

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

State Auto Financial CORP

Form 10-Q

August 08, 2017

false--12-31Q2201710-Q0000874977Accelerated FilerState Auto Financial

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

FORM 10-Q

Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2017

or

Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission File Number 000-19289

STATE AUTO FINANCIAL CORPORATION

(Exact name of Registrant as specified in its charter)

Ohio

(State or other jurisdiction of
incorporation or organization)

31-1324304

(I.R.S. Employer
Identification No.)

518 East Broad Street, Columbus, Ohio 43215-3976

(Address of principal executive offices)

(Zip Code)

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

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

Yes 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 No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company) Emerging growth company

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

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

Yes No

On July 28, 2017, the Registrant had 42,069,515 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)

	June 30, 2017	December 31, 2016
	(unaudited)	
Assets		
Fixed maturities, available-for-sale, at fair value (amortized cost \$2,138.3 and \$2,095.9, respectively)	\$ 2,167.1	\$2,109.3
Equity securities, available-for-sale, at fair value (cost \$321.5 and \$323.1, respectively)	391.4	382.8
Other invested assets, available-for-sale, at fair value (cost \$25.6 and \$25.5, respectively)	50.6	45.1
Other invested assets	5.6	5.4
Notes receivable from affiliate	70.0	70.0
<i>Total investments</i>	2,684.7	2,612.6
Cash and cash equivalents	48.8	51.1
Accrued investment income and other assets	39.7	40.0
Deferred policy acquisition costs (affiliated net assumed \$47.0 and \$50.7, respectively)	125.0	129.8
Reinsurance recoverable on losses and loss expenses payable	2.7	3.6
Prepaid reinsurance premiums	6.0	6.1
Due from affiliate	22.9	—
Current federal income taxes	6.6	6.7
Net deferred federal income taxes	88.9	102.1
Property and equipment, at cost	7.2	7.4
Total assets	\$ 3,032.5	\$2,959.4
Liabilities and Stockholders' Equity		
Losses and loss expenses payable (affiliated net assumed \$660.5 and \$630.9, respectively)	\$ 1,233.6	\$1,181.6
Unearned premiums (affiliated net assumed \$234.9 and \$220.9, respectively)	627.4	617.8
Notes payable (affiliates \$15.2 and \$15.2, respectively)	122.1	122.1
Pension and postretirement benefits (affiliated net ceded \$36.4 and \$40.1, respectively)	67.6	74.4
Due to affiliate	—	2.4
Other liabilities (affiliated net assumed \$17.9 and \$11.0, respectively)	67.4	69.8
Total liabilities	2,118.1	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; 48.9 and 48.6 shares issued, respectively, at stated value of \$2.50 per share	122.2	121.6
Treasury stock, 6.8 and 6.8 shares, respectively, at cost	(116.7)	(116.5)
Additional paid-in capital	165.6	159.9
Accumulated other comprehensive income (affiliated net ceded \$51.9 and \$53.7, respectively)	53.4	32.5
Retained earnings	689.9	693.8
Total stockholders' equity	914.4	891.3
Total liabilities and stockholders' equity	\$ 3,032.5	\$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

	Three months ended June 30	
(unaudited)	2017	2016
Earned premiums (affiliated net assumed \$118.1 and \$117.6, respectively)	\$320.1	\$322.4
Net investment income (affiliates \$1.2 and \$1.2, respectively)	19.1	19.1
Net realized gains (losses) on investments:		
Total other-than-temporary impairment losses	(0.8)	(0.6)
Other net realized investment gains	16.6	7.1
Total net realized gains on investments	15.8	6.5
Other income from affiliates	0.7	0.5
Total revenues	355.7	348.5
Losses and loss expenses (affiliated net assumed \$83.4 and \$86.8, respectively)	230.4	262.9
Acquisition and operating expenses (affiliated net assumed \$71.8 and \$68.4, respectively)	109.9	107.2
Interest expense (affiliates \$0.2 and \$0.2, respectively)	1.5	1.4
Other expenses	2.0	2.1
Total expenses	343.8	373.6
Income (loss) before federal income taxes	11.9	(25.1)
Federal income tax expense (benefit):		
Current	0.2	—
Deferred	3.0	(0.5)
Total federal income tax expense (benefit)	3.2	(0.5)
Net income (loss)	\$8.7	\$(24.6)
Earnings (loss) per common share:		
Basic	\$0.21	\$(0.59)
Diluted	\$0.21	\$(0.59)
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)

Condensed Consolidated Statements of Income

(\$ in millions, except per share amounts)

