State Auto Financial CORP
Form 10-Q
May 03, 2017

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

FORM 10-Q

ý **Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended March 31, 2017
or
¨ **Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from __________ to __________
Commission File Number 000-19289

STATE AUTO FINANCIAL CORPORATION

(Exact name of Registrant as specified in its charter)

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

Yes ý No ¨

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

Large accelerated filer ¨	Accelerated filer ý
Non-accelerated filer ¨	Smaller reporting company ¨
(Do not check if a smaller reporting company)	Emerging growth company ¨

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

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Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ¨ No ý
On April 28, 2017, the Registrant had 42,002,494 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 amounts)	**March 31, 2017** (unaudited)	December 31, 2016
Assets		
Fixed maturities, available-for-sale, at fair value (amortized cost $2,104.7 and $2,095.9, respectively)	**$ 2,123.5**	$ 2,109.3
Equity securities, available-for-sale, at fair value (cost $321.3 and $323.1, respectively)	**395.6**	382.8
Other invested assets, available-for-sale, at fair value (cost $25.5 and $25.5, respectively)	**48.1**	45.1
Other invested assets	**5.4**	5.4
Notes receivable from affiliate	**70.0**	70.0
Total investments	**2,642.6**	2,612.6
Cash and cash equivalents	**44.8**	51.1
Accrued investment income and other assets	**46.6**	40.0
Deferred policy acquisition costs (affiliated net assumed $47.6 and $50.7, respectively)	**124.0**	129.8
Reinsurance recoverable on losses and loss expenses payable	**4.8**	3.6
Prepaid reinsurance premiums	**6.0**	6.1
Due from affiliate	**1.1**	—
Current federal income taxes	**6.8**	6.7
Net deferred federal income taxes	**94.9**	102.1
Property and equipment, at cost	**7.3**	7.4
Total assets	**$ 2,978.9**	$ 2,959.4
Liabilities and Stockholders' Equity		
Losses and loss expenses payable (affiliated net assumed $646.8 and $630.9, respectively)	**$ 1,217.3**	$ 1,181.6
Unearned premiums (affiliated net assumed $222.2 and $220.9, respectively)	**606.5**	617.8
Notes payable (affiliates $15.2 and $15.2, respectively)	**122.1**	122.1
Postretirement and pension benefits (affiliated net ceded $38.3 and $40.1, respectively)	**71.2**	74.4
Due to affiliate	**—**	2.4
Other liabilities (affiliated net assumed $16.5 and $11.0, respectively)	**60.7**	69.8
Total liabilities	**2,077.8**	2,068.1
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; 48.8 and 48.6 shares issued, respectively, at stated value of $2.50 per share	**121.9**	121.6
Treasury stock, 6.9 and 6.8 shares, respectively, at cost	**(116.7)**	(116.5)
Additional paid-in capital	**162.6**	159.9
Accumulated other comprehensive income (affiliated net ceded $52.8 and $53.7, respectively)	**47.9**	32.5
Retained earnings	**685.4**	693.8
Total stockholders' equity	**901.1**	891.3
Total liabilities and stockholders' equity	**$ 2,978.9**	$ 2,959.4

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)	Three months ended March 31	
(unaudited)	**2017**	2016
Earned premiums (affiliated net assumed $114.8 and $113.4, respectively)	**$317.3**	$319.9
Net investment income (affiliates $1.2 and $1.2, respectively)	**18.7**	17.4
Net realized gains on investments:		
Total other-than-temporary impairment losses	**(2.1)**	(3.7)
Other net realized investment gains	**9.9**	5.0
Total net realized gains on investments	**7.8**	1.3
Other income from affiliates	**0.5**	0.6
Total revenues	**344.3**	339.2
Losses and loss expenses (affiliated net assumed $86.2 and $93.7, respectively)	**234.0**	225.0
Acquisition and operating expenses (affiliated net assumed $80.3 and $70.6, respectively)	**112.2**	107.5
Interest expense (affiliates $0.2 and $0.2, respectively)	**1.4**	1.3
Other expenses	**1.9**	1.6
Total expenses	**349.5**	335.4
(Loss) income before federal income taxes	**(5.2)**	3.8
Federal income tax (benefit) expense:		
Current	**(0.1)**	—
Deferred	**(1.0)**	0.8
Total federal income tax (benefit) expense	**(1.1)**	0.8
Net (loss) income	**$(4.1)**	$3.0
(Loss) earnings per common share:		
Basic	**$(0.10)**	$0.07
Diluted	**$(0.10)**	$0.07
Dividends paid per common share	**$0.10**	$0.10

See accompanying notes to condensed consolidated financial statements.

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

Consolidated Statements of Comprehensive Income

($ in millions, except per share amounts)	Three months ended March 31	
(unaudited)	**2017**	2016
Net (loss) income	**$(4.1)**	$3.0
Other comprehensive income, net of tax:		
Net unrealized holding gains on investments:		
Unrealized holding gains	**30.8**	37.0
Reclassification adjustments for gains realized in net income	**(7.8)**	(1.3)
Income tax expense	**(8.0)**	(12.5)
Total net unrealized holding gains on investments	**15.0**	23.2
Net unrecognized benefit plan obligations:		
Reclassification adjustments for amortization to statements of income:		
Negative prior service cost	**(1.4)**	(1.4)
Net actuarial loss	**2.1**	2.4
Income tax expense	**(0.3)**	(0.4)
Total net unrecognized benefit plan obligations	**0.4**	0.6
Other comprehensive income	**15.4**	23.8
Comprehensive income	**$11.3**	$26.8

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 Cash Flows

($ in millions)	Three months ended March 31	
(unaudited)	**2017**	2016
Cash flows from operating activities:		
Net (loss) income	**$(4.1)**	$3.0
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization, net	**3.1**	4.4
Share-based compensation	**1.7**	1.4
Net realized gains on investments	**(7.8)**	(1.3)
Changes in operating assets and liabilities:		
Deferred policy acquisition benefits	**5.8**	1.6
Accrued investment income and other assets	**(0.5)**	(3.7)
Postretirement and pension benefits	**(2.9)**	(1.8)
Other liabilities and due to/from affiliates, net	**(14.0)**	4.9
Reinsurance recoverable on losses and loss expenses payable and prepaid reinsurance premiums	**(1.1)**	(0.1)
Losses and loss expenses payable	**35.7**	30.5
Unearned premiums	**(11.3)**	(15.5)
Federal income taxes	**(0.9)**	1.1
Net cash provided by operating activities	**3.7**	24.5
Cash flows from investing activities:		
Purchases of fixed maturities available-for-sale	**(120.5)**	(160.6)
Purchases of equity securities available-for-sale	**(39.0)**	(30.8)
Purchases of other invested assets	**(0.2)**	(0.4)
Maturities, calls and pay downs of fixed maturities available-for-sale	**54.1**	60.8
Sales of fixed maturities available-for-sale	**50.7**	75.8
Sales of equity securities available-for-sale	**47.6**	23.6
Sales of other invested assets available-for-sale	**0.3**	0.2
Net cash used in investing activities	**(7.0)**	(31.4)
Cash flows from financing activities:		
Proceeds from issuance of common stock	**1.5**	0.8
Payments to acquire treasury stock	**(0.2)**	(0.2)
Payment of dividends	**(4.3)**	(4.1)
Net cash used in financing activities	**(3.0)**	(3.5)
Net decrease in cash and cash equivalents	**(6.3)**	(10.4)
Cash and cash equivalents at beginning of period	**51.1**	58.1
Cash and cash equivalents at end of period	**$44.8**	$47.7
Supplemental disclosures:		
Interest paid (affiliates $0.2 and $0.2, respectively)	**$1.4**	$1.3

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)
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 month period ended March 31, 2017, are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. The balance sheet at December 31, 2016, has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete financial statements.

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

Adoption of Recent Accounting Pronouncements

Improvements to Employee Share-Based Payment Accounting

The amendments in this guidance simplify the accounting for share-based payment award transactions including: income tax consequences, classification of awards as either equity or liabilities, classification of excess tax benefits, and classification on the statement of cash flows. The guidance is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The Company adopted this guidance prospectively at January 1, 2017. Prior periods were not adjusted and it did not have a material impact on the condensed consolidated financial statements for the thee month period ended March 31, 2017.

