

SELECTIVE INSURANCE GROUP INC

Form 10-Q

May 02, 2008

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: March 31, 2008

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: 001-33067
SELECTIVE INSURANCE GROUP, INC.
(Exact name of registrant as specified in its charter)**

New Jersey

22-2168890

(State or Other Jurisdiction of Incorporation or Organization)

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

40 Wantage Avenue
Branchville, New Jersey

07890

(Address of Principal Executive Offices)

(Zip Code)

(973) 948-3000

(Registrant's Telephone Number, Including Area Code)

(Former name, former address and former fiscal year, if changed since last report)

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 report), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting 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)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of March 31, 2008, there were 53,306,769 shares of common stock, par value \$2.00 per share, outstanding.

SELECTIVE INSURANCE GROUP, INC.
Table of Contents

| | Page No |
|---|---------|
| <u>PART I. FINANCIAL INFORMATION</u> | |
| <u>Item 1. Financial Statements</u> | 2 |
| <u>Consolidated Balance Sheets as of March 31, 2008 (Unaudited) and December 31, 2007</u> | 2 |
| <u>Unaudited Consolidated Statements of Income for the Quarters Ended March 31, 2008 and 2007</u> | 3 |
| <u>Unaudited Consolidated Statements of Stockholders' Equity for the Quarters Ended March 31, 2008 and 2007</u> | 4 |
| <u>Unaudited Consolidated Statements of Cash Flow for the Quarters Ended March 31, 2008 and 2007</u> | 5 |
| <u>Notes to Unaudited Interim Consolidated Financial Statements</u> | 6 |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 13 |
| <u>Forward-Looking Statements</u> | 13 |
| <u>Introduction</u> | 13 |
| <u>Critical Accounting Policies and Estimates</u> | 13 |
| <u>Financial Highlights of Results for First Quarter 2008 and First Quarter 2007</u> | 14 |
| <u>Results of Operations and Related Information by Segment</u> | 14 |
| <u>Financial Condition, Liquidity, and Capital Resources</u> | 26 |
| <u>Off-Balance Sheet Arrangements</u> | 28 |
| <u>Contractual Obligations and Contingent Liabilities and Commitments</u> | 28 |
| <u>Federal Income Taxes</u> | 28 |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u> | 29 |
| <u>Item 4. Controls and Procedures</u> | 29 |
| <u>PART II. OTHER INFORMATION</u> | |
| <u>Item 1. Legal Proceedings</u> | 29 |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | 30 |

| | |
|---|----|
| <u>Item 4. Submission of Matters to a Vote of Security Holders</u> | 30 |
|---|----|

| | |
|--------------------------------|----|
| <u>Item 6. Exhibits</u> | 31 |
|--------------------------------|----|

Exhibit 10.18i

Exhibit 10.18j

Exhibit 10.18k

Exhibit 11

Exhibit 31.1

Exhibit 31.2

Exhibit 32.1

Exhibit 32.2

Table of Contents

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
SELECTIVE INSURANCE GROUP, INC.
CONSOLIDATED BALANCE SHEETS

| (\$ in thousands, except share amounts) | Unaudited March 31, 2008 | December 31, 2007 |
|--|---|------------------------------|
| ASSETS | | |
| Investments: | | |
| Fixed maturity securities, held-to-maturity at amortized cost (fair value of: \$4,429 2008; \$5,927 2007) | \$ 4,304 | 5,783 |
| Fixed maturity securities, available-for-sale at fair value (amortized cost of: \$3,016,348 2008; \$3,049,913 2007) | 3,021,670 | 3,073,547 |
| Equity securities, available-for-sale at fair value (cost of: \$147,174 2008; \$160,390 2007) | 232,787 | 274,705 |
| Short-term investments at cost which approximates fair value | 212,545 | 190,167 |
| Equity securities, trading at fair value (cost of: \$17,358 2008) | 23,219 | |
| Other investments | 197,097 | 188,827 |
| Total investments | 3,691,622 | 3,733,029 |
| Cash and cash equivalents | 9,837 | 8,383 |
| Interest and dividends due or accrued | 35,153 | 36,141 |
| Premiums receivable, net of allowance for uncollectible accounts of: \$4,254 2008; \$3,905 2007 | 496,548 | 496,363 |
| Other trade receivables, net of allowance for uncollectible accounts of: \$184 2008; \$244 2007 | 22,493 | 21,875 |
| Reinsurance recoverable on paid losses and loss expenses | 7,307 | 7,429 |
| Reinsurance recoverable on unpaid losses and loss expenses | 222,968 | 227,801 |
| Prepaid reinsurance premiums | 82,761 | 82,182 |
| Current federal income tax | | 4,235 |
| Deferred federal income tax | 42,302 | 22,375 |
| Property and equipment at cost, net of accumulated depreciation and amortization of: \$121,693 2008; \$117,832 2007 | 56,418 | 58,561 |
| Deferred policy acquisition costs | 225,558 | 226,434 |
| Goodwill | 33,637 | 33,637 |
| Other assets | 43,882 | 43,547 |
| Total assets | \$ 4,970,486 | 5,001,992 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Liabilities: | | |
| Reserve for losses | \$ 2,199,024 | 2,182,572 |
| Reserve for loss expenses | 368,274 | 359,975 |
| Unearned premiums | 850,494 | 841,348 |
| Senior convertible notes | | 8,740 |
| Notes payable | 286,158 | 286,151 |
| Current federal income tax | 5,619 | |

| | | |
|-------------------------------|------------------|-----------|
| Commissions payable | 34,436 | 60,178 |
| Accrued salaries and benefits | 78,257 | 88,079 |
| Other liabilities | 102,532 | 98,906 |
| Total liabilities | 3,924,794 | 3,925,949 |

Stockholders Equity:

Preferred stock of \$0 par value per share:

Authorized shares: 5,000,000; no shares issued or outstanding

Common stock of \$2 par value per share:

Authorized shares: 360,000,000

Issued: 94,851,326 - 2008; 94,652,930 - 2007

189,703

189,306

Additional paid-in capital

203,789

192,627

Retained earnings

1,125,597

1,105,946

Accumulated other comprehensive income

53,205

86,043

Treasury stock at cost (shares: 41,544,557 2008; 40,347,894 2007)

(526,602)

(497,879)