	Six months ended June 30	
(unaudited)	2017	2016
Earned premiums (affiliated net assumed \$232.9 and \$231.0, respectively)	\$637.4	\$642.3
Net investment income (affiliates \$2.4 and \$2.4, respectively)	37.8	36.5
Net realized gains (losses) on investments:		
Total other-than-temporary impairment losses	(2.9)	(4.3)
Other net realized investment gains	26.5	12.1
Total net realized gains on investments	23.6	7.8
Other income from affiliates	1.2	1.1
Total revenues	700.0	687.7
Losses and loss expenses (affiliated net assumed \$169.6 and \$180.5, respectively)	464.4	487.9
Acquisition and operating expenses (affiliated net assumed \$152.1 and \$138.9, respectively)	222.1	214.7
Interest expense (affiliates \$0.4 and \$0.4, respectively)	2.9	2.7
Other expenses	3.9	3.7
Total expenses	693.3	709.0
Income (loss) before federal income taxes	6.7	(21.3)
Federal income tax expense:		
Current	0.1	—
Deferred	2.0	0.3
Total federal income tax expense	2.1	0.3
Net income (loss)	\$4.6	\$(21.6)
Earnings (loss) per common share:		
Basic	\$0.11	\$(0.52)
Diluted	\$0.11	\$(0.52)
Dividends paid per common share	\$0.20	\$0.20

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

<i>(\$ in millions, except per share amounts)</i>	Three months ended June 30	
(unaudited)	2017	2016
Net income (loss)	\$8.7	\$(24.6)
Other comprehensive income, net of tax:		
Net unrealized holding gains on investments:		
Unrealized holding gains	23.8	38.2
Reclassification adjustments for gains realized in net income	(15.8)	(6.5)
Income tax expense	(2.8)	(11.1)
<i>Total net unrealized holding gains on investments</i>	5.2	20.6
Net unrecognized benefit plan obligations:		
Reclassification adjustments for amortization to statements of income:		
Negative prior service cost	(1.4)	(1.4)
Net actuarial loss	1.9	2.3
Income tax expense	(0.2)	(0.2)
<i>Total net unrecognized benefit plan obligations</i>	0.3	0.7
<i>Other comprehensive income</i>	5.5	21.3
Comprehensive income (loss)	\$14.2	\$(3.3)

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)

Consolidated Statements of Comprehensive Income

	Six months ended June 30	
<i>(\$ in millions, except per share amounts)</i>	2017	2016
(unaudited)		
Net income (loss)	\$4.6	\$(21.6)
Other comprehensive income, net of tax:		
Net unrealized holding gains on investments:		
Unrealized holding gains	54.6	75.2
Reclassification adjustments for gains realized in net income	(23.6)	(7.8)
Income tax expense	(10.8)	(23.6)
<i>Total net unrealized holding gains on investments</i>	20.2	43.8
Net unrecognized benefit plan obligations:		
Reclassification adjustments for amortization to statements of income:		
Negative prior service cost	(2.8)	(2.8)
Net actuarial loss	4.0	4.7
Income tax expense	(0.5)	(0.6)
<i>Total net unrecognized benefit plan obligations</i>	0.7	1.3
<i>Other comprehensive income</i>	20.9	45.1
Comprehensive income	\$25.5	\$23.5

See accompanying notes to condensed consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

Condensed Consolidated Statements of Cash Flows

(\$ in millions)

(unaudited)

Cash flows from operating activities:

	Six months ended June 30	
	2017	2016
Net income (loss)	\$4.6	\$(21.6)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization, net	6.1	7.4
Share-based compensation	2.8	2.2
Net realized gains on investments	(23.6)	(7.8)
Changes in operating assets and liabilities:		
Deferred policy acquisition benefits	4.8	(2.7)
Accrued investment income and other assets	0.1	(0.4)
Postretirement and pension benefits	(6.0)	(3.8)
Other liabilities and due to/from affiliates, net	(32.5)	(27.8)
Reinsurance recoverable on losses and loss expenses payable and prepaid reinsurance premiums	1.0	0.7
Losses and loss expenses payable	52.0	90.2
Unearned premiums	9.6	7.4
Deferred tax expense (benefit) on share-based awards	1.3	(0.3)
Federal income taxes	1.2	1.0
Net cash provided by operating activities	21.4	44.5
Cash flows from investing activities:		
Purchases of fixed maturities available-for-sale	(244.5)	(292.0)
Purchases of equity securities available-for-sale	(69.0)	(45.0)
Purchases of other invested assets	(0.7)	(0.7)
Maturities, calls and pay downs of fixed maturities available-for-sale	94.5	101.2
Sales of fixed maturities available-for-sale	108.2	126.4
Sales of equity securities available-for-sale	91.9	65.0
Sales of other invested assets available-for-sale	0.5	0.4
Net cash used in investing activities	(19.1)	(44.7)
Cash flows from financing activities:		
Proceeds from issuance of common stock	4.1	3.3
Payments to acquire treasury stock	(0.2)	(0.2)
Payment of dividends	(8.5)	(8.3)
Deferred tax expense (benefit) on share-based awards	—	0.3
Net cash used in financing activities	(4.6)	(4.9)
Net decrease in cash and cash equivalents	(2.3)	(5.1)
Cash and cash equivalents at beginning of period	51.1	58.1
Cash and cash equivalents at end of period	\$48.8	\$53.0
<u>Supplemental disclosures:</u>		
Interest paid (affiliates \$0.4 and \$0.4, respectively)	\$2.8	\$2.6