Pending Adoption of Recent Accounting Pronouncements

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

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES
(a majority-owned subsidiary of State Automobile Mutual Insurance Company)
Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

2. Investments

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

($ millions) **March 31, 2017**	Cost or amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
Fixed maturities:				
U.S. treasury securities and obligations of U.S. government agencies	**$441.3**	**$9.9**	**$(5.7)**	**$445.5**
Obligations of states and political subdivisions	**607.3**	**14.1**	**(2.3)**	**619.1**
Corporate securities	**431.6**	**6.3**	**(1.7)**	**436.2**
U.S. government agencies mortgage-backed securities	**624.5**	**7.9**	**(9.7)**	**622.7**
Total fixed maturities	**2,104.7**	**38.2**	**(19.4)**	**2,123.5**
Equity securities:				
Large-cap securities	**97.4**	**39.3**	**(0.2)**	**136.5**
Small-cap securities	**56.0**	**20.5**	**—**	**76.5**
Mutual and exchange traded funds	**167.9**	**14.8**	**(0.1)**	**182.6**
Total equity securities	**321.3**	**74.6**	**(0.3)**	**395.6**
Other invested assets	**25.5**	**22.6**	**—**	**48.1**
Total available-for-sale securities	**$2,451.5**	**$135.4**	**$(19.7)**	**$2,567.2**

($ millions) December 31, 2016	Cost or amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
Fixed maturities:				
U.S. treasury securities and obligations of U.S. government agencies	$401.9	$8.9	$(6.1)	$404.7
Obligations of states and political subdivisions	634.6	12.3	(3.2)	643.7
Corporate securities	445.7	6.1	(2.2)	449.6
U.S. government agencies mortgage-backed securities	613.7	8.5	(10.9)	611.3
Total fixed maturities	2,095.9	35.8	(22.4)	2,109.3
Equity securities:				
Large-cap securities	108.9	32.7	(2.6)	139.0
Small-cap securities	57.2	21.9	—	79.1
Mutual and exchange traded funds	157.0	8.5	(0.8)	164.7
Total equity securities	323.1	63.1	(3.4)	382.8
Other invested assets	25.5	19.6	—	45.1
Total available-for-sale securities	$2,444.5	$118.5	$(25.8)	$2,537.2

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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 March 31, 2017 and December 31, 2016:

($ millions, except # of positions)	Less than 12 months			12 months or more			Total		
March 31, 2017	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	**$257.0**	**$(5.7)**	**35**	**$—**	**$—**	**—**	**$257.0**	**$(5.7)**	**35**
Obligations of states and political subdivisions	**126.6**	**(2.3)**	**17**	**—**	**—**	**—**	**126.6**	**(2.3)**	**17**
Corporate securities	**114.0**	**(1.3)**	**17**	**15.7**	**(0.4)**	**3**	**129.7**	**(1.7)**	**20**
U.S. government agencies mortgage-backed securities	**347.5**	**(8.9)**	**49**	**20.0**	**(0.8)**	**9**	**367.5**	**(9.7)**	**58**
Total fixed maturities	**845.1**	**(18.2)**	**118**	**35.7**	**(1.2)**	**12**	**880.8**	**(19.4)**	**130**
Equity securities:									
Large-cap equity securities	**1.3**	**—**	**2**	**4.6**	**(0.2)**	**2**	**5.9**	**(0.2)**	**4**
Mutual and exchange traded funds	**2.4**	**(0.1)**	**1**	**—**	**—**	**—**	**2.4**	**(0.1)**	**1**
Total equity securities	**3.7**	**(0.1)**	**3**	**4.6**	**(0.2)**	**2**	**8.3**	**(0.3)**	**5**
Total temporarily impaired securities	**$848.8**	**$(18.3)**	**121**	**$40.3**	**$(1.4)**	**14**	**$889.1**	**$(19.7)**	**135**

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

The Company reviewed its investments at March 31, 2017, and determined that 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 months ended March 31, 2017 and 2016:

($ millions)	**2017**	2016
Equity securities:		
Large-cap securities	**$(1.5)**	$(0.2)
Small-cap securities	**(0.6)**	(1.2)
Fixed maturities:	**—**	(2.3)
Total other-than-temporary impairments	**$(2.1)**	$(3.7)

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 March 31, 2017:

($ millions)	Amortized cost	Fair value
Due in 1 year or less	**$ 52.1**	**$52.6**
Due after 1 year through 5 years	**540.6**	**546.7**
Due after 5 years through 10 years	**306.6**	**310.0**
Due after 10 years	**580.9**	**591.5**
U.S. government agencies mortgage-backed securities	**624.5**	**622.7**
Total	**$ 2,104.7**	**$2,123.5**

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

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

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES
(a majority-owned subsidiary of State Automobile Mutual Insurance Company)
Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

The following table sets forth the components of net investment income for the three months ended March 31, 2017 and 2016:

($ millions)	**2017**	2016
Fixed maturities	**$15.8**	$14.9
Equity securities	**1.7**	1.5
Cash and cash equivalents, and other	**1.5**	1.4
Investment income	**19.0**	17.8
Investment expenses	**0.3**	0.4
Net investment income	**$18.7**	$17.4

The Company’s current investment strategy does not rely on the use of derivative financial instruments.
Proceeds on sales of available-for-sale securities were $98.6 million and $99.6 million for the three months ended March 31, 2017, and 2016, respectively.
The following table sets forth the realized and unrealized holding gains (losses) on the Company’s investment portfolio for the three months ended March 31, 2017 and 2016:

($ millions)	**2017**	2016
Realized gains:		
Fixed maturities	**$0.3**	$1.5
Equity securities	**9.7**	4.1
Total realized gains	**10.0**	5.6
Realized losses:		
Equity securities:		
Sales	**(0.1)**	(0.6)
OTTI	**(2.1)**	(1.4)
Fixed maturities:		
OTTI	**—**	(2.3)
Total realized losses	**(2.2)**	(4.3)
Net realized gains on investments	**$7.8**	$1.3
Change in unrealized holding gains (losses), net of tax:		
Fixed maturities	**$5.4**	$36.2
Equity securities	**14.6**	(1.0)
Other invested assets	**3.0**	0.5
Deferred federal income tax liability	**(8.0)**	(12.5)
Change in net unrealized holding gains (losses), net of tax	**$15.0**	$23.2

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES
(a majority-owned subsidiary of State Automobile Mutual Insurance Company)
Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

3. Fair Value of Financial Instruments

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

- Level 1 includes observable inputs which reflect quoted prices for identical assets or liabilities in active markets at the measurement date.
- Level 2 includes observable inputs for assets or liabilities other than quoted prices included in Level 1, and it includes valuation techniques which use prices for similar assets and liabilities.
- Level 3 includes unobservable inputs which reflect the reporting entity's estimates of the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk).

The Company utilizes one nationally recognized pricing service to estimate the majority of its available-for-sale investment portfolio's fair value. The Company obtains one price per security and the processes and control procedures employed by the Company are designed to ensure the value is accurately recorded on an unadjusted basis. Through discussions with the pricing service, the Company gains an understanding of the methodologies used to price the different types of securities, that the data and the valuation methods utilized are appropriate and consistently applied, and that the assumptions are reasonable and representative of fair value. To validate the reasonableness of the valuations obtained from the pricing service, the Company compares to other fair value pricing information gathered from other independent pricing sources. At March 31, 2017, and December 31, 2016, the Company did not adjust any of the prices received from the pricing service.

Transfers between level categorizations may occur due to changes in the availability of market observable inputs. Transfers in and out of level categorizations are reported as having occurred at the beginning of the quarter in which the transfer occurred. There were no transfers between level categorizations during the three months ended March 31, 2017, and 2016.

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

Fixed Maturities

The Company utilizes a third party pricing service to estimate fair value measurements for the majority of its fixed maturities. The fair value estimate of the Company's fixed maturity investments are determined by evaluations that are based on observable market information rather than market quotes. Inputs to the evaluations include, but are not limited to, market prices from recently completed transactions and transactions of comparable securities, interest rate yield curves, credit spreads, and other market-observable information. The fixed maturity portfolio pricing obtained from the pricing service is reviewed for reasonableness. The Company regularly selects a random sample of security prices which are compared to one or more alternative pricing sources for reasonableness. Any discrepancies with the pricing are returned to the pricing service for further explanation and, if necessary, adjustments are made. To date, the Company has not identified any significant discrepancies in the pricing provided by its third party pricing service. Investments valued using these inputs include U.S. treasury securities and obligations of U.S. government agencies, obligations of states and political subdivisions, corporate securities (except for a security discussed below), and U.S. government agencies mortgage-backed securities. All unadjusted estimates of fair value for fixed maturities priced by the pricing service are included in the amounts disclosed in Level 2 of the hierarchy. If market inputs are unavailable, then no fair value is provided by the pricing service. For these securities, fair value is determined either by requesting brokers who are knowledgeable about these securities to provide a quote; or the Company internally determines the fair values by employing widely accepted pricing valuation models, and depending on the level of observable market inputs, renders the fair value estimate as Level 2 or Level 3. The Company holds one corporate fixed maturity security included in Level 3 and estimates its fair value using the present value of the future cash flows. Due to the limited amount of observable market information for this security, the Company includes the fair value estimate in Level 3.

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Equities

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

Other Invested Assets

Included in other invested assets is one international fund (“the fund”) that invests in equity securities of foreign issuers and is managed by a third party investment manager. The fund had a fair value of $38.4 million and $35.7 million at March 31, 2017, and December 31, 2016, respectively, which was determined using the fund’s net asset value. The Company employs procedures to assess the reasonableness of the fair value of the fund including obtaining and reviewing the fund’s audited financial statements. There are no unfunded commitments related to the fund. The Company may not sell its investment in the fund; however, the Company may redeem all or a portion of its investment in the fund at net asset value per share with the appropriate prior written notice. In accordance with Accounting Standard Codification 820-10, this investment is measured at fair value using the net asset value per share practical expedient and has not been classified in the fair value hierarchy. Fair values presented here are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the condensed consolidated balance sheets.

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

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES
(a majority-owned subsidiary of State Automobile Mutual Insurance Company)
Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

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

($ millions) **March 31, 2017**	Total	Level 1	Level 2	Level 3
Fixed maturities:				
U.S. treasury securities and obligations of U.S. government agencies	**$445.5**	**$—**	**$445.5**	**$—**
Obligations of states and political subdivisions	**619.1**	**—**	**619.1**	**—**
Corporate securities	**436.2**	**—**	**432.6**	**3.6**
U.S. government agencies mortgage-backed securities	**622.7**	**—**	**622.7**	**—**
Total fixed maturities	**2,123.5**	**—**	**2,119.9**	**3.6**
Equity securities:				
Large-cap securities	**136.5**	**136.5**	**—**	**—**
Small-cap securities	**76.5**	**76.5**	**—**	**—**
Mutual and exchange traded funds	**182.6**	**182.6**	**—**	**—**
Total equity securities	**395.6**	**395.6**	**—**	**—**
Other invested assets	**9.7**	**9.7**	**—**	**—**
Total available-for-sale investments	**$2,528.8**	**$405.3**	**$2,119.9**	**$3.6**

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

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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 months ended March 31, 2017, and the year ended December 31, 2016, separately for each major category of assets:

($ millions)	Fixed maturities
Balance at January 1, 2017	**$ 3.5**
Total realized gains – included in earnings	**—**
Total unrealized losses – included in other comprehensive income	**—**
Purchases	**0.1**
Sales	**—**
Transfers into Level 3	**—**
Transfers out of Level 3	**—**
Balance at March 31, 2017	**$ 3.6**

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

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 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, 2017, was $4.9 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.