Total stockholders equity

1,045,692

1,076,043

Commitments and contingencies

Total liabilities and stockholders equity

\$ 4,970,486

5,001,992

The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

2

Table of Contents

7

Table of Contents**SELECTIVE INSURANCE GROUP, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME**

| (\$ in thousands, except per share amounts) | Quarters ended March 31, | |
|--|--------------------------|----------|
| | 2008 | 2007 |
| Revenues: | | |
| Net premiums written | \$ 389,840 | 417,185 |
| Net increase in unearned premiums and prepaid reinsurance premiums | (8,567) | (37,172) |
| Net premiums earned | 381,273 | 380,013 |
| Net investment income earned | 37,866 | 39,863 |
| Net realized gains | 1,515 | 11,243 |
| Diversified Insurance Services revenue | 29,799 | 29,178 |
| Other income | 660 | 1,812 |
| Total revenues | 451,113 | 462,109 |
| Expenses: | | |
| Losses incurred | 210,130 | 203,310 |
| Loss expenses incurred | 43,049 | 42,983 |
| Policy acquisition costs | 128,680 | 122,918 |
| Dividends to policyholders | 535 | 1,487 |
| Interest expense | 5,309 | 6,331 |
| Diversified Insurance Services expenses | 25,514 | 24,811 |
| Other expenses | 11,294 | 11,070 |
| Total expenses | 424,511 | 412,910 |
| Income before federal income tax | 26,602 | 49,199 |
| Federal income tax expense (benefit): | | |
| Current | 11,135 | 15,611 |
| Deferred | (5,036) | (3,664) |
| Total federal income tax expense | 6,099 | 11,947 |
| Net income | 20,503 | 37,252 |
| Earnings per share: | | |
| Basic net income | \$ 0.39 | 0.68 |
| Diluted net income | \$ 0.38 | 0.62 |

Dividends to stockholders \$ **0.13** 0.12

The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

Table of Contents**SELECTIVE INSURANCE GROUP, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF
STOCKHOLDERS' EQUITY**

| (\$ in thousands, except per share amounts) | Quarters ended March 31, | | | |
|---|--------------------------|-----------|----------|-----------|
| | | 2008 | 2007 | |
| Common stock: | | | | |
| Beginning of year | \$ | 189,306 | | 183,124 |
| Dividend reinvestment plan (shares: 19,298 2008; 18,764 2007) | | 38 | | 38 |
| Convertible debentures (shares: 45,759 2008; 107,344 2007) | | 92 | | 215 |
| Stock purchase and compensation plans (shares: 133,339 2008; 586,729 2007) | | 267 | | 1,173 |
| End of period | | 189,703 | | 184,550 |
| Additional paid-in capital: | | | | |
| Beginning of year | | 192,627 | | 153,246 |
| Dividend reinvestment plan | | 429 | | 422 |
| Convertible debentures | | 645 | | 171 |
| Stock purchase and compensation plans | | 10,088 | | 10,702 |
| End of period | | 203,789 | | 164,541 |
| Retained earnings: | | | | |
| Beginning of year | | 1,105,946 | | 986,017 |
| Cumulative-effect adjustment due to adoption of FAS 159, net of deferred income tax effect of \$3,344 | | 6,210 | | |
| Net income | | 20,503 | 20,503 | 37,252 |
| Cash dividends to stockholders (\$0.13 per share 2008; \$0.12 per share 2007) | | (7,062) | | (6,842) |
| End of period | | 1,125,597 | | 1,016,427 |
| Accumulated other comprehensive income: | | | | |
| Beginning of year | | 86,043 | | 100,601 |
| Cumulative-effect adjustment due to adoption of FAS 159, net of deferred income tax effect of \$(3,344) | | (6,210) | | |
| Other comprehensive (loss) income (decrease) increase in: | | | | |
| Net unrealized gains on investment securities, Net of deferred income tax effect of \$(14,357) 2008; \$(1,740) 2007 | | (26,663) | (26,663) | (3,232) |
| | | | | (3,232) |

Edgar Filing: SELECTIVE INSURANCE GROUP INC - Form 10-Q

| | | | | |
|--|--------------|---------|-----------|--------|
| Defined benefit pension plans, net of deferred income tax effect of \$19 2008; \$51 2007 | 35 | 35 | 93 | 93 |
| End of period | 53,205 | | 97,462 | |
| Comprehensive (loss) income | | (6,125) | | 34,113 |
| Treasury stock: | | | | |
| Beginning of year | (497,879) | | (345,761) | |
| Acquisition of treasury stock (shares: 1,196,663 2008; 3,127,376 2007) | (28,723) | | (78,355) | |
| End of period | (526,602) | | (424,116) | |
| Total stockholders equity | \$ 1,045,692 | | 1,038,864 | |

Selective Insurance Group, Inc. also has authorized, but not issued, 5,000,000 shares of preferred stock without par value, of which 300,000 shares have been designated Series A junior preferred stock without par value. The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

Table of Contents**SELECTIVE INSURANCE GROUP, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOW**

| (\$ in thousands) | Quarters ended March 31, | |
|--|---------------------------------|-------------|
| | 2008 | 2007 |
| Operating Activities | | |
| Net income | \$ 20,503 | 37,252 |
| <i>Adjustments to reconcile net income to net cash provided by operating activities:</i> | | |
| Depreciation and amortization | 7,129 | 6,975 |
| Share-based compensation expense | 8,896 | 8,630 |
| Net realized gains | (1,515) | (11,243) |
| Deferred tax | (5,036) | (3,664) |
| Unrealized loss on trading securities | 1,888 | |
| <i>Changes in assets and liabilities:</i> | | |
| Increase in reserves for losses and loss expenses, net of reinsurance recoverable on unpaid losses and loss expenses | 29,598 | 63,053 |
| Increase in unearned premiums, net of prepaid reinsurance and advance premiums | 8,295 | 38,107 |
| Increase in net federal income tax payable | 9,854 | 13,206 |
| Increase in premiums receivable | (185) | (37,163) |
| (Increase) decrease in other trade receivables | (618) | 1,633 |
| Decrease (increase) in deferred policy acquisition costs | 876 | (8,656) |
| Decrease in interest and dividends due or accrued | 1,033 | 822 |
| Decrease in reinsurance recoverable on paid losses and loss expenses | 122 | 983 |
| Decrease in accrued salaries and benefits | (11,724) | (20,874) |
| Decrease in accrued insurance expenses | (24,950) | (24,887) |
| Purchase of trading securities | (4,530) | |
| Sale of trading securities | 4,696 | |
| Other-net | 1,621 | 11,030 |
| Net adjustments | 25,450 | 37,952 |
| Net cash provided by operating activities | 45,953 | 75,204 |
| Investing Activities | | |
| Purchase of fixed maturity securities, available-for-sale | (77,944) | (89,915) |
| Purchase of equity securities, available-for-sale | (7,212) | (31,550) |
| Purchase of other investments | (15,506) | (20,228) |
| Purchase of short-term investments | (341,234) | (285,836) |
| Sale of fixed maturity securities, available-for-sale | 30,452 | 8,351 |
| Sale of short-term investments | 318,696 | 325,948 |
| Redemption and maturities of fixed maturity securities, held-to-maturity | 1,492 | 172 |
| Redemption and maturities of fixed maturity securities, available-for-sale | 79,566 | 63,004 |
| Sale of equity securities, available-for-sale | 6,995 | 32,149 |