See accompanying notes to condensed consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

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

Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of State Auto Financial Corporation and Subsidiaries (“State Auto Financial” or the “Company”) have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles (“GAAP”) for complete financial statements. In the opinion of the Company, all adjustments (consisting of normal, recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six month period ended June 30, 2017, are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. The balance sheet at December 31, 2016, has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete financial statements.

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

Adoption of Recent Accounting Pronouncements

Employee Share-Based Payment Accounting

The amendments in this guidance simplify the accounting for share-based payment award transactions including: income tax consequences, classification of awards as either equity or liabilities, classification of excess tax benefits, and classification on the statement of cash flows. The guidance is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The Company adopted this guidance prospectively at January 1, 2017, and prior periods were not adjusted. For the three and six months ended June 30, 2017, the Company recognized \$1.3 million of income tax expense as a result of adopting this guidance.

Pending Adoption of Recent Accounting Pronouncements

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 June 30, 2017 and December 31, 2016:

(\$ millions)

June 30, 2017

Fixed maturities:

	Cost or amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
U.S. treasury securities and obligations of U.S. government agencies	\$437.5	\$7.8	\$(4.8)	\$440.5
Obligations of states and political subdivisions	613.1	19.4	(0.8)	631.7
Corporate securities	481.3	6.1	(1.2)	486.2
U.S. government agencies mortgage-backed securities	606.4	9.7	(7.4)	608.7
<i>Total fixed maturities</i>	2,138.3	43.0	(14.2)	2,167.1

Equity securities:

Large-cap securities	80.6	34.1	(0.4)	114.3
Small-cap securities	53.0	19.1	—	72.1
Mutual and exchange traded funds	187.9	19.7	(2.6)	205.0
<i>Total equity securities</i>	321.5	72.9	(3.0)	391.4
Other invested assets	25.6	25.0	—	50.6
<i>Total available-for-sale securities</i>	\$2,485.4	\$140.9	\$(17.2)	\$2,609.1

(\$ millions)

December 31, 2016

Fixed maturities:

	Cost or amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
U.S. treasury securities and obligations of U.S. government agencies	\$401.9	\$8.9	\$(6.1)	\$404.7
Obligations of states and political subdivisions	634.6	12.3	(3.2)	643.7
Corporate securities	445.7	6.1	(2.2)	449.6
U.S. government agencies mortgage-backed securities	613.7	8.5	(10.9)	611.3
<i>Total fixed maturities</i>	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
<i>Total equity securities</i>	323.1	63.1	(3.4)	382.8
Other invested assets	25.5	19.6	—	45.1
<i>Total available-for-sale securities</i>	\$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 June 30, 2017 and December 31, 2016:

(\$ millions, except # of positions)	Less than 12 months			12 months or more			Total		
	Fair value	Unrealized losses	Number of positions	Fair value	Unrealized losses	Number of positions	Fair value	Unrealized losses	Number of positions
June 30, 2017									
Fixed maturities:									
U.S. treasury securities and obligations of U.S. government agencies	\$262.4	\$(4.8)	33	\$—	\$—	—	\$262.4	\$(4.8)	33
Obligations of states and political subdivisions	68.3	(0.8)	9	—	—	—	68.3	(0.8)	9
Corporate securities	103.7	(1.0)	17	15.9	(0.2)	3	119.6	(1.2)	20
U.S. government agencies mortgage-backed securities	295.5	(6.4)	40	30.4	(1.0)	13	325.9	(7.4)	53
<i>Total fixed maturities</i>	729.9	(13.0)	99	46.3	(1.2)	16	776.2	(14.2)	115
Equity securities:									
Large-cap equity securities	3.9	(0.3)	4	4.6	(0.1)	2	8.5	(0.4)	6
Mutual and exchange traded funds	52.8	(2.6)	1	—	—	—	52.8	(2.6)	1
<i>Total equity securities</i>	56.7	(2.9)	5	4.6	(0.1)	2	61.3	(3.0)	7
<i>Total temporarily impaired securities</i>	\$786.6	\$(15.9)	104	\$50.9	\$(1.3)	18	\$837.5	\$(17.2)	122