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, 2017**			December 31, 2016		
	Carrying value	**Fair value**	**Interest rate**	Carrying value	Fair value	Interest rate
Notes receivable from affiliate	**$70.0**	**$74.3**	**7.00 %**	$70.0	$75.7	7.00 %

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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, 2017**			December 31, 2016		
	Carrying value	**Fair Value**	**Interest rate**	Carrying value	Fair value	Interest rate
FHLB Loan due 2021: issued $21.5, September 2016 with fixed interest	**$21.5**	**$21.0**	**1.73 %**	$21.5	$21.0	1.73 %
FHLB Loan due 2033: issued $85.0, July 2013 with fixed interest	**85.4**	**85.3**	**5.03 %**	85.4	85.6	5.03 %
Affiliate Subordinated Debentures due 2033: issued $15.5, May 2003 with variable interest	**15.2**	**15.2**	**5.25 %**	15.2	15.2	5.13 %
Total notes payable	**$122.1**	**$121.5**		$122.1	$121.8	

4. Losses and Loss Expenses Payable
The following table sets forth the activity in the liability for losses and loss expenses for the three months ended March 31, 2017 and 2016:

($ millions)	**2017**	2016
Losses and loss expenses payable, at beginning of period	**$1,181.6**	$1,053.0
Less: reinsurance recoverable on losses and loss expenses payable	**3.6**	5.9
Net balance at beginning of period	**1,178.0**	1,047.1
Incurred related to:		
Current year	**243.7**	215.4
Prior years	**(9.7)**	9.6
Total incurred	**234.0**	225.0
Paid related to:		
Current year	**60.1**	52.3
Prior years	**139.4**	142.8
Total paid	**199.5**	195.1
Net balance at end of period	**1,212.5**	1,077.0
Plus: reinsurance recoverable on losses and loss expenses payable	**4.8**	6.5
Losses and loss expenses payable, at end of period	**$1,217.3**	$1,083.5

The Company recorded favorable development related to prior years' loss and loss expense reserves for the three months ended March 31, 2017, of $9.7 million compared to adverse development of $9.6 million for the same 2016 period. Favorable development of prior years' unallocated loss adjustment expenses and catastrophe reserves were approximately $2.7 million and $2.2 million, respectively, of the 2017 development. Favorable development of prior accident years' non-catastrophe loss and ALAE reserves was primarily driven by the commercial insurance segment. The commercial insurance segment non-catastrophe loss and ALAE reserves contributed $7.6 million of favorable development in 2017, driven by other commercial, small commercial package and workers' compensation of $3.2 million, $2.0 million and $1.9 million, respectively. Favorable development in these lines was driven by lower than anticipated severity emerging from multiple accident years. Slightly offsetting the favorable development was adverse development in the personal insurance segment of $2.3 million , driven by homeowners' which contributed $2.8 million of adverse development, primarily from accident year 2016, which included three large losses that occurred in late 2016.

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Favorable development of catastrophe reserves was approximately $0.7 million for the three months ended March 31, 2016, and adverse development of unallocated loss adjustment expenses was $1.6 million for the same 2016 period. The specialty insurance segment non-catastrophe loss and ALAE reserves accounted for $4.9 million of adverse development, which was driven by programs with adverse development of $3.9 million. Adverse development in programs was primarily due to two programs with commercial auto exposures, both of which are in run-off. The personal insurance segment contributed $3.4 million of the adverse development, driven by personal auto which developed unfavorably by $3.2 million, primarily due to higher than anticipated bodily injury severity from the prior two accident years.

5. Reinsurance

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

The following table sets forth a summary of the Company's external reinsurance transactions, as well as reinsurance transactions with State Auto Mutual under the Pooling Arrangement, for the three months ended March 31, 2017 and 2016:

($ millions)	**2017**	2016
Premiums earned:		
Assumed from external insurers and reinsurers	**$1.1**	$1.4
Assumed under Pooling Arrangement	**317.3**	319.9
Ceded to external insurers and reinsurers	**(6.1)**	(6.8)
Ceded under Pooling Arrangement	**(202.5)**	(206.5)
Net assumed premiums earned	**$109.8**	$108.0
Losses and loss expenses incurred:		
Assumed from external insurers and reinsurers	**$1.6**	$1.1
Assumed under Pooling Arrangement	**234.4**	225.4
Ceded to external insurers and reinsurers	**(2.0)**	(1.9)
Ceded under Pooling Arrangement	**(148.2)**	(131.7)
Net assumed losses and loss expenses incurred	**$85.8**	$92.9

6. Income Taxes

The following table sets forth the reconciliation between actual federal income tax (benefit) expense and the amount computed at the indicated statutory rate for the three months ended March 31, 2017 and 2016:

($ millions)	**2017**		2016	
Amount at statutory rate	**$(1.8)**	**35.0 %**	$1.3	35.0 %
Tax-exempt interest and dividends received deduction	**(1.5)**	**29.1**	(2.0)	(52.8)
Other, net	**2.2**	**(42.4)**	1.5	37.8
Federal income tax (benefit) expense and effective rate	**$(1.1)**	**21.7 %**	$0.8	20.0 %

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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 months ended March 31, 2017 and 2016:

($ millions)	Pension		Postretirement	
	2017	2016	**2017**	2016
Service cost	**$1.7**	$1.6	**$—**	$—
Interest cost	**2.9**	2.9	**0.2**	0.2
Expected return on plan assets	**(4.2)**	(3.7)	**—**	—
Amortization of:				
Negative prior service cost	**—**	—	**(1.4)**	(1.4)
Net actuarial loss	**2.0**	2.3	**0.1**	0.1
Net periodic cost (benefit)	**$2.4**	$3.1	**$(1.1)**	$(1.1)

The Company contributed $3.3 million to its pension plan for the three months ended March 31, 2017, and expects to contribute an additional $6.5 million in 2017.

8. Other Comprehensive Income and Accumulated Other Comprehensive Income

The following table sets forth the changes in the Company's accumulated other comprehensive income component ("AOCI"), net of tax, for the three months ended March 31, 2017 and 2016:

($ millions)	Unrealized Gains and Losses on Available-for-Sale Securities	Benefit Plan Items	Total
Beginning balance at January 1, 2017	**$ 62.8**	**$ (30.3)**	**$32.5**
Other comprehensive income before reclassifications	**20.1**	**—**	**20.1**
Amounts reclassified from AOCI (a)	**(5.1)**	**0.4**	**(4.7)**
Net current period other comprehensive	**15.0**	**0.4**	**15.4**

income			
Ending balance at March 31, 2017	**$ 77.8**	**$ (29.9)**	**$ 47.9**
Beginning balance at January 1, 2016	$ 68.5	$ (30.9)	$ 37.6
Other comprehensive loss before reclassifications	24.0	—	24.0
Amounts reclassified from AOCI (a)	(0.8)	0.6	(0.2)
Net current period other comprehensive income	23.2	0.6	23.8
Ending balance at March 31, 2016	$ 91.7	$ (30.3)	$ 61.4

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

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The following table sets forth the reclassifications out of accumulated other comprehensive income, by component, to the Company's condensed consolidated statement of income for the three months ended March 31, 2017 and 2016:

($ millions)

Details about Accumulated Other Comprehensive Income Components	Three months ended March 31		Affected line item in the Condensed Consolidated Statements of Income
	2017	2016	
Unrealized gains on available for sale securities	**$7.8**	$1.3	Realized gain on sale of securities
	7.8	1.3	Total before tax
	(2.7)	(0.5)	Tax expense
	5.1	0.8	Net of tax
Amortization of benefit plan items			
Negative prior service cost	**1.4**	1.4	(b)
Net actuarial loss	**(2.1)**	(2.4)	(b)
	(0.7)	(1.0)	Total before tax
	0.3	0.4	Tax benefit
	(0.4)	(0.6)	Net of tax
Total reclassifications for the period	**$4.7**	$0.2	

(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).

9. Net (Loss) Earnings 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, 2017 and 2016:

($ and shares in millions, except per share amounts)	**2017**	2016
Numerator:		
Net (loss) income for basic (loss) earnings per common share	**$(4.1)**	$3.0
Denominator:		
Weighted average shares for basic net (loss) earnings per common share	**41.9**	41.4
Effect of dilutive share-based awards	**—**	0.4
Adjusted weighted average shares for diluted net (loss) earnings per common share	**41.9**	41.8
Basic net (loss) earnings per common share	**$(0.10)**	$0.07
Diluted net (loss) earnings per common share	**$(0.10)**	$0.07

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, 2017 and 2016:

(shares in millions)	**2017**	2016
Total number of antidilutive options and awards	**0.6**	1.7

10. Segment Information

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

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

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

Certain amounts previously reported within the commercial insurance segment due to immateriality and convenience, are now reported in the personal insurance segment. Prior reporting periods have been restated to conform to the new presentation.