| | | |
|---|-----------------|----------|
| Proceeds from other investments | 2,609 | 2,578 |
| Purchase of property and equipment | (1,825) | (2,292) |
| Net cash (used in) provided by investing activities | (3,911) | 2,381 |
| Financing Activities | | |
| Dividends to stockholders | (6,572) | (6,262) |
| Acquisition of treasury stock | (28,723) | (78,355) |
| Net proceeds from stock purchase and compensation plans | 2,196 | 1,980 |
| Excess tax benefits from share-based payment arrangements | 1,265 | 2,486 |
| Principal payments of convertible bonds | (8,754) | |
| Net cash used in financing activities | (40,588) | (80,151) |
| Net increase (decrease) in cash and cash equivalents | 1,454 | (2,566) |
| Cash and cash equivalents, beginning of year | 8,383 | 6,443 |
| Cash and cash equivalents, end of period | \$ 9,837 | 3,877 |

Supplemental Disclosures of Cash Flow Information

Cash paid during the year for:

| | | |
|---|-----------------|-------|
| Interest | \$ 1,968 | 3,095 |
| Federal income tax | | 400 |
| Supplemental schedule of non-cash financing activity: | | |
| Conversion of convertible debentures | 169 | 380 |

The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

Table of Contents

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. Organization

Selective Insurance Group, Inc., through its subsidiaries, (collectively referred to as *we* or *our*) offers property and casualty insurance products and diversified insurance services and products. Selective Insurance Group, Inc. was incorporated in New Jersey in 1977 and its main offices are located in Branchville, New Jersey. Selective Insurance Group, Inc.'s common stock is publicly traded on the NASDAQ Global Select Market under the symbol *SIGI*.

We classify our business into three operating segments:

Insurance Operations, which sells property and casualty insurance products and services primarily in 21 states in the Eastern and Midwestern United States;

Investments; and

Diversified Insurance Services, which provides human resource administration outsourcing products and services, and federal flood insurance administrative services.

NOTE 2. Basis of Presentation

These interim unaudited consolidated financial statements (*Financial Statements*) include the accounts of our parent company and its subsidiaries, and have been prepared in conformity with (i) U.S. generally accepted accounting principles (*GAAP*); and (ii) the rules and regulations of the U.S. Securities and Exchange Commission (*SEC*) regarding interim financial reporting. The preparation of *Financial Statements* in conformity with *GAAP* requires us to make estimates and assumptions that affect the reported financial statement balances, as well as the disclosure of contingent assets and liabilities. Actual results could differ from those estimates. All significant intercompany accounts and transactions between our parent company and its subsidiaries are eliminated in consolidation. These *Financial Statements* reflect all adjustments that, in our opinion, are normal, recurring, and necessary for a fair presentation of our results of operations and financial condition. These *Financial Statements* cover the first quarters ended March 31, 2008 (*First Quarter 2008*) and March 31, 2007 (*First Quarter 2007*). These *Financial Statements* do not include all of the information and disclosures required by *GAAP* and the *SEC* for audited financial statements. Results of operations for any interim period are not necessarily indicative of results for a full year. Consequently, these *Financial Statements* should be read in conjunction with the consolidated financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2007 (*2007 Annual Report*).

NOTE 3. Adoption of Accounting Pronouncements

In June 2007, the Emerging Issues Task Force (*EITF*) of the Financial Accounting Standards Board (*FASB*) issued *EITF Issue No. 06-11 Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards* (*EITF 06-11*). *EITF 06-11* requires that the tax benefit from dividends or dividend equivalents that are charged to retained earnings and are paid to employees for equity classified nonvested equity shares, nonvested equity share units, and outstanding equity share options be recognized as an increase to additional paid-in capital. We applied the provisions of this *EITF*, which was effective on a prospective basis beginning with dividends declared in fiscal years beginning after December 15, 2007, in the first quarter of 2008. The adoption of this *EITF* did not have a material impact on our results of operations or financial condition.

NOTE 4. Fair Value Measurements

On January 1, 2008, we adopted *FASB Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (*FAS 159*). *FAS 159* provides companies with an option to report selected financial assets and liabilities at fair value (*fair value option*). We elected to apply the fair value option to a portfolio of securities currently being managed by one outside manager, as this manager requires the flexibility to trade as necessary in order to maximize returns; therefore, we do not have the ability or intent to hold these securities throughout any anticipated recovery periods. The securities for which we elected the fair value option were previously held as available-for-sale securities and are now classified as trading securities.

Table of Contents

The following table provides information regarding the reclassification and corresponding cumulative-effect adjustment on retained earnings resulting from the initial application of FAS 159 for this portfolio:

| | Pre-Adoption Carrying/Fair Value at January 1, 2008 | Impact of Fair Value Election Adoption | Post-Adoption Carrying/Fair Value at January 1, 2008 |
|--------------------------------|--|---|---|
| Equity Securities: | | | |
| Available-for-sale securities | \$ 274,705 | (25,113) | 249,592 |
| Trading securities | | 25,113 | 25,113 |
| Total Equity Securities | 274,705 | | 274,705 |

| | Retained Earnings | Accumulated Other Comprehensive Income | Total |
|--|------------------------------|---|------------------|
| Beginning balance at January 1, 2008 | \$ 1,105,946 | 86,043 | 1,191,989 |
| Pre-tax cumulative effect of adoption of fair value option | 9,554 | (9,554) | |
| Deferred tax impact | (3,344) | 3,344 | |
| Adjusted beginning balance at January 1, 2008 | 1,112,156 | 79,833 | 1,191,989 |

On January 1, 2008, we also adopted FASB Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157), which defines fair value, establishes a framework for measuring fair value, and expands disclosure about fair value measurements. The impact of adopting this standard did not have a material impact on our results of operations or financial condition.