(\$ millions, except # of positions)	Less than 12 months			12 months or more			Total		
	Fair value	Unrealized losses	Number of positions	Fair value	Unrealized losses	Number of positions	Fair value	Unrealized losses	Number of positions
December 31, 2016									
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
<i>Total fixed maturities</i>	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
<i>Total equity securities</i>	39.0	(1.7)	9	8.8	(1.7)	5	47.8	(3.4)	14
<i>Total temporarily impaired securities</i>	\$891.6	\$(22.5)	124	\$58.7	\$(3.3)	20	\$950.3	\$(25.8)	144

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

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The Company reviewed its investments at June 30, 2017, and determined that no additional other-than-temporary impairment ("OTTI") existed in the gross unrealized holding losses other than those listed in the table below. The following table sets forth the realized losses related to other-than-temporary impairments on the Company's investment portfolio recognized for the three and six months ended June 30, 2017 and 2016:

(\$ millions)	Three months		Six months	
	ended June 30		ended June 30	
	2017	2016	2017	2016
Equity securities:				
Large-cap securities	\$—	\$—	\$(1.5)	\$(0.2)
Small-cap securities	(0.8)	(0.6)	(1.4)	(1.8)
Fixed maturities:	—	—	—	(2.3)
<i>Total other-than-temporary impairments</i>	\$(0.8)	\$(0.6)	\$(2.9)	\$(4.3)

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 June 30, 2017:

(\$ millions)	Amortized cost	Fair value
Due in 1 year or less	\$ 45.5	\$ 45.6
Due after 1 year through 5 years	558.6	563.8
Due after 5 years through 10 years	350.6	354.4
Due after 10 years	577.2	594.6
U.S. government agencies mortgage-backed securities	606.4	608.7
<i>Total</i>	\$ 2,138.3	\$ 2,167.1

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 June 30, 2017, State Auto P&C had U.S. government agencies mortgage-backed fixed maturity securities, with a carrying value of approximately \$106.5 million, that were pledged as collateral for the FHLB Loans (as defined in Note 3). In accordance with the terms of the FHLB Loans, State Auto P&C retains all rights regarding these pledged securities.

Fixed maturities with fair values of \$9.3 million and \$9.2 million were on deposit with insurance regulators as required by law at June 30, 2017, and December 31, 2016, respectively. The Company retains all rights regarding these securities.

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The following table sets forth the components of net investment income for the three and six months ended June 30, 2017 and 2016:

(\$ millions)	Three months ended June 30		Six months ended June 30	
	2017	2016	2017	2016
Fixed maturities	\$15.9	\$16.7	\$31.7	\$31.6
Equity securities	2.0	1.5	3.7	3.0
Cash and cash equivalents, and other	1.5	1.3	3.0	2.7
<i>Investment income</i>	19.4	19.5	38.4	37.3
Investment expenses	0.3	0.4	0.6	0.8
<i>Net investment income</i>	\$19.1	\$19.1	\$37.8	\$36.5

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 \$200.6 million and \$191.8 million for the six months ended June 30, 2017, and 2016, respectively.

The following table sets forth the realized and unrealized holding gains (losses) on the Company's investment portfolio for the three and six months ended June 30, 2017 and 2016:

(\$ millions)	Three months ended June 30		Six months ended June 30	
	2017	2016	2017	2016
Realized gains:				
Fixed maturities	\$2.0	\$0.6	\$2.3	\$2.1
Equity securities	14.6	6.6	24.3	10.7
Other invested assets	0.1	0.1	0.1	0.1
<i>Total realized gains</i>	16.7	7.3	26.7	12.9
Realized losses:				
Equity securities:				
Sales	(0.1)	(0.2)	(0.2)	(0.8)
OTTI	(0.8)	(0.6)	(2.9)	(2.0)
Fixed maturities:				
OTTI	—	—	—	(2.3)
<i>Total realized losses</i>	(0.9)	(0.8)	(3.1)	(5.1)
<i>Net realized gains on investments</i>	\$15.8	\$6.5	\$23.6	\$7.8
Change in unrealized holding gains (losses), net of tax:				
Fixed maturities	\$10.0	\$29.5	\$15.4	\$65.7
Equity securities	(4.4)	2.8	10.2	1.8
Other invested assets	2.4	(0.6)	5.4	(0.1)
Deferred federal income tax liability	(2.8)	(11.1)	(10.8)	(23.6)
<i>Change in net unrealized holding gains (losses), net of tax</i>	\$5.2	\$20.6	\$20.2	\$43.8

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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 June 30, 2017, and December 31, 2016, the Company did not adjust any of the prices received from the pricing service.