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

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

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Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

The following table sets forth financial information regarding the Company's reportable segments for the three months ended March 31, 2017 and 2016:

($ millions)	**2017**	2016
Revenue from external sources:		
Insurance segments		
Personal insurance	**$152.7**	$153.5
Commercial insurance	**103.6**	111.4
Specialty insurance	**61.0**	55.0
Total insurance segments	**317.3**	319.9
Investment operations segment		
Net investment income	**18.7**	17.4
Net realized capital gains	**7.8**	1.3
Total investment operations segment	**26.5**	18.7
All other	**0.5**	0.6
Total revenue from external sources	**344.3**	339.2
Intersegment revenue	**1.5**	1.4
Total revenue	**345.8**	340.6
Reconciling items:		
Eliminate intersegment revenue	**(1.5)**	(1.4)
Total consolidated revenues	**$344.3**	$339.2
Segment income before federal income tax:		
Insurance segments SAP underwriting (loss) gain		
Personal insurance	**$(10.6)**	$4.4
Commercial insurance	**(4.9)**	(7.4)
Specialty insurance	**(8.6)**	(8.7)
Total insurance segments (loss) gain	**(24.1)**	(11.7)
Investment operations segment		
Net investment income	**18.7**	17.4
Net realized capital gains	**7.8**	1.3
Total investment operations segment	**26.5**	18.7
All other	**0.1**	0.1
Total segment income before tax expense	**2.5**	7.1
Reconciling items:		
GAAP expense adjustments	**(5.4)**	(1.2)
Interest expense on corporate debt	**(1.4)**	(1.3)
Corporate expenses	**(0.9)**	(0.8)
Total reconciling items	**(7.7)**	(3.3)
Total consolidated (loss) income before federal income tax expense	**$(5.2)**	$3.8

Investable assets attributable to the Company's investment operations segment totaled $2,687.4 million and $2,663.7 million at March 31, 2017, and December 31, 2016, respectively.

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 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, 2016 (the "2016 Form 10-K").

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

The discussion and analysis presented below includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements generally can be identified by the use of forward-looking terminology such as "may," "will," "expect," "intend," "estimate," "anticipate," "project," "believe" or "continue" or the negative thereof or variations thereon or similar terminology. Forward-looking statements speak only as of the date the statements were made available. Although we believe that the expectations reflected in forward-looking statements have a reasonable basis, we can give no assurance that these expectations will prove to be correct. Forward-looking statements are subject to risks and uncertainties that could cause actual events or results to differ materially from those expressed in or implied by the statements. For a discussion of the most significant risks and uncertainties that could cause our actual results to differ materially from those projected, see "Risk Factors" in Item 1A of the 2016 Form 10-K, updated by Part II, Item 1A of this Form 10-Q. Except to the limited extent required by applicable law, we undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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

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

Certain amounts previously reported within the commercial insurance segment due to immateriality and convenience, are now reported in the personal insurance segment. Prior reporting periods have been restated to conform to the new presentation.

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

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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	%

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RESULTS OF OPERATIONS

Our pre-tax loss for the three months ended March 31, 2017 was $5.2 million compared to pre-tax income of $3.8 million in 2016. The decrease was primarily due to an increase in catastrophe losses and acquisition and operating expenses when compared to the same 2016 period. While the number of weather events classified as catastrophes for the three months ended March 31, 2017 was flat compared to the same period of 2016, the 2017 events were more severe than those experienced in 2016. During the first quarter 2017, widespread storms impacted the Ohio Valley region, South Carolina, Texas, Mississippi and Georgia. The month of March was particularly severe as it accounted for nearly 80% of our catastrophe losses. Slightly more than half of the catastrophe losses for the quarter were in the homeowners line of business.

The following table sets forth certain key performance indicators we use to monitor our operations for the three months ended March 31, 2017 and 2016:

($ millions, except per share amounts)	**2017**	2016
GAAP Basis:		
Total revenues	**$344.3**	$339.2
(Loss) income before federal income taxes	**$(5.2)**	$3.8
Net (loss) income	**$(4.1)**	$3.0
Basic (loss) earnings per share	**$(0.10)**	$0.07
Diluted (loss) earnings per share	**$(0.10)**	$0.07
Stockholders’ equity	**$901.1**	$908.9
Return on average equity (LTM)	**1.5 %**	3.3 %
Book value per share	**$21.50**	$21.95
Debt to capital ratio	**11.9 %**	10.0 %
Cat loss and ALAE ratio	**10.8 %**	4.7 %
Non-cat loss and LAE ratio	**63.0 %**	65.6 %
Loss and LAE ratio	**73.8 %**	70.3 %
Expense ratio	**35.4 %**	33.6 %
Combined ratio	**109.2 %**	103.9 %
Premium written growth	**0.4 %**	(0.7)%
Investment yield	**3.0 %**	2.9 %
SAP Basis:		
Cat loss and ALAE ratio	**10.8 %**	4.7 %
Non-cat loss and ALAE ratio	**57.2 %**	59.2 %
ULAE ratio	**5.9 %**	6.6 %
Loss and LAE ratio	**73.9 %**	70.5 %
Expense ratio	**34.9 %**	34.8 %
Combined ratio	**108.8 %**	105.3 %

($ millions)	Twelve months ended March 31	
	2017	2016
Net premiums written to surplus	**1.5**	1.6

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Insurance Segments

We measure our top-line growth for our insurance segments based on net written premiums, which provide us with an indication of how well we are doing in terms of revenue growth before it is actually earned. Our policies provide a fixed amount of coverage for a stated period of time, often referred to as the “policy term.” As such, our written premiums are recognized as earned ratably over the policy term. The unearned portion of written premiums, called unearned premiums, is reflected on our balance sheet as a liability and represents our obligation to provide coverage for the unexpired term of the policies.

Insurance industry regulators require our insurance subsidiaries to report their financial condition and results of operations using SAP. We use SAP financial results, along with industry standard financial measures determined on a SAP basis and certain measures determined on a GAAP basis, to internally monitor the performance of our insurance segments and reward our employees.

One of the more significant differences between GAAP and SAP is that SAP requires all underwriting expenses to be expensed immediately and not deferred over the same period that the premium is earned. In converting SAP underwriting results to GAAP underwriting results, acquisition costs are deferred and amortized over the periods the related written premiums are earned. For a discussion of deferred acquisition costs, see “Critical Accounting Policies – Deferred Acquisition Costs” section included in Item 7 of our 2016 Form 10-K.

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

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The following tables set forth our insurance segments' SAP underwriting gain (loss) and SAP combined ratios for the three months ended March 31, 2017 and 2016:

($ in millions)

March 31, 2017	Personal	Commercial	Specialty	Total
Net written premiums	**$141.6**	**$ 100.2**	**$64.3**	**$306.1**
Net earned premiums	**152.7**	**103.6**	**61.0**	**317.3**
Losses and LAE incurred:				
Cat loss and ALAE	**24.6**	**7.5**	**2.2**	**34.3**
Non-cat loss and ALAE	**83.8**	**55.2**	**42.5**	**181.5**
Total Loss and ALAE	**108.4**	**62.7**	**44.7**	**215.8**
ULAE	**10.6**	**6.0**	**2.0**	**18.6**
Total Loss and LAE	**119.0**	**68.7**	**46.7**	**234.4**
Underwriting expenses	**44.3**	**39.8**	**22.9**	**107.0**
Net underwriting loss	**$(10.6)**	**$ (4.9)**	**$(8.6)**	**$(24.1)**
Cat loss and ALAE ratio	**16.1 %**	**7.3 %**	**3.6 %**	**10.8 %**
Non-cat loss and ALAE ratio	**54.9 %**	**53.2 %**	**69.6 %**	**57.2 %**
Total Loss and ALAE ratio	**71.0 %**	**60.5 %**	**73.2 %**	**68.0 %**
ULAE ratio	**6.9 %**	**5.8 %**	**3.5 %**	**5.9 %**
Total Loss and LAE ratio	**77.9 %**	**66.3 %**	**76.7 %**	**73.9 %**
Expense ratio	**31.3 %**	**39.6 %**	**35.5 %**	**34.9 %**
Combined ratio	**109.2 %**	**105.9 %**	**112.2 %**	**108.8 %**

($ in millions)

March 31, 2016	Personal	Commercial	Specialty	Total
Net written premiums	$142.3	$ 102.1	$60.4	$304.8
Net earned premiums	153.5	111.4	55.0	319.9
Losses and LAE incurred:				
Cat loss and ALAE	12.5	2.0	0.5	15.0
Non-cat loss and ALAE	81.2	70.5	37.8	189.5
Total Loss and ALAE	93.7	72.5	38.3	204.5
ULAE	11.5	7.0	2.4	20.9
Total Loss and LAE	105.2	79.5	40.7	225.4
Underwriting expenses	43.9	39.3	23.0	106.2
Net underwriting gain (loss)	$4.4	$ (7.4)	$(8.7)	$(11.7)
Cat loss and ALAE ratio	8.1 %	1.8 %	0.9 %	4.7 %
Non-cat loss and ALAE ratio	52.9 %	63.2 %	68.9 %	59.2 %
Total Loss and ALAE ratio	61.0 %	65.0 %	69.8 %	63.9 %
ULAE ratio	7.5 %	6.2 %	4.6 %	6.6 %
Total Loss and LAE ratio	68.5 %	71.2 %	74.4 %	70.5 %
Expense ratio	30.8 %	38.5 %	38.0 %	34.8 %
Combined ratio	99.3 %	109.7 %	112.4 %	105.3 %

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Personal Insurance Segment
The following tables set forth the SAP underwriting gain (loss) and SAP combined ratios by major product line for our personal insurance segment for the three months ended March 31, 2017 and 2016:
Table 1
($ in millions)

March 31, 2017	Personal Auto	Homeowners	Farm & Ranch	Other Personal	Total
Net written premiums	**$82.3**	**$ 45.2**	**$9.9**	**$ 4.2**	**$141.6**
Net earned premiums	**82.9**	**55.5**	**9.4**	**4.9**	**152.7**
Losses and LAE incurred:					
Cat loss and ALAE	**3.2**	**18.0**	**2.4**	**1.0**	**24.6**
Non-cat loss and ALAE	**55.8**	**22.9**	**3.5**	**1.6**	**83.8**
Total Loss and ALAE	**59.0**	**40.9**	**5.9**	**2.6**	**108.4**
ULAE	**4.7**	**4.7**	**0.7**	**0.5**	**10.6**
Total Loss and LAE	**63.7**	**45.6**	**6.6**	**3.1**	**119.0**
Underwriting expenses	**23.6**	**15.5**	**3.6**	**1.6**	**44.3**
Net underwriting (loss) gain	**$(4.4)**	**$ (5.6)**	**$(0.8)**	**$ 0.2**	**$(10.6)**
Cat loss and ALAE ratio	**3.9 %**	**32.5 %**	**25.6 %**	**18.9 %**	**16.1 %**
Non-cat loss and ALAE ratio	**67.4 %**	**41.2 %**	**37.4 %**	**34.0 %**	**54.9 %**
Total Loss and ALAE ratio	**71.3 %**	**73.7 %**	**63.0 %**	**52.9 %**	**71.0 %**
ULAE ratio	**5.6 %**	**8.5 %**	**7.1 %**	**9.0 %**	**6.9 %**
Total Loss and LAE ratio	**76.9 %**	**82.2 %**	**70.1 %**	**61.9 %**	**77.9 %**
Expense ratio	**28.7 %**	**34.3 %**	**36.6 %**	**38.6 %**	**31.3 %**
Combined ratio	**105.6 %**	**116.5 %**	**106.7%**	**100.5 %**	**109.2 %**

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Table 2
($ in millions)

March 31, 2016	Personal Auto	Homeowners	Farm & Ranch	Other Personal	Total
Net written premiums	$80.5	$ 48.1	$9.0	$4.7	$142.3
Net earned premiums	82.3	57.3	8.6	5.3	153.5
Losses and LAE incurred:					
Cat loss and ALAE	1.3	10.6	0.4	0.2	12.5
Non-cat loss and ALAE	56.0	18.8	3.3	3.1	81.2
Total Loss and ALAE	57.3	29.4	3.7	3.3	93.7
ULAE	6.3	4.3	0.5	0.4	11.5
Total Loss and LAE	63.6	33.7	4.2	3.7	105.2
Underwriting expenses	22.4	16.3	3.2	2.0	43.9
Net underwriting (loss) gain	$(3.7)	$ 7.3	$1.2	$(0.4)	$4.4
Cat loss and ALAE ratio	1.6 %	18.5 %	4.5 %	3.4 %	8.1 %
Non-cat loss and ALAE ratio	68.0 %	32.8 %	38.5 %	58.3 %	52.9 %
Total Loss and ALAE ratio	69.6 %	51.3 %	43.0 %	61.7 %	61.0 %
ULAE ratio	7.6 %	7.6 %	6.1 %	7.6 %	7.5 %
Total Loss and LAE ratio	77.2 %	58.9 %	49.1 %	69.3 %	68.5 %
Expense ratio	27.9 %	33.8 %	36.4 %	40.1 %	30.8 %
Combined ratio	105.1 %	92.7 %	85.5 %	109.4 %	99.3 %

The personal insurance segment's net written premiums for the three months ended March 31, 2017, decreased slightly compared to the same 2016 period (Tables 1 - 2). Rate actions implemented on our personal auto product throughout 2016 to improve profitability contributed to overall net written premium growth, despite a decline in policies in force. Personal auto new business counts were up for the first quarter 2017 when compared to the same 2016 period. Homeowners net written premium declined for the first quarter 2017 reflecting lower new business counts and policies in force when compared to the same 2016 period. Growth in farm & ranch continued, with increases in both net written premium and policies in force compared to the same 2016 period. Throughout 2016, we increased the number of personal lines agency appointments and conducted pricing reviews designed to improve personal lines production.

The personal insurance segment's SAP catastrophe loss ratio for the three months ended March 31, 2017, was 16.1% compared to 8.1% for the same 2016 period (Tables 1 - 2). The personal insurance segment's SAP catastrophe loss ratio was impacted by the catastrophe events discussed above.

The personal insurance segment’s SAP non-catastrophe loss and ALAE ratio for the three months ended March 31, 2017, was 54.9% compared to 52.9% for the same 2016 period (Tables 1 - 2). The 2.0 point increase in the SAP non-catastrophe loss and ALAE ratio for the three months ended March 31, 2017, compared to the same 2016 period was due to an 8.4 point increase in the homeowners SAP non-catastrophe loss and ALAE ratio. Homeowners results for the quarter were impacted by 5.1 points of adverse development of prior accident year loss and ALAE estimates, primarily from accident year 2016, which included three individual losses occurring in late 2016. The personal auto SAP non-catastrophe loss and ALAE ratio for the three months ended March 31, 2017, improved 0.6 points compared to the same 2016 period. The 2017 current accident year loss ratio for the three months ended March 31, 2017 increased 3.9 points compared to the current accident year loss ratio for the same 2016 period. Throughout 2016 we increased ultimate loss estimates for the 2016 accident year as severity trends continued to increase. The current accident year increase was offset by favorable development of prior accident year loss and ALAE estimates of 0.7 points compared to 3.8 points of adverse development of prior accident losses for the same 2016 period.

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Commercial Insurance Segment
The following tables set forth the SAP underwriting gain (loss) and SAP combined ratios by major product line for our commercial insurance segment the three months ended March 31, 2017 and 2016:
Table 3
($ in millions)

March 31, 2017	Commercial Auto	Small Commercial Package	Middle Market Commercial	Workers' Comp	Other Commercial	Total
Net written premiums	**$ 18.4**	**$ 30.5**	**$ 25.8**	**$ 21.7**	**3.8**	**$ 100.2**
Net earned premiums	**19.5**	**31.3**	**27.0**	**21.5**	**4.3**	**103.6**
Losses and LAE incurred:						
Cat loss and ALAE	**0.3**	**4.1**	**3.1**	**—**	**—**	**7.5**
Non-cat loss and ALAE	**12.9**	**13.7**	**17.0**	**12.7**	**(1.1)**	**55.2**
Total Loss and ALAE	**13.2**	**17.8**	**20.1**	**12.7**	**(1.1)**	**62.7**
ULAE	**1.1**	**0.9**	**1.6**	**2.2**	**0.2**	**6.0**
Total Loss and LAE	**14.3**	**18.7**	**21.7**	**14.9**	**(0.9)**	**68.7**
Underwriting expenses	**7.6**	**13.3**	**10.0**	**6.9**	**2.0**	**39.8**
Net underwriting (loss) gain	**$ (2.4)**	**$ (0.7)**	**$ (4.7)**	**$ (0.3)**	**3.2**	**$ (4.9)**
Cat loss and ALAE ratio	**1.6 %**	**13.0 %**	**11.6 %**	**— %**	**— %**	**7.3 %**
Non-cat loss and ALAE ratio	**66.0 %**	**44.0 %**	**63.1 %**	**58.9 %**	**(25.5)%**	**53.2 %**
Total Loss and ALAE ratio	**67.6 %**	**57.0 %**	**74.7 %**	**58.9 %**	**(25.5)%**	**60.5 %**
ULAE ratio	**6.1 %**	**2.8 %**	**5.7 %**	**10.3 %**	**4.8 %**	**5.8 %**
Total Loss and LAE ratio	**73.7 %**	**59.8 %**	**80.4 %**	**69.2 %**	**(20.7)%**	**66.3 %**
Expense ratio	**41.2 %**	**43.5 %**	**38.5 %**	**31.9 %**	**51.7 %**	**39.6 %**
Combined ratio	**114.9 %**	**103.3 %**	**118.9 %**	**101.1 %**	**31.0 %**	**105.9 %**

Table 4
($ in millions)

March 31, 2016	Commercial Auto	Small Commercial Package	Middle Market Commercial	Workers' Comp	Other Commercial	Total
Net written premiums	$ 19.8	$ 31.3	$ 24.3	$ 22.8	$ 3.9	$ 102.1
Net earned premiums	23.7	32.2	28.2	23.0	4.3	111.4
Losses and LAE incurred:						
Cat loss and ALAE	0.1	1.2	0.7	—	—	2.0
Non-cat loss and ALAE	16.3	19.3	18.4	14.5	2.0	70.5
Total Loss and ALAE	16.4	20.5	19.1	14.5	2.0	72.5
ULAE	1.0	1.9	1.5	2.2	0.4	7.0
Total Loss and LAE	17.4	22.4	20.6	16.7	2.4	79.5
Underwriting expenses	7.4	12.5	10.7	7.0	1.7	39.3
Net underwriting (loss) gain	$ (1.1)	$ (2.7)	$ (3.1)	$ (0.7)	$ 0.2	$ (7.4)
Cat loss and ALAE ratio	0.6 %	3.8 %	2.3 %	— %	— %	1.8 %
Non-cat loss and ALAE ratio	68.8 %	59.8 %	65.3 %	62.9 %	46.9 %	63.2 %
Total Loss and ALAE ratio	69.4 %	63.6 %	67.6 %	62.9 %	46.9 %	65.0 %
ULAE ratio	4.3 %	5.6 %	5.3 %	9.8 %	6.8 %	6.2 %
Total Loss and LAE ratio	73.7 %	69.2 %	72.9 %	72.7 %	53.7 %	71.2 %
Expense ratio	37.2 %	40.0 %	44.0 %	30.7 %	43.6 %	38.5 %
Combined ratio	110.9 %	109.2 %	116.9 %	103.4 %	97.3 %	109.7 %

Net written premiums for the commercial insurance segment for the three months ended March 31, 2017, decreased 1.9% compared to the same 2016 period (Tables 3 - 4). The decrease was primarily driven by (i) our decision to exit larger account business, (ii) rate actions to improve profitability in commercial auto, and (iii) our focus on underwriting discipline. Despite these actions, new business premiums increased for the three months ended March 31, 2017, for commercial auto, small commercial package and middle market commercial compared to the same 2016 period due primarily to efforts undertaken in 2016 to (i) expand and strengthen our agency relationships, and (ii) reinforce our underwriting appetite for commercial exposures with our agency force.

The commercial insurance segment's SAP catastrophe loss and ALAE ratio for the three months ended March 31, 2017, was 7.3% compared to 1.8% for the same 2016 period (Tables 3 - 4). The commercial insurance segment's SAP catastrophe loss ratio was impacted by the catastrophe events discussed above.

The commercial insurance segment’s SAP non-catastrophe loss and ALAE ratio for the three months ended March 31, 2017, was 53.2% compared to 63.2% for the same 2016 period (Tables 3 - 4). The SAP non-catastrophe loss and ALAE ratio for the three months ended March 31, 2017, improved 10.0 points when compared to the same 2016 period, primarily driven by (i) favorable development of prior accident year losses compared to adverse development in the same 2016 period and (ii) pricing, underwriting and claims improvements implemented throughout the last 18 months, including improved risk classification, rate increases and reductions in claims leakage. The commercial auto ratio for the three months ended March 31, 2017, improved 2.8 points to 66.0% due to favorable development of prior accident year losses of $1.5 million. The small commercial package SAP non-catastrophe loss and ALAE ratio improved 15.8 points to 44.0% for the three months ended March 31, 2017, compared to the same 2016 period. The improvement was due to favorable development of prior accident year ultimate loss estimates of $2.0 million compared to adverse development of $1.0 million in the same 2016 period. The middle market commercial SAP non-catastrophe loss and ALAE ratio for the three months ended March 31, 2017, was 63.1% compared to 65.3% for the same 2016 period. The workers' compensation SAP non-catastrophe loss and ALAE ratio for the three months ended March 31, 2017, was 58.9% compared to 62.9% for the same 2016 period. The 4.0 point improvement was due to greater favorable development of prior accident year losses for the three months ended March 31, 2017, compared to the same 2016 period. While all accident years prior to 2016 developed favorably, the majority of the development was related to accident year 2015.

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Specialty Insurance Segment
The following tables set forth the SAP underwriting gain (loss) and SAP combined ratios by major product line for our specialty insurance segment for the three months ended March 31, 2017 and 2016:
Table 5
($ in millions)

March 31, 2017	E&S Property	E&S Casualty	Programs	Total
Net written premiums	**$ 9.2**	**$ 26.7**	**$ 28.4**	**$ 64.3**
Net earned premiums	**11.0**	**23.3**	**26.7**	**61.0**
Losses and LAE incurred:				
Cat loss and ALAE	**2.1**	**—**	**0.1**	**2.2**
Non-cat loss and ALAE	**3.3**	**17.4**	**21.8**	**42.5**
Total Loss and ALAE	**5.4**	**17.4**	**21.9**	**44.7**
ULAE	**(0.4)**	**1.0**	**1.4**	**2.0**
Total Loss and LAE	**5.0**	**18.4**	**23.3**	**46.7**
Underwriting expenses	**5.1**	**9.6**	**8.2**	**22.9**
Net underwriting gain (loss)	**$ 0.9**	**$ (4.7)**	**$ (4.8)**	**$ (8.6)**
Cat loss and ALAE ratio	**19.5 %**	**(0.1)%**	**0.4 %**	**3.6 %**
Non-cat loss and ALAE ratio	**29.7 %**	**74.6 %**	**81.6 %**	**69.6 %**
Total Loss and ALAE ratio	**49.2 %**	**74.5 %**	**82.0 %**	**73.2 %**
ULAE ratio	**(3.4)%**	**4.3 %**	**5.5 %**	**3.5 %**
Total Loss and LAE ratio	**45.8 %**	**78.8 %**	**87.5 %**	**76.7 %**
Expense ratio	**54.9 %**	**35.9 %**	**28.8 %**	**35.5 %**
Combined ratio	**100.7 %**	**114.7 %**	**116.3 %**	**112.2 %**

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Table 6
($ in millions)

March 31, 2016	E&S Property	E&S Casualty	Programs	Total
Net written premiums	$ 6.3	$ 22.1	$ 32.0	$ 60.4
Net earned premiums	9.8	20.2	25.0	55.0
Losses and LAE incurred:				
Cat loss and ALAE	0.4	—	0.1	0.5
Non-cat loss and ALAE	3.0	12.5	22.3	37.8
Total Loss and ALAE	3.4	12.5	22.4	38.3
ULAE	0.3	0.8	1.3	2.4
Total Loss and LAE	3.7	13.3	23.7	40.7
Underwriting expenses	4.5	7.8	10.7	23.0
Net underwriting gain (loss)	$ 1.6	$ (0.9)	$ (9.4)	$ (8.7)
Cat loss and ALAE ratio	4.4 %	— %	0.2 %	0.9 %
Non-cat loss and ALAE ratio	30.5 %	62.2 %	89.6 %	68.9 %
Total Loss and ALAE ratio	34.9 %	62.2 %	89.8 %	69.8 %
ULAE ratio	2.8 %	4.1 %	5.6 %	4.6 %
Total Loss and LAE ratio	37.7 %	66.3 %	95.4 %	74.4 %
Expense ratio	70.7 %	35.4 %	33.4 %	38.0 %
Combined ratio	108.4 %	101.7 %	128.8 %	112.4 %

Net written premiums for the specialty insurance segment for the three months ended March 31, 2017, increased 6.5% compared to the same 2016 period (Tables 5 - 6). The increase was primarily driven by new business growth in E&S property and E&S casualty slightly offset by lower programs net written premium as a result of our decision to exit program business. The expansion of our internal underwriting team in the fourth quarter of 2016 contributed to the E&S property growth. The growth within E&S casualty was primarily due to increased production from our umbrella and gas & propane distribution underwriting teams.
The specialty insurance segment’s SAP catastrophe loss and ALAE ratio for the three months ended March 31, 2017, increased 2.7 points compared to the same 2016 period (Tables 5 - 6). The specialty insurance segment's SAP catastrophe loss ratio was impacted by the catastrophe events discussed above.
The specialty insurance segment’s SAP non-catastrophe loss and ALAE ratio for the three months ended March 31, 2017, increased 0.7 points compared to the same 2016 period (Tables 5 - 6). During the first quarter 2017, ultimate loss estimates for prior accident years increased $0.5 million, compared to $4.9 million for the same 2016 period. Higher ultimate loss estimates for current accident year losses offset the improvement in prior accident year loss development. The higher ultimate loss estimates for the current accident year reflect higher severity from habitational risks within our general liability book.

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Losses and LAE Development
Losses and loss expenses represent the combined estimated ultimate liability for claims occurring in a period, along with any change in the estimated ultimate liability for claims occurring in prior periods.
The following table sets forth a tabular presentation of the development of the prior accident years ultimate liability by product for the three months ended March 31, 2017 and 2016:

($ millions)	Three months ended March 31		
	2017	2016	$ Change
	Redundancy /(Deficiency)		
Non-cat loss and ALAE:			
Personal Insurance Segment:			
Personal Auto	**$ 0.6**	$ (3.2)	$ 3.8
Homeowners	**(2.8)**	(0.1)	(2.7)
Farm & Ranch	**—**	0.1	(0.1)
Other Personal	**(0.1)**	(0.2)	0.1
Total Personal Insurance Segment	**(2.3)**	(3.4)	1.1
Commercial Insurance Segment:			
Commercial Auto	**1.5**	—	1.5
Small Commercial Package	**2.0**	(1.0)	3.0
Middle Market Commercial	**(1.0)**	(0.5)	(0.5)
Workers' Compensation	**1.9**	0.9	1.0
Other Commercial	**3.2**	0.2	3.0
Total Commercial Insurance Segment	**7.6**	(0.4)	8.0
Specialty Insurance Segment:			
E&S Property	**(0.4)**	(0.3)	(0.1)
E&S Casualty	**0.2**	(0.7)	0.9
Programs	**(0.3)**	(3.9)	3.6
Total Specialty Insurance Segment	**(0.5)**	(4.9)	4.4
Cat Loss and ALAE	**2.2**	0.7	1.5
ULAE	**2.7**	(1.6)	4.3
Total	**$ 9.7**	$ (9.6)	$ 19.3

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

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

($ millions)	**March 31, 2017**	December 31, 2016	$ Change
Personal Insurance Segment:			
Personal Auto	**$192.3**	$ 192.7	$ (0.4)
Homeowners	**64.5**	50.0	14.5
Farm & Ranch	**15.9**	14.3	1.6
Other Personal	**10.4**	8.8	1.6
Total Personal Insurance Segment	**283.1**	265.8	17.3
Commercial Insurance Segment:			
Commercial Auto	**100.4**	98.3	2.1
Small Commercial Package	**122.8**	126.2	(3.4)
Middle Market Commercial	**163.8**	157.7	6.1
Workers' Compensation	**188.3**	185.6	2.7
Other Commercial	**21.8**	23.4	(1.6)
Total Commercial Insurance Segment	**597.1**	591.2	5.9
Specialty insurance segment:			
E&S Property	**27.8**	29.8	(2.0)
E&S Casualty	**148.5**	137.4	11.1
Programs	**156.0**	153.8	2.2
Total Specialty Insurance Segment	**332.3**	321.0	11.3
Total losses and loss expenses payable, net of reinsurance recoverable on losses and loss expenses payable	**$1,212.5**	$ 1,178.0	$ 34.5

Losses and loss expenses payable increased $34.5 million since December 31, 2016, primarily due to exposure growth and higher current accident year loss estimates in E&S casualty and the first quarter 2017 catastrophe losses discussed above.
We conduct quarterly reviews of loss development reports and make judgments in determining the reserves for ultimate losses and loss expenses payable. Several factors are considered by us when estimating ultimate liabilities, including consistency in relative case reserve adequacy, consistency in claims settlement practices, recent legal developments, historical data, actuarial projections, accounting projections, exposure changes, anticipated inflation, current business conditions, catastrophe developments, late reported claims, and other reasonableness tests.
The risks and uncertainties inherent in our estimates include, but are not limited to, actual settlement experience different from historical data, trends, changes in business and economic conditions, court decisions creating unanticipated liabilities, ongoing interpretation of policy provisions by the courts, inconsistent decisions in lawsuits regarding coverage and additional information discovered before settlement of claims. Our results of operations and financial condition could be impacted, perhaps significantly, in the future if the ultimate payments required for claims settlement vary from the liability currently recorded. For a discussion of our reserving methodologies, see "Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies – Losses and Loss Expenses Payable" in Item 7 of the 2016 Form 10-K.

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Acquisition and Operating Expenses
Our GAAP acquisition and operating expense ratios was 35.4% for the three months ended March 31, 2017, compared to 33.6% for the same 2016 period. The 1.8 point increase when compared to the same 2016 period is primarily due to (i) the impact of our technology investments and (ii) a decrease in the deferral rate of certain underwriting expenses.

Investment Operations Segment
Our investments in fixed maturities, equity securities and certain other invested assets are reported as available-for-sale and carried at fair value. The unrealized holding gains or losses, net of applicable deferred taxes, are included as a separate component of stockholders' equity as accumulated other comprehensive income and as such are not included in the determination of net income.
We have investment policy guidelines with respect to purchasing fixed maturity investments for our insurance subsidiaries which preclude investments in bonds that are rated below investment grade by a recognized rating service at the time of purchase. Our fixed maturity portfolio is composed of high quality, investment grade issues, consisting primarily of debt issues rated AAA, AA or A. We obtain investment ratings from Moody's, Standard & Poor's and Fitch. If there is a split rating, we assign the lowest rating obtained. At March 31, 2017, there was one fixed maturity investments rated below investment grade in our available-for-sale investment portfolio.
For further discussion regarding the management of our investment portfolio, see "Management's Discussion and Analysis of Financial Condition and Results of Operations – Results of Operations – Investment Operations Segment" in Item 7 of the 2016 Form 10-K.
Composition of Investment Portfolio
The following table sets forth the composition of our investment portfolio at carrying value at March 31, 2017 and December 31, 2016:

($ millions)	**March 31, 2017**	**% of Total**	December 31, 2016	% of Total
Cash and cash equivalents	**$ 44.8**	**1.7**	$ 51.1	1.9
Fixed maturities, at fair value:				
Fixed maturities	**1,951.6**	**72.6**	1,947.5	73.1
Treasury inflation-protected securities	**171.9**	**6.4**	161.8	6.1
Total fixed maturities	**2,123.5**	**79.0**	2,109.3	79.2
Notes receivable from affiliate (a)	**70.0**	**2.6**	70.0	2.6

Equity securities, at fair value:				
Large-cap securities	**136.5**	**5.1**	139.0	5.2
Small-cap securities	**76.5**	**2.8**	79.1	3.0
Mutual and exchange traded funds	**182.6**	**6.8**	164.7	6.2
Total equity securities	**395.6**	**14.7**	382.8	14.4
Other invested assets, at fair value:				
International funds	**38.4**	**1.4**	35.7	1.3
Other invested assets	**9.7**	**0.4**	9.4	0.4
Total other invested assets, at fair value	**48.1**	**1.8**	45.1	1.7
Other invested assets, at cost	**5.4**	**0.2**	5.4	0.2
Total portfolio	**$ 2,687.4**	**100.0**	$ 2,663.7	100.0

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

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

The following table sets forth the amortized cost and fair value of available-for-sale fixed maturities by contractual maturity at March 31, 2017:

($ millions)	Amortized cost	Fair value
Due in 1 year or less	**$ 52.1**	**$52.6**
Due after 1 year through 5 years	**540.6**	**546.7**
Due after 5 years through 10 years	**306.6**	**310.0**
Due after 10 years	**580.9**	**591.5**
U.S. government agencies mortgage-backed securities	**624.5**	**622.7**
Total	**$ 2,104.7**	**$2,123.5**

Expected maturities may differ from contractual maturities as the issuers may have the right to call or prepay the obligations with or without call or prepayment penalties. The duration of the fixed maturity portfolio was approximately 4.65 and 4.45 as of March 31, 2017, and December 31, 2016, respectively.

Investment Operations Revenue

The following table sets forth the components of net investment income for the three months ended March 31, 2017 and 2016:

($ millions)	**2017**		2016	
Gross investment income:				
Fixed maturities	**$15.8**		$14.9	
Equity securities	**1.7**		1.5	
Other	**1.5**		1.4	
Total gross investment income	**19.0**		17.8	
Less: Investment expenses	**0.3**		0.4	
Net investment income	**$18.7**		$17.4	
Average invested assets (at cost)	**$2,405.7**		$2,268.7	
Annualized investment yield	**3.0**	**%**	2.9	%
Annualized investment yield, after tax	**2.3**	**%**	2.2	%
Net investment income, after tax	**$13.7**		$13.3	
Effective tax rate	**26.8**	**%**	23.5	%

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The following table sets forth realized gains (losses) and the proceeds received from the sale of our investment portfolio for the three months ended March 31, 2017 and 2016:

($ in millions)	**2017**		2016	
	Realized gains (losses)	Proceeds received on sale	Realized gains (losses)	Proceeds received on sale
Realized gains:				
Fixed maturities	**$0.3**	**$ 50.7**	$1.5	$ 75.8
Equity securities	**9.7**	**45.1**	4.1	20.4
Other invested assets	**—**	**0.3**	—	0.2
Total realized gains	**10.0**	**96.1**	5.6	96.4
Realized losses:				
Equity securities:				
Sales	**(0.1)**	**2.5**	(0.6)	3.2
OTTI	**(2.1)**	**—**	(1.4)	—
Fixed maturities				
OTTI	**—**	**—**	(2.3)	—
Total realized losses	**(2.2)**	**2.5**	(4.3)	3.2
Net realized gains on investments	**$7.8**	**$ 98.6**	$1.3	$ 99.6

Net realized gains increased $6.5 million for the three months ended March 31, 2017, when compared to the same 2016 period, driven by sales in the U.S. large-cap portfolio.
When a fixed maturity security has been determined to have an other-than-temporary decline in fair value, the impairment charge is separated into an amount representing the credit loss, which is recognized in earnings, and the amount related to non-credit factors, which is recognized in accumulated other comprehensive income. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies – Investments" included in Item 7 of the 2016 Form 10-K for other-than-temporary impairment ("OTTI") indicators. Future increases or decreases in fair value, if not other-than-temporary, are included in accumulated other comprehensive income. We did not recognize any OTTI on our fixed maturity portfolio for the three months ended March 31, 2017, and we recognized $2.3 million of OTTI on our fixed maturity portfolio for the three months ended March 31, 2016.
When an equity security or other invested asset has been determined to have a decline in fair value that is other-than-temporary, we adjust the cost basis of the security to fair value. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies – Investments" included in Item 7 of the 2016 Form 10-K for OTTI impairment indicators. This results in a charge to earnings as a realized loss, which is not reversed for subsequent recoveries in fair value. Future increases or decreases in fair value, if not other-than-temporary, are included in accumulated other comprehensive income.
The following table sets forth the realized losses related to OTTI on our investment portfolio recognized for the three months ended March 31, 2017 and 2016:

($ millions, except # of positions)	**2017**		2016	
	Number of positions	Total impairment	Number of positions	Total impairment
Equity securities:				
Large-cap securities	**1**	**$ (1.5)**	1	$ (0.2)
Small-cap securities	**10**	**(0.6)**	10	(1.2)
Fixed maturities	**—**	**—**	1	(2.3)
Total other-than-temporary impairments	**11**	**$ (2.1)**	12	$ (3.7)

Gross Unrealized Investment Gains and Losses

Based upon our review of our investment portfolio at March 31, 2017, we determined that there were no individual investments with an unrealized holding loss that had a fair value significantly below cost continually for more than one year. The following table sets forth detailed information on our available-for-sale investment portfolio by lot at fair value for our gross unrealized holding gains (losses) at March 31, 2017:

($ millions, except # of positions)	Cost or amortized cost	Gross unrealized holding gains	Number of gain positions	Gross unrealized holding losses	Number of loss positions	Fair value
Fixed maturities:						
U.S. treasury securities and obligations of U.S. government agencies	**$441.3**	**$9.9**	**20**	**$(5.7)**	**35**	**$445.5**
Obligations of states and political subdivisions	**607.3**	**14.1**	**146**	**(2.3)**	**17**	**619.1**
Corporate securities	**431.6**	**6.3**	**57**	**(1.7)**	**20**	**436.2**
U.S. government agencies mortgage-backed securities	**624.5**	**7.9**	**47**	**(9.7)**	**58**	**622.7**
Total fixed maturities	**2,104.7**	**38.2**	**270**	**(19.4)**	**130**	**2,123.5**
Equity securities:						
Large-cap securities	**97.4**	**39.3**	**42**	**(0.2)**	**4**	**136.5**
Small-cap securities	**56.0**	**20.5**	**73**	**—**	**—**	**76.5**
Mutual and exchange traded funds	**167.9**	**14.8**	**11**	**(0.1)**	**1**	**182.6**
Total equity securities	**321.3**	**74.6**	**126**	**(0.3)**	**5**	**395.6**
Other invested assets	**25.5**	**22.6**	**2**	**—**	**—**	**48.1**
Total available-for-sale investments	**$2,451.5**	**$135.4**	**398**	**$(19.7)**	**135**	**$2,567.2**

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

($ millions)	**March 31, 2017**	December 31, 2016	$ Change
Available-for-sale investments:			
Unrealized holding gains:			
Fixed maturities	**$18.8**	$ 13.4	$5.4
Equity securities	**74.3**	59.7	14.6
Other invested assets	**22.6**	19.6	3.0
Unrealized gains	**115.7**	92.7	23.0
Net deferred federal income tax liability	**(37.9)**	(29.9)	(8.0)
Unrealized gains, net of tax	**$77.8**	$ 62.8	$15.0

Fair Value Measurements

We primarily use one independent nationally recognized pricing service in developing fair value estimates. We obtain one price per security, and our processes and control procedures are designed to ensure the value is accurately recorded on an unadjusted basis. Through discussions with the pricing service, we gain an understanding of the methodologies used to price the different types of securities, that the data and the valuation methods utilized are appropriate and consistently applied, and that the assumptions are reasonable and representative of fair value. To validate the reasonableness of the valuations obtained from the pricing service, we compare to other fair value pricing information gathered from other independent pricing sources. See Note 3, “Fair Value of Financial Instruments” to our

condensed consolidated financial statements included in Item 1 of this Form 10-Q for a presentation of our available-for-sale investments within the fair value hierarchy at March 31, 2017, and December 31, 2016.
As of March 31, 2017, Level 3 assets as a percentage of total assets were 0.1% which we have determined to be insignificant.

Other Items

Income Taxes

The following table sets forth the components of our federal income tax expense for the three months ended March 31, 2017 and 2016, respectively.

($ millions)	**2017**	2016
(Loss) income before federal income taxes	**$(5.2)**	$3.8
Federal income tax (benefit) expense:		
Current	**(0.1)**	—
Deferred	**(1.0)**	0.8
Total federal income tax (benefit) expense	**(1.1)**	0.8
Net (loss) income	**$(4.1)**	$3.0

The effective tax rate was 21.7% for the three months ended March 31, 2017, compared to 20.0% for the same 2016 period. For additional information, see Note 6 of our condensed consolidated financial statements included in Item 1 of this Form 10-Q.

LIQUIDITY AND CAPITAL RESOURCES

General

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

Liquidity

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

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

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

We generally manage our cash flows through current operational activity and maturing investments, without a need to liquidate any of our other investments; however, should our written premiums decline or paid losses increase significantly, or a combination thereof, we may need to liquidate investments at losses in order to meet our cash obligations. This action was not necessary for the three months ended March 31, 2017.

We maintain a portion of our investment portfolio in relatively short-term and highly liquid investments to ensure the immediate availability of funds to pay claims and expenses. At March 31, 2017, and December 31, 2016, we had $44.8 million and $51.1 million, respectively, in cash and cash equivalents, and $2,567.2 million and $2,537.2 million, respectively, of total available-for-sale investments. Our fixed maturities available-for-sale included $9.3 million and $9.2 million of securities on deposit with insurance regulators as required by law at March 31, 2017, and December 31, 2016; in addition, substantially all of our fixed maturity and equity securities are traded on public markets. For a further discussion regarding investments, see "Investments Operations Segment" included in this Item 2.

Cash provided by operating activities was $3.7 million and $24.5 million for the three months ended March 31, 2017, and 2016, respectively. Net cash from operations will vary from period to period if there are significant changes in underwriting results, primarily a combination of the level of premiums written and loss and loss expenses paid, changes in cash flows from investment income or federal income tax activity.

Cash used in investing activities was $7.0 million and $31.4 million for the three months ended March 31, 2017, and 2016, respectively. The change was primarily driven by (i) a decrease in fixed maturity purchases, (ii) less proceeds from sales of fixed maturities, and (iii) an increase in proceeds from sales of equity securities when compared to the same 2016 period.

Cash used in financing activities was $3.0 million and $3.5 million for the three months ended March 31, 2017, and 2016 respectively.

Borrowing Arrangements

Credit Facility

State Auto P&C has a $100.0 million five-year revolving credit facility (the "Credit Facility") maturing in July 2018 with a syndicate of lenders. During the term of the Credit Facility, State Auto P&C has the right to increase the total facility to a maximum amount of $150.0 million, provided that no event of default has occurred and is continuing. The Credit Facility is available for general corporate purposes and provides for interest-only payments during its term, with principal and interest due in full at maturity. Interest is based on LIBOR or a base rate plus a calculated margin amount. All advances under the Credit Facility are to be fully secured by a pledge of specific investment securities of State Auto P&C. The Credit Facility includes certain covenants and requirements, including financial requirements that State Auto Financial maintain a minimum net worth and a certain debt to capitalization ratio. As of March 31, 2017, State Auto P&C had not made any borrowings under the Credit Facility and State Auto P&C and State Auto Financial were in compliance with all covenants and requirements of the Credit Facility.

FHLB Loans

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

Subordinated Debentures

State Auto Financial’s Delaware business trust subsidiary (the “Capital Trust”) has outstanding $15.0 million liquidation amount of capital securities, due 2033. In connection with the Capital Trust’s issuance of the capital securities and the related purchase by State Auto Financial of all of the Capital Trust’s common securities (liquidation amount of $0.5 million), State Auto Financial has issued to the Capital Trust $15.5 million aggregate principal amount of unsecured Floating Rate Junior Subordinated Debt Securities due 2033 (the “Subordinated Debentures”). The sole assets of the Capital Trust are the Subordinated Debentures and any interest accrued thereon. Interest on the Capital Trust’s capital and common securities is payable quarterly at a rate equal to the three-month LIBOR rate plus 4.20%, adjusted quarterly. The applicable interest rates for March 31, 2017, and 2016 were 5.25% and 4.53%, respectively.

Reinsurance Arrangements

Members of the State Auto Group follow the customary industry practice of reinsuring a portion of their exposures and paying to the reinsurers a portion of the premiums received. Insurance is ceded principally to reduce net liability on individual risks or for individual loss occurrences, including catastrophic losses. Although reinsurance does not legally discharge the individual members of the State Auto Group from primary liability for the full amount of limits applicable under their policies, it does make the assuming reinsurer liable to the extent of the reinsurance ceded.

To minimize the risk of reinsurer default, the State Auto Group cedes only to third-party reinsurers who are rated A- or better by A.M. Best or Standard & Poor’s and also utilizes both domestic and international markets to diversify its credit risk. We utilize reinsurance to limit our loss exposure and contribute to our liquidity and capital resources.

Each member of the State Auto Group is party to working reinsurance treaties for casualty, workers’ compensation and property lines with several reinsurers arranged through reinsurance intermediaries. We have also secured other reinsurance to limit the net cost of large loss events for certain types of coverage. The State Auto Group also makes use of facultative reinsurance for unique risk situations. The State Auto Group also participates in state insurance pools and associations. In general, these pools and associations are state sponsored and/or operated, impose mandatory participation by insurers doing business in that state, and offer coverage for hard-to-place risks at premium rates established by the state sponsor or operator, thereby transferring risk of loss to the participating insurers in exchange for premiums which may not be commensurate with the risk assumed.

For a discussion of our other reinsurance arrangements see “Management’s Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources - Reinsurance Arrangements” in Item 7 of the 2016 Form 10-K.

Regulatory Considerations

At March 31, 2017, all of our insurance subsidiaries were in compliance with statutory requirements relating to capital adequacy.

ADOPTION OF RECENT ACCOUNTING PRONOUNCEMENTS

Improvements to Employee Share-Based Payment Accounting

The amendments in this guidance simplify the accounting for share-based payment award transactions including: income tax consequences, classification of awards as either equity or liabilities, classification of excess tax benefits, and classification on the statement of cash flows. The guidance is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. We adopted this guidance prospectively at January 1, 2017. Prior periods were not adjusted and it did not have a material impact on the condensed consolidated financial statements for the thee month period ended March 31, 2017.

CREDIT AND FINANCIAL STRENGTH RATINGS

There were no changes to our credit or financial strength ratings during the first quarter of 2017.

MARKET RISK

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

Item 3. Quantitative and Qualitative Disclosure of Market Risk

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

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Item 4. Controls and Procedures

Disclosure Controls and Procedures

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

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

Changes in Internal Control over Financial Reporting

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

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PART II – OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

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

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

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

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Item 6. Exhibits

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

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SIGNATURE

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

	State Auto Financial Corporation
Date: May 3, 2017	/s/ Steven E. English
	Steven E. English
	Chief Financial Officer
	(Duly Authorized Officer and
	Principal Financial Officer)