The following table provides quantitative disclosures regarding fair value measurements of our invested assets:

| (\$ in 000s) Description | Fair Value Measurements at 3/31/08 Using Quoted Prices | | | |
|--------------------------------|---|---|--|--|
| | Assets Measured at Fair Value at 3/31/08 | in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Trading securities: | | | | |
| Equity securities | \$ 23,148 | 23,148 | | |
| Available-for-sale securities: | | | | |
| Fixed maturity securities | 3,021,669 | 45,010 | 2,976,659 | |
| Equity securities | 232,787 | 232,787 | | |
| Short-term investments | 212,545 | 212,545 | | |
| Other investments ¹ | 28,649 | | 28,649 | |
| Total | \$ 3,518,798 | 513,490 | 3,005,308 | |

¹ Alternative investments are not included in the above table as they are accounted for under the equity method of accounting and are not carried at fair value.

Investment income associated with the above invested assets is included in net investment income in the Consolidated Income Statement, including unrealized gains and losses on our trading securities. In First Quarter 2008, net investment income included \$1.9 million of loss that was recognized representing the change in market value on our trading securities, the majority of which related to trading securities that we still held as of March 31, 2008.

Fair market valuations in the above table were generated using various valuation techniques. Level 1 fair market values were derived through the use of quoted prices in an active market for identical assets. Level 2 fair market values were derived through matrix pricing, which is a mathematical technique used principally to value debt securities by relying on the securities' relationship to other benchmark quoted securities and not by relying exclusively on quoted prices for specific securities. There were no Level 3 fair market values as of March 31, 2008.

Table of Contents**NOTE 5. Reinsurance**

The following table summarizes the direct, assumed, and ceded reinsurance amounts by income statement caption. For more information concerning reinsurance, refer to Note 7, Reinsurance in Item 8. Financial Statements and Supplementary Data in our 2007 Annual Report.

| (\$ in thousands) | Unaudited | |
|---|---------------------------------|----------|
| | Quarter ended March 31, 2008 | 2007 |
| Premiums written: | | |
| Direct | \$ 435,376 | 456,479 |
| Assumed | 4,670 | 4,484 |
| Ceded | (50,206) | (43,778) |
| Net | \$ 389,840 | 417,185 |
| Premiums earned: | | |
| Direct | \$ 423,175 | 414,764 |
| Assumed | 7,724 | 8,370 |
| Ceded | (49,626) | (43,121) |
| Net | \$ 381,273 | 380,013 |
| Losses and loss expenses incurred: | | |
| Direct | \$ 258,954 | 251,744 |
| Assumed | 5,017 | 6,671 |
| Ceded | (10,792) | (12,122) |
| Net | \$ 253,179 | 246,293 |

The ceded premiums and losses related to our Flood operations are as follows:

| (\$ in thousands) | Unaudited | |
|---|---------------------------------|----------|
| | Quarter ended March 31, 2008 | 2007 |
| Ceded premiums written | \$ (37,778) | (32,019) |
| Ceded premiums earned | (36,507) | (30,881) |
| Ceded losses and loss expenses incurred | (4,788) | (2,263) |

NOTE 6. Segment Information

We have classified our operations into three segments, the disaggregated results of which are reported to and used by senior management to manage our operations:

Insurance Operations, which are evaluated based on statutory underwriting results (net premiums earned (NPE), incurred losses and loss expenses, policyholders dividends, policy acquisition costs, and other underwriting expenses), and statutory combined ratios;

Investments, which are evaluated based on net investment income and net realized gains and losses; and

Diversified Insurance Services, which, because they are not dependent on insurance underwriting cycles, are evaluated based on several measures including, but not limited to, results of operations in accordance with GAAP, with a focus on return on revenues (net income divided by revenues).

Table of Contents

We do not aggregate any of our operating segments. The Insurance Operations and Diversified Insurance Services segments share a common marketing or distribution system and create new opportunities for independent insurance agents to bring value-added services and products to our customers. Our commercial and personal lines property and casualty insurance products, flood insurance, and human resource administration outsourcing products are sold through independent insurance agents.

Our subsidiaries also provide services to each other in the normal course of business. These transactions totaled \$3.4 million in First Quarter 2008 and \$4.4 million in First Quarter 2007. These transactions were eliminated in all consolidated statements. In computing the results of each segment, we do not make adjustments for interest expense, net general corporate expenses, or federal income taxes. We do not maintain separate investment portfolios for the segments and therefore, do not allocate assets to the segments.

The following tables present revenues (net investment income and net realized gains on investments in the case of the Investments segment) and pre-tax income for the individual segments:

| Revenue by segment (\$ in thousands) | Unaudited Quarter ended March 31, | |
|--|--|-------------|
| | 2008 | 2007 |
| Insurance Operations: | | |
| Net premiums earned: | | |
| Commercial automobile | \$ 79,224 | 78,789 |
| Workers compensation | 78,466 | 82,476 |
| General liability | 103,269 | 103,460 |
| Commercial property | 49,936 | 46,568 |
| Business owners policy | 14,142 | 12,841 |
| Bonds | 4,775 | 4,700 |
| Other | 165 | 177 |
| Total commercial lines | 329,977 | 329,011 |
| Personal automobile | 32,605 | 33,936 |
| Homeowners | 16,571 | 15,142 |
| Other | 2,120 | 1,924 |
| Total personal lines | 51,296 | 51,002 |
| Total net premiums earned | 381,273 | 380,013 |
| Miscellaneous income | 660 | 1,751 |
| Total insurance operations revenues | 381,933 | 381,764 |
| Investments: | | |
| Net investment income | 37,866 | 39,863 |
| Net realized gain on investments | 1,515 | 11,243 |
| Total investment revenues | 39,381 | 51,106 |
| Diversified Insurance Services: | | |
| Human resource administration outsourcing | 15,118 | 16,795 |
| Flood insurance | 12,097 | 10,410 |

| | | |
|---|-------------------|---------|
| Other | 2,584 | 1,973 |
| Total Diversified Insurance Services revenues | 29,799 | 29,178 |
| Total all segments | 451,113 | 462,048 |
| Other income | | 61 |
| Total revenues | \$ 451,113 | 462,109 |

Table of Contents

| | Unaudited Quarter ended March 31, | |
|--|--|---------------|
| Income (loss) before federal income tax (\$ in thousands) | 2008 | 2007 |
| Insurance Operations: | | |
| Commercial lines underwriting | \$ 4,371 | 12,630 |
| Personal lines underwriting | (5,823) | (2,913) |
| Underwriting (loss) income, before federal income tax | (1,452) | 9,717 |
| GAAP combined ratio | 100.4% | 97.4 |
| Statutory combined ratio | 98.3% | 95.6 |
| Investments: | | |
| Net investment income | 37,866 | 39,863 |
| Net realized gain on investments | 1,515 | 11,243 |
| Total investment income, before federal income tax | 39,381 | 51,106 |
| Diversified Insurance Services: | | |
| Income before federal income tax | 4,285 | 4,367 |
| Total all segments | 42,214 | 65,190 |
| Interest expense | (5,309) | (6,331) |
| General corporate expenses | (10,303) | (9,660) |
| Income before federal income tax | \$ 26,602 | 49,199 |

NOTE 7. Retirement Plans

The following tables show the costs of the Retirement Income Plan for Selective Insurance Company of America (Retirement Income Plan) and the retirement life insurance component (Retirement Life Plan) of the Welfare Benefits Plan for Employees of Selective Insurance Company of America. For more information concerning these plans, refer to Note 16, Retirement Plans in Item 8. Financial Statements and Supplementary Data in our 2007 Annual Report.

| (\$ in thousands) | Retirement Income Plan Unaudited, Quarter ended March 31, | | Retirement Life Plan Unaudited, Quarter ended March 31, | |
|---|--|-------------|--|-------------|
| | 2008 | 2007 | 2008 | 2007 |
| Components of Net Periodic Benefit Cost: | | | | |
| Service cost | \$ 1,759 | 1,788 | 81 | 81 |
| Interest cost | 2,440 | 2,184 | 134 | 125 |
| Expected return on plan assets | (2,961) | (2,710) | | |
| Amortization of unrecognized prior service cost | 37 | 38 | (8) | (8) |
| Amortization of unrecognized net loss | 25 | 114 | | |
| Net periodic cost | \$ 1,300 | 1,414 | 207 | 198 |

**Weighted-Average Expense Assumptions for
the years ended December 31:**

| | | | | |
|--------------------------------|--------------|------|--------------|------|
| Discount rate | 6.50% | 5.90 | 6.50% | 5.90 |
| Expected return on plan assets | 8.00% | 8.00 | % | |
| Rate of compensation increase | 4.00% | 4.00 | 4.00% | 4.00 |

Table of Contents**Note 8. Comprehensive (Loss) Income**

The components of comprehensive (loss) income, both gross and net of tax, are as follows:

Quarter ended March 31, 2008

(\$ in thousands)

| | Gross | Tax | Net |
|--|--------------|------------|------------|
| Net Income | \$ 26,602 | 6,099 | 20,503 |
| Components of other comprehensive loss: | | | |
| <i>Unrealized losses on securities:</i> | | | |
| Unrealized holding losses during the period | (39,515) | (13,830) | (25,685) |
| Less: Reclassification adjustment for gains included in net income | (1,505) | (527) | (978) |
| Net unrealized losses | (41,020) | (14,357) | (26,663) |
| <i>Defined benefit pension plans:</i> | | | |
| Reversal of amortization items: | | | |
| Net actuarial loss | 25 | 9 | 16 |
| Prior service cost | 29 | 10 | 19 |
| Defined benefit pension plans | 54 | 19 | 35 |
| Comprehensive loss | \$ (14,364) | (8,239) | (6,125) |

Quarter ended March 31, 2007

(\$ in thousands)

| | Gross | Tax | Net |
|--|--------------|------------|------------|
| Net income | \$ 49,199 | 11,947 | 37,252 |
| Components of other comprehensive income: | | | |
| <i>Unrealized gains/(losses) on securities:</i> | | | |
| Unrealized holding gains during the period | 6,271 | 2,195 | 4,076 |
| Previous unrealized gains currently realized in net income | (11,243) | (3,935) | (7,308) |
| Net unrealized losses | (4,972) | (1,740) | (3,232) |
| <i>Defined benefit pension plans:</i> | | | |
| Reversal of amortization items: | | | |
| Net actuarial loss | 114 | 40 | 74 |
| Prior service cost | 30 | 11 | 19 |
| Defined benefit pension plans | 144 | 51 | 93 |
| Comprehensive income | \$ 44,371 | 10,258 | 34,113 |

NOTE 9. Commitments and Contingencies

At March 31, 2008, we had contractual obligations that expire at various dates through 2022 to invest up to an additional \$146.5 million in other investments. There is no certainty that any such additional investment will be required.

Table of Contents

NOTE 10. Litigation

In the ordinary course of conducting business, we are named as defendants in various legal proceedings. Most of these proceedings are claims litigation involving our seven insurance subsidiaries (the Insurance Subsidiaries) as either (a) liability insurers defending or providing indemnity for third-party claims brought against insureds or (b) insurers defending first-party coverage claims brought against us. We account for such activity through the establishment of unpaid loss and loss adjustment expense reserves. We expect that the ultimate liability, if any, with respect to such ordinary-course claims litigation, after consideration of provisions made for potential losses and costs of defense, will not be material to our consolidated financial condition, results of operations, or cash flows.

Our Insurance Subsidiaries are also from time to time involved in other legal actions, some of which assert claims for substantial amounts. These actions include, among others, putative state class actions seeking certification of a state or national class. Such putative class actions have alleged, for example, improper reimbursement of medical providers paid under workers compensation and personal and commercial automobile insurance policies. Our Insurance Subsidiaries are also from time to time involved in individual actions in which extra-contractual damages, punitive damages, or penalties are sought, such as claims alleging bad faith in the handling of insurance claims. We believe that we have valid defenses to these cases. We expect that the ultimate liability, if any, with respect to such lawsuits, after consideration of provisions made for estimated losses, will not be material to our consolidated financial condition. Nonetheless, given the large or indeterminate amounts sought in certain of these actions, and the inherent unpredictability of litigation, an adverse outcome in certain matters could, from time to time, have a material adverse effect on our consolidated results of operations or cash flows in particular quarterly or annual periods.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

In this Quarterly Report on Form 10-Q, we discuss and make statements regarding our intentions, beliefs, current expectations, and projections regarding our company's future operations and performance. Such statements are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are often identified by words such as anticipates, believes, expects, will, should, and intends and their negatives. We caution prospective investors that such forward-looking statements are not guarantees of future performance. Risks and uncertainties are inherent in our future performance. Factors that could cause actual results to differ materially from those indicated by such forward-looking statements include, but are not limited to, those discussed under Item 1A. Risk Factors in our 2007 Annual Report. These risk factors may not be exhaustive. We operate in a continually changing business environment and new risk factors may emerge from time to time. We can neither predict such new risk factors nor can we assess the impact, if any, of such new risk factors on our businesses or the extent to which any factor or combination of factors may cause actual results to differ materially from those expressed or implied in any forward-looking statements in this report. In light of these risks, uncertainties, and assumptions, the forward-looking events discussed in this report might not occur. We make forward-looking statements based on currently available information and assume no obligation to update these statements due to changes in underlying factors, new information, future developments, or otherwise.

