loss and ALAE	58.7	68.9	57.8	62.2
ULAE	6.4	5.4	6.4	6.7
Loss and LAE ratio	67.5	77.1	68.3	76.8
Expense ratio	34.9	33.7	34.3	33.4
Combined ratio	102.4	110.8	102.6	110.2
			Twelve Months Ended September 30	
			2013	2012
Net premiums written to surplus			1.6	1.7

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

## Homeowners Quota Share Arrangement

To reduce risk and volatility in our homeowners book of business, while at the same time providing us with additional catastrophe reinsurance protection, the State Auto Group entered into a quota share reinsurance agreement on December 31, 2011 with a syndicate of unaffiliated reinsurers covering its homeowners book of business (the "HO QS Arrangement"). Under the HO QS Arrangement, the State Auto Group ceded to the reinsurers 75% of its homeowners business under policies in force at December 31, 2011 and new and renewal policies thereafter issued during the term of the agreement. The HO QS Arrangement is in effect until December 31, 2014. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources – Reinsurance Arrangements" in Item 7 of the 2012 Form 10-K for a discussion of the HO QS Arrangement.

The following tables set forth, on a GAAP and pro forma basis, certain of our key performance indicators before and after the impact of the HO QS Arrangement cession for the three and nine months ended September 30, 2013 and 2012.

## Reconciliation Table 1

(\$ millions)	GAAP HO QS Arrangement Cession - Overall Results			
	As Reported	HO QS Cession	Pro-Forma without HO QS Cession	
Three months ended September 30, 2013				
Net written premiums	\$ 259.9	\$ 48.6	\$ 308.5	
Earned premiums	266.0	43.9	309.9	
Losses and LAE incurred:				
Cat loss and ALAE	6.4	5.0	11.4	
Non-cat loss and LAE	172.4	16.2	188.6	
Total Loss and LAE incurred	178.8	21.2	200.0	
Acquisition and operating expenses	90.9	12.7	103.6	
Net underwriting (loss) gain	\$ (3.7 )	\$ 10.0	\$ 6.3	
Cat loss and ALAE ratio	2.4	% 11.3	% 3.7	%
Non-cat loss and LAE ratio	64.8	% 36.9	% 60.8	%
Total Loss and LAE ratio	67.2	% 48.2	% 64.5	%
Expense ratio	34.2	% 29.0	% 33.4	%
Combined ratio	101.4	% 77.2	% 97.9	%

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

## Reconciliation Table 2

(\$ millions)	GAAP HO QS Arrangement Cession - Overall Results			Pro-Forma without HO QS Cession
	As Reported	HO QS Cession	Cession	
Nine months ended September 30, 2013				
Net written premiums	\$ 808.7	\$ 135.9		\$ 944.6
Earned premiums	790.8	132.8		923.6
Losses and LAE incurred:				
Cat loss and ALAE	32.2	19.2		51.4
Non-cat loss and LAE	505.7	55.5		561.2
Total Loss and LAE incurred	537.9	74.7		612.6
Acquisition and operating expenses	266.7	38.5		305.2
Net underwriting (loss) gain	\$ (13.8 )	\$ 19.6		\$ 5.8
Cat loss and ALAE ratio	4.1	% 14.5	% 5.6	%
Non-cat loss and LAE ratio	63.9	% 41.8	% 60.7	%
Total Loss and LAE ratio	68.0	% 56.3	% 66.3	%
Expense ratio	33.7	% 29.0	% 33.0	%
Combined ratio	101.7	% 85.3	% 99.3	%

## Reconciliation Table 3

(\$ millions)	GAAP HO QS Arrangement Cession - Overall Results			Pro-Forma without HO QS Cession
	As Reported	HO QS Cession	Cession	
Three months ended September 30, 2012				
Net written premiums	\$ 266.0	\$ 47.5		\$ 313.5
Earned premiums	261.4	42.4		303.8
Losses and LAE incurred:				
Cat loss and ALAE	7.2	0.1		7.3
Non-cat loss and LAE	194.2	17.0		211.2
Total Loss and LAE incurred	201.4	17.1		218.5
Acquisition and operating expenses	86.4	12.2		98.6
Net underwriting (loss) gain	\$ (26.4 )	\$ 13.1		\$ (13.3 )
Cat loss and ALAE ratio	2.8	% 0.2	% 2.4	%
Non-cat loss and LAE ratio	74.3	% 40.1	% 69.5	%
Total Loss and LAE ratio	77.1	% 40.3	% 71.9	%
Expense ratio	33.1	% 29.0	% 32.5	%
Combined ratio	110.2	% 69.3	% 104.4	%



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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

## Reconciliation Table 4

(\$ millions)	GAAP HO QS Arrangement Cession - Overall Results			Pro-Forma without HO QS	
	As Reported	HO QS Cession	Cession	Cession	
Nine months ended September 30, 2012					
Net written premiums	\$ 798.7	\$ 131.4		\$ 930.1	
Earned premiums	774.7	125.9		900.6	
Losses and LAE incurred:					
Cat loss and ALAE	61.2	47.5		108.7	
Non-cat loss and LAE	533.2	60.4		593.6	
Total Loss and LAE incurred	594.4	107.9		702.3	
Acquisition and operating expenses	257.6	36.5		294.1	
Net underwriting loss	\$ (77.3 )	\$ (18.5 )		\$ (95.8 )	
Cat loss and ALAE ratio	7.9	% 37.7		% 12.1	%
Non-cat loss and LAE ratio	68.8	% 48.0		% 65.9	%
Total Loss and LAE ratio	76.7	% 85.7		% 78.0	%
Expense ratio	33.3	% 29.0		% 32.7	%
Combined ratio	110.0	% 114.7		% 110.7	%

The following tables set forth, on a SAP and pro forma basis, certain of our key performance indicators before and after the impact of the HO QS Arrangement cession for the three and nine months ended September 30, 2013 and 2012.