Transfers between level categorizations may occur due to changes in the availability of market observable inputs. Transfers in and out of level categorizations are reported as having occurred at the beginning of the quarter in which the transfer occurred. There were no transfers between level categorizations during the three and six months ended June 30, 2017, and 2016.

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

Fixed Maturities

The Company utilizes a third party pricing service to estimate fair value measurements for the majority of its fixed maturities. The fair value estimate of the Company's fixed maturity investments are determined by evaluations that are based on observable market information rather than market quotes. Inputs to the evaluations include, but are not limited to, market prices from recently completed transactions and transactions of comparable securities, interest rate yield curves, credit spreads, and other market-observable information. The fixed maturity portfolio pricing obtained from the pricing service is reviewed for reasonableness. The Company regularly selects a random sample of security prices which are compared to one or more alternative pricing sources for reasonableness. Any discrepancies with the pricing are returned to the pricing service for further explanation and, if necessary, adjustments are made. To date, the Company has not identified any significant discrepancies in the pricing provided by its third party pricing service. Investments valued using these inputs include U.S. treasury securities and obligations of U.S. government agencies, obligations of states and political subdivisions, corporate securities (except for a security discussed below), and U.S. government agencies mortgage-backed securities. All unadjusted estimates of fair value for fixed maturities priced by the pricing service are included in the amounts disclosed in Level 2 of the hierarchy. If market inputs are unavailable, then no fair value is provided by the pricing service. For these securities, fair value is determined either by requesting brokers who are knowledgeable about these securities to provide a quote; or the Company internally determines the fair values by employing widely accepted pricing valuation models, and depending on the level of observable market inputs, renders the fair value estimate as Level 2 or Level 3. The Company held one corporate fixed maturity security included in Level 3 and estimated its fair value using the present value of the future cash flows. Due to the limited amount of observable market information for this security, the Company included the fair value estimate in Level 3. This security was sold during the second quarter of 2017.

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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 \$40.6 million and \$35.7 million at June 30, 2017, and December 31, 2016, respectively, which was determined using the fund’s net asset value. The Company employs procedures to assess the reasonableness of the fair value of the fund including obtaining and reviewing the fund’s audited financial statements. There are no unfunded commitments related to the fund. The Company may not sell its investment in the fund; however, the Company may redeem all or a portion of its investment in the fund at net asset value per share with the appropriate prior written notice. In accordance with Accounting Standard Codification 820-10, this investment is measured at fair value using the net asset value per share practical expedient and has not been classified in the fair value hierarchy. Fair values presented here are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the condensed consolidated balance sheets. The remainder of the Company’s other invested assets consist primarily of holdings in publicly-traded mutual funds. The Company believes that its prices for these publicly-traded mutual funds based on an observable market price for an identical asset in an active market reflect their fair values and consequently these securities have been disclosed in Level 1.

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The following tables set forth the Company's available-for-sale investments within the fair value hierarchy at June 30, 2017 and December 31, 2016:

(\$ millions)

June 30, 2017

	Total	Level 1	Level 2	Level 3
Fixed maturities:				
U.S. treasury securities and obligations of U.S. government agencies	\$440.5	\$—	\$440.5	\$ —
Obligations of states and political subdivisions	631.7	—	631.7	—
Corporate securities	486.2	—	486.2	—
U.S. government agencies mortgage-backed securities	608.7	—	608.7	—
<i>Total fixed maturities</i>	2,167.1	—	2,167.1	—
Equity securities:				
Large-cap securities	114.3	114.3	—	—
Small-cap securities	72.1	72.1	—	—
Mutual and exchange traded funds	205.0	205.0	—	—
<i>Total equity securities</i>	391.4	391.4	—	—
Other invested assets	10.0	10.0	—	—
<i>Total available-for-sale investments</i>	\$2,568.5	\$401.4	\$2,167.1	\$ —

(\$ millions)

December 31, 2016

Total	Level 1	Level 2	Level 3
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