Introduction

We offer property and casualty insurance products and diversified insurance services through our various subsidiaries. We classify our businesses into three operating segments: (i) Insurance Operations, (ii) Investments, and (iii) Diversified Insurance Services.

The purpose of the Management's Discussion and Analysis (MD&A) is to provide an understanding of the consolidated results of operations and financial condition and known trends and uncertainties that may have a material impact in future periods. Consequently, investors should read the MD&A in conjunction with the consolidated financial statements in our 2007 Annual Report.

In the MD&A, we will discuss and analyze the following:

Critical Accounting Policies and Estimates;

Financial Highlights of Results for First Quarter 2008 and First Quarter 2007;

Results of Operations and Related Information by Segment;

Financial Condition, Liquidity, and Capital Resources;

Off-Balance Sheet Arrangements;

Contractual Obligations and Contingent Liabilities and Commitments; and

Federal Income Taxes.

Critical Accounting Policies and Estimates

These unaudited interim consolidated financial statements include amounts based on our informed estimates and judgments for those transactions that are not yet complete. Such estimates and judgments affect the reported amounts in the financial statements. Those estimates and judgments that were most critical to the preparation of the financial statements involved the following: (i) reserves for losses and loss expenses; (ii) deferred policy acquisition costs; (iii) pension and postretirement benefit plan actuarial assumptions; (iv) other-than-temporary investment impairments; (v) goodwill; and (vi) reinsurance. These estimates and judgments require the use of assumptions about matters that are highly uncertain and, therefore, are subject to change as facts and circumstances develop. If different estimates and judgments had been applied, materially different amounts might have been reported in the financial statements. Our

2007 Annual Report, pages 37 through 44, provides a discussion of each of these critical accounting policies.

Table of Contents**Financial Highlights of Results for First Quarter 2008 and First Quarter 2007**

| (\$ in thousands, except per share amounts) | Unaudited Quarter ended March 31, | | Change % or Points |
|---|---|---------|--------------------------|
| | 2008 | 2007 | |
| Total revenues | \$ 451,113 | 462,109 | (2)% |
| Net income | 20,503 | 37,252 | (45) |
| Diluted net income per share | 0.38 | 0.62 | (39) |
| Diluted weighted-average outstanding shares | 53,882 | 60,372 | (11) |
| GAAP combined ratio | 100.4% | 97.4 | 3.0 pts |
| Statutory combined ratio | 98.3 | 95.6 | 2.7 |
| Annualized return on average equity | 7.7 | 14.1 | (6.4) |

Net income decreased in First Quarter 2008 compared to First Quarter 2007 reflecting:

A \$9.7 million revenue decrease related to net realized investment gains that were \$1.5 million in First Quarter 2008 compared to \$11.2 million in First Quarter 2007. This decrease, which was \$6.3 million on an after-tax basis, resulted from the sale of various equity securities in First Quarter 2007 to reallocate sector exposures.

A \$2.0 million revenue decrease related to net investment income that was \$37.9 million in First Quarter 2008 compared to \$39.9 million in First Quarter 2007. This decrease, which was \$1.8 million on an after-tax basis, was primarily the result of a \$1.9 million pre-tax decrease in the fair value of our trading portfolio.

A \$2.3 million after-tax restructuring charge reflecting costs associated with our workforce reduction expense initiative in which approximately 80 positions were eliminated, including 60 employees that were displaced. As the result of this initiative, we anticipate realizing annualized pre-tax savings of approximately \$7 million.

The physical damage portion of our commercial automobile line of business and our commercial property line of business reflect increased severity reflected in after-tax property losses of \$3.7 million. In addition, our Commercial Lines have put some pressure on the GAAP loss and loss expense ratio compared to the same period last year reflecting ongoing pure price reductions on renewal business, as evidenced by pure price decreases that amounted to 3% in First Quarter 2008. Partially offsetting these items are continued profitability improvements in our workers compensation line of business due to the execution of our strategic initiatives on this line.

Diluted net income per share decreased in First Quarter 2008 compared to First Quarter 2007 due to the net income decreases described above, partially offset by the reduction in diluted weighted-average shares outstanding. As part of our capital management program, in the twelve-month period ending March 31, 2008, we repurchased approximately 3.8 million shares under our authorized repurchase programs and, during the fourth quarter of 2007, we net-share settled our senior convertible notes resulting in the issuance of approximately 1.2 million shares as well as the elimination of approximately 3.2 million common stock equivalents.

Results of Operations and Related Information by Segment**Insurance Operations**

Our Insurance Operations segment writes property and casualty insurance business through seven insurance subsidiaries (the Insurance Subsidiaries). Our Insurance Operations segment sells property and casualty insurance products and services primarily in 21 states in the Eastern and Midwestern United States through approximately 900 independent insurance agencies. Our Insurance Operations segment consists of two components: (i) commercial lines (Commercial Lines), which markets primarily to businesses, and represents approximately 86% of net premiums written (NPW), and (ii) personal lines (Personal Lines), which markets primarily to individuals and represents

approximately 14% of NPW. The underwriting performance of these lines are generally measured by four different statutory ratios: (i) loss and loss expense ratio; (ii) underwriting expense ratio; (iii) dividend ratio; and (iv) combined ratio. For further details regarding these ratios see the discussion in the Insurance Operations Results section of Item 1. Business. of our 2007 Annual Report.

Table of Contents**Summary of Insurance Operations**

| All Lines (\$ in thousands) | Unaudited Quarter ended March 31, | | Change % or Points |
|---|---|---------|--------------------------|
| | 2008 | 2007 | |
| GAAP Insurance Operations Results: | | | |
| NPW | \$ 389,840 | 417,185 | (7)% |
| NPE | 381,273 | 380,013 | |
| Less: | | | |
| Losses and loss expenses incurred | 253,179 | 246,293 | 3 |
| Net underwriting expenses incurred | 129,011 | 122,516 | 5 |
| Dividends to policyholders | 535 | 1,487 | (64) |
| Underwriting (loss) income | \$ (1,452) | 9,717 | (115)% |
| GAAP Ratios: | | | |
| Loss and loss expense ratio | 66.4% | 64.8 | 1.6 pts |
| Underwriting expense ratio | 33.9% | 32.2 | 1.7 |
| Dividends to policyholders ratio | 0.1% | 0.4 | (0.3) |
| Combined ratio | 100.4% | 97.4 | 3.0 |
| Statutory Ratios:¹ | | | |
| Loss and loss expense ratio | 65.9% | 64.5 | 1.4 |
| Underwriting expense ratio | 32.3% | 30.7 | 1.6 |
| Dividends to policyholders ratio | 0.1% | 0.4 | (0.3) |
| Combined ratio | 98.3% | 95.6 | 2.7 pts |

¹ The statutory ratios include our flood line of business, which is included in the Diversified Insurance Services segment on a GAAP basis and therefore excluded from the GAAP ratios. The total statutory combined ratio excluding flood

was 98.9% for
First Quarter
2008 compared
to 96.1% for
First Quarter
2007.

NPW decreased in First Quarter 2008 compared to First Quarter 2007 due to the highly competitive insurance marketplace and the slowing economy. These factors are evidenced in our new business, which was \$74.7 million, down from \$85.2 million in First Quarter 2007, and the following:

A \$5.6 million decrease in net renewals, reflecting relatively flat retention of 78% and commercial line renewal price decreases of 0.4% in First Quarter 2008 compared to renewal price increases of 0.4% in First Quarter 2007.

A \$6.5 million decrease in endorsement and audit activity.

These decreases were partially offset by a \$2.8 million increase in Personal Lines NPW due to increased retention in our homeowners line of business and higher rates on both homeowners and personal automobile written outside of New Jersey, partially offset by a decrease in New Jersey personal automobile business resulting from the loss of a portion of our book that was repriced at higher pricing levels through our MATRIX[®] pricing system and subsequently did not renew.

The 1.6-point increase in the GAAP loss and loss expense ratio in First Quarter 2008 compared to First Quarter 2007 was primarily attributable to an increase of 1.5 points attributable to the physical damage portion of our commercial automobile line of business and our commercial property line of business. In addition, our Commercial Lines have put some pressure on the GAAP loss and loss expense ratio compared to the same period last year reflecting ongoing pure price reductions on renewal business, as evidenced by pure price decreases that amounted to 3% in First Quarter 2008. Partially offsetting these items are continued profitability improvements in our workers compensation line of business due to the execution of our strategic initiatives on this line.

Table of Contents

The increase in the GAAP underwriting expense ratio in First Quarter 2008 compared to First Quarter 2007 was primarily attributable to increases in underwriting expenses and a decline in NPW. The expense increases are primarily driven by a \$3.6 million, or 1.0 point, restructuring charge in First Quarter 2008 that is expected to generate \$7 million in annualized pre-tax savings. While the restructuring will reduce labor costs, the GAAP underwriting expense ratio will not realize the benefit of this initiative until previously deferred labor costs are fully recognized in expense over the next twelve months. It is our expectation that as these higher labor costs are recognized, deferred policy acquisition costs as a percentage of our unearned premium balance will decline. In addition to the restructuring charge in First Quarter 2008, we announced targeted changes to agency commissions that will be implemented in most states in July 2008. These changes maintain highly competitive awards for agents who produce the strongest results for us, while reducing commissions where our historically higher payments have not generated an appropriate level of profitable growth. The changes will bring our program more in line with the competition; however commissions on 87% of our direct premiums written will not be affected and the supplemental commission program that rewards agencies that generate profitable growth will not be affected by the changes. These commission revisions are expected to generate annualized pre-tax savings of approximately \$7 million.

Insurance Operations Outlook

Historically, the results of the property and casualty insurance industry have experienced significant fluctuations due to competition, economic conditions, interest rates, loss cost trends, and other factors. During 2007, the industry experienced low levels of catastrophe losses and a softening market characterized by accelerated competition, leading to pricing deterioration in the primary insurance market that was worse than originally anticipated. This trend is intensifying and we expect it to continue throughout 2008 and potentially into 2009. The average forecast, according to the U.S. Property/Casualty Review & Preview from A.M. Best (the Forecast) dated January 28, 2008, calls for negative growth in NPW of 0.6% in 2008 and an increase in expected statutory combined ratios, both of which indicate underwriting deterioration. Accelerated marketplace competition, coupled with low premium growth rates, has also led to an increased interest in merger and acquisition activity within the industry. In First Quarter 2008, Standard & Poor's (S&P) indicated their belief that, if price declines continue at their current pace, analyst outlooks on some commercial lines carriers will likely be revised downward in the second half of 2008, possibly leading to a negative outlook for the commercial lines sector by the end of the year.

In an effort to grow our business profitably in these challenging market conditions, we have implemented a clearly defined plan to improve risk selection and mitigate higher frequency and severity trends to compliment our strong agency relationships and unique field-based model. Some of the tools we use to lower frequency and severity are knowledge management, predictive modeling, safety management, managed care, and enhanced claims review. We have developed market-planning tools that allow us to strategically appoint additional independent agencies and agency management specialists (AMSs) in under-penetrated territories that have classes of business we know historically have been profitable. Through the end of First Quarter 2008, the Insurance Subsidiaries wrote business through approximately 900 independent insurance agencies, who are serviced by approximately 100 field-based AMSs making hands-on underwriting decisions on a daily basis.

In addition to this high touch component of our business model, we have developed technology that allows agents and the Insurance Subsidiaries field teams to input business seamlessly into our systems, while also allowing them to select and price accounts at optimal levels through predictive modeling. Technology that allows for the seamless placement of business into our systems includes our One & Done® small business system and our xSELeRate® straight-through processing system. Premiums of \$271,000 per workday were processed through our One & Done® small business system in First Quarter 2008, up 27% from First Quarter 2007. We have set a multi-year small business growth target of \$350,000 in One & Done® business per work day, and in 2008 our efforts are centered on: (i) better managing price points and scale; (ii) implementing a more comprehensive marketing and branding strategy; and (iii) updating the distribution model to address agent and customer needs.

We also continue to pursue our organic growth strategy. In 2007, we entered our 21st primary state, Massachusetts, for Commercial Lines only, and we have expanded Personal Lines into Rhode Island, Minnesota, and Iowa, states already within our existing Commercial Lines footprint. In 2008, we have plans to expand our footprint to Tennessee, where

we expect to make an initial appointment of 20 agencies and to start writing Commercial Lines business in June or July of 2008, with Personal Lines business later in 2008. In addition to our organic growth strategy, we are taking note of opportunities that marketplace competition may be creating and do not rule out making an opportunistic acquisition.

Table of Contents**Review of Underwriting Results by Line of Business****Commercial Lines Results**

| Commercial Lines (\$ in thousands) | Unaudited Quarter ended March 31, | | Change % or Points |
|---|---|---------|--------------------------|
| | 2008 | 2007 | |
| GAAP Insurance Operations Results: | | | |
| NPW | \$ 340,086 | 370,256 | (8)% |
| NPE | 329,977 | 329,011 | |
| Less: | | | |
| Losses and loss expenses incurred | 213,189 | 208,259 | 2 |
| Net underwriting expenses incurred | 111,882 | 106,635 | 5 |
| Dividends to policyholders | 535 | 1,487 | (64) |
| Underwriting income | \$ 4,371 | 12,630 | (65)% |
| GAAP Ratios: | | | |
| Loss and loss expense ratio | 64.6% | 63.3 | 1.3 pts |
| Underwriting expense ratio | 33.9% | 32.4 | 1.5 |
| Dividends to policyholders ratio | 0.2% | 0.5 | (0.3) |
| Combined ratio | 98.7% | 96.2 | 2.5 |
| Statutory Ratios: | | | |
| Loss and loss expense ratio | 64.2% | 63.0 | 1.2 |
| Underwriting expense ratio | 32.5% | 30.6 | 1.9 |
| Dividends to policyholders ratio | 0.2% | 0.4 | (0.2) |
| Combined ratio | 96.9% | 94.0 | 2.9 pts |

NPW decreased in First Quarter 2008 compared to First Quarter 2007 due to the highly competitive insurance marketplace and the slowing economy, which is primarily impacting our contractors business, which represents 45% of our Commercial Lines operations. These factors are evidenced in total Commercial Lines new business, which amounted to \$63.6 million in First Quarter 2008, down from \$76.7 million in First Quarter 2007, and the following:

A \$5.8 million decrease in Commercial Lines net renewals, which includes relatively flat retention of 78% and commercial lines renewal price decreases of 0.4% in First Quarter 2008 compared to renewal price increases of 0.4% in First Quarter 2007. We are experiencing the most pressure on the high end of our middle market and large account business, in response to which our agents are actively managing our book by renewing accounts as much as 60 days in advance of the expiration date.

A \$6.4 million decrease in Commercial Lines endorsement and audit activity.

NPE was flat in First Quarter 2008 compared to First Quarter 2007, consistent with the fluctuation in NPW for the twelve-month period ended March 31, 2008 as compared to the twelve-month period ended March 31, 2007.

The 1.3-point increase in the GAAP loss and loss expense ratio in First Quarter 2008 compared to First Quarter 2007 was primarily attributable to the physical damage portion of our commercial automobile line of business and our commercial property line of business. In addition, our Commercial Lines have put some pressure on the GAAP loss and loss expense ratio compared to the same period last year reflecting ongoing pure price reductions on renewal business, as evidenced by pure price decreases that amounted to 3% in First Quarter 2008. Partially offsetting these items are continued profitability improvements in our workers compensation line of business due to the execution of our strategic initiatives on this line.

The deterioration in the GAAP underwriting expense ratio in First Quarter 2008 compared to First Quarter 2007 was primarily driven by a \$3.6 million restructuring charge in First Quarter 2008, of which \$3.1 million was related to our Commercial Lines business. The restructuring charge, which added approximately 1.0 point to the Commercial Lines GAAP underwriting ratio, reflects costs associated with our workforce reduction expense initiative in First Quarter 2008. While the restructuring will reduce labor costs, the GAAP underwriting expense ratio will not realize the benefit of this initiative until previously deferred labor costs are fully recognized in expense over the next twelve months. It is our expectation that as these higher labor costs are recognized, deferred policy acquisition costs as a percentage of our unearned premium balance will decline.

Table of Contents

The following is a discussion of our most significant commercial lines of business:

General Liability

| (\$ in thousands) | Unaudited Quarter ended March 31, | | Change % or Points |
|-------------------------------------|---|---------|--------------------------|
| | 2008 | 2007 | |
| Statutory NPW | \$ 111,283 | 118,691 | (6)% |
| Statutory NPE | 103,269 | 103,460 | |
| Statutory combined ratio | 97.1% | 95.0 | 2.1 pts |
| % of total statutory commercial NPW | 33% | 32 | |

New business premiums in this line of business were down \$2.9 million, or 13%, in First Quarter 2008 compared to First Quarter 2007; and premiums for endorsement and audit activity were down \$3.2 million, or 76%, for the same comparative periods. In addition, retention on this line decreased one point to 76% in First Quarter 2008 compared to 77% in First Quarter 2007. These decreases are primarily driven by the competitive nature of the insurance marketplace. We are experiencing the highest level of competition in our middle market and large account business, while our small account business, which we define as policies with premiums less than \$25,000, experienced moderate growth. Overall policy counts for this line increased 6% in First Quarter 2008 compared to First Quarter 2007.

Pricing pressure and higher loss costs continue to put pressure on profitability in this line of business. However we continue to concentrate on our long-term strategy to improve profitability, which focuses on: (i) contractor growth in business segments with lower completed operations exposures; and (ii) contract and subcontractor underwriting guidelines to minimize losses.

Workers Compensation

| (\$ in thousands) | Unaudited Quarter ended March 31, | | Change % or Points |
|-------------------------------------|---|--------|--------------------------|
| | 2008 | 2007 | |
| Statutory NPW | \$ 80,300 | 93,651 | (14)% |
| Statutory NPE | 78,466 | 82,489 | (5) |
| Statutory combined ratio | 94.5% | 98.2 | (3.7) pts |
| % of total statutory commercial NPW | 23% | 25 | |

In First Quarter 2008, NPW on this line decreased, despite a 3% increase in total policy counts, which is primarily the result of: (i) competitive pressure, mainly on the upper end of our middle market business and our large account business; (ii) a one-point decrease in retention to 78% in First Quarter 2008 compared to 79% in First Quarter 2007; and (iii) renewal price increases, including exposure, which were 0.9% in First Quarter 2008 compared to 2.9% in First Quarter 2007.

The 3.7-point improvement in the statutory combined ratio of this line in First Quarter 2008 compared to First Quarter 2007 reflects: (i) the ongoing progress resulting from the execution of our multi-faceted workers compensation strategy, which incorporates our knowledge management and predictive modeling initiatives and underwriting process improvements, that enable us to retain and write more of our best accounts; and (ii) favorable prior year statutory development of approximately \$4 million, or 5.1 points, in First Quarter 2008 compared to favorable development in First Quarter 2007 of approximately \$2 million, or 2.4 points.

Table of ContentsCommercial Automobile

| (\$ in thousands) | Unaudited Quarter ended March 