## Reconciliation Table 5

(\$ millions)	SAP HO QS Arrangement Cession - Overall Results			Pro-Forma without HO QS	
	As Reported	HO QS Cession	Cession	Cession	
Three months ended September 30, 2013					
Net written premiums	\$ 259.9	\$ 48.6		\$ 308.5	
Earned premiums	266.0	43.9		309.9	
Losses and LAE incurred:					
Cat loss and ALAE	6.4	5.0		11.4	
Non-cat loss and ALAE	155.9	16.2		172.1	
Total Loss and ALAE	162.3	21.2		183.5	
ULAE	17.1	—		17.1	
Total Loss and ALAE incurred	179.4	21.2		200.6	
Underwriting expenses	90.6	14.1		104.7	
Net underwriting (loss) gain	\$ (4.0 )	\$ 8.6		\$ 4.6	
Cat loss and ALAE ratio	2.4	% 11.3		% 3.7	%
Non-cat loss and ALAE ratio	58.7	% 36.9		% 55.6	%
Total loss and ALAE ratio	61.1	% 48.2		% 59.3	%

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ULAE ratio	6.4	% —	5.5	%
Total loss and LAE ratio	67.5	% 48.2	% 64.8	%
Expense ratio	34.9	% 29.0	% 33.9	%
Combined ratio	102.4	% 77.2	% 98.7	%

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

## Reconciliation Table 6

(\$ millions)	SAP HO QS Arrangement Cession - Overall Results			Pro-Forma without HO QS	
	As Reported	HO QS Cession	Cession	Cession	
Nine months ended September 30, 2013					
Net written premiums	\$ 808.7	\$ 135.9		\$ 944.6	
Earned premiums	790.8	132.8		923.6	
Losses and LAE incurred:					
Cat loss and ALAE	32.2	19.2		51.4	
Non-cat loss and ALAE	457.2	55.5		512.7	
Total Loss and ALAE	489.4	74.7		564.1	
ULAE	50.8	—		50.8	
Total Loss and ALAE incurred	540.2	74.7		614.9	
Underwriting expenses	277.7	39.4		317.1	
Net underwriting (loss) gain	\$(27.1 )	\$ 18.7		\$(8.4 )	
Cat loss and ALAE ratio	4.1	% 14.5		% 5.6	%
Non-cat loss and ALAE ratio	57.8	% 41.8		% 55.5	%
Total loss and ALAE ratio	61.9	% 56.3		% 61.1	%
ULAE ratio	6.4	% —		5.5	%
Total loss and LAE ratio	68.3	% 56.3		% 66.6	%
Expense ratio	34.3	% 29.0		% 33.6	%
Combined ratio	102.6	% 85.3		% 100.2	%

## Reconciliation Table 7

(\$ millions)	SAP HO QS Arrangement Cession - Overall Results			Pro-Forma without HO QS	
	As Reported	HO QS Cession	Cession	Cession	
Three months ended September 30, 2012					
Net written premiums	\$ 266.0	\$ 47.5		\$ 313.5	
Earned premiums	261.4	42.4		303.8	
Losses and LAE incurred:					
Cat loss and ALAE	7.2	0.1		7.3	
Non-cat loss and ALAE	180.3	17.0		197.3	
Total Loss and ALAE	187.5	17.1		204.6	
ULAE	14.0	—		14.0	
Total Loss and ALAE incurred	201.5	17.1		218.6	
Underwriting expenses	89.5	13.7		103.2	
Net underwriting (loss) gain	\$(29.6 )	\$ 11.6		\$(18.0 )	
Cat loss and ALAE ratio	2.8	% 0.2		% 2.4	%
Non-cat loss and ALAE ratio	68.9	% 40.1		% 64.9	%

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Total loss and ALAE ratio	71.7	% 40.3	% 67.3	%
ULAE ratio	5.4	% —	4.6	%
Total loss and LAE ratio	77.1	% 40.3	% 71.9	%
Expense ratio	33.7	% 29.0	% 32.9	%
Combined ratio	110.8	% 69.3	% 104.8	%

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## STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

## Reconciliation Table 8

(\$ millions)	SAP HO QS Arrangement Cession - Overall Results			
	As Reported	HO QS Cession	Pro-Forma without HO QS Cession	
Nine months ended September 30, 2012				
Net written premiums	\$798.7	\$ 131.4	\$ 930.1	
Earned premiums	774.7	125.9	900.6	
Losses and LAE incurred:				
Cat loss and ALAE	61.2	47.5	108.7	
Non-cat loss and ALAE	481.6	60.4	542.0	
Total Loss and ALAE	542.8	107.9	650.7	
ULAE	52.2	—	52.2	
Total Loss and ALAE incurred	595.0	107.9	702.9	
Underwriting expenses	266.7	38.1	304.8	
Net underwriting loss	\$(87.0)	) \$ (20.1)	) \$ (107.1)	
Cat loss and ALAE ratio	7.9	% 37.7	% 12.1	%
Non-cat loss and ALAE ratio	62.2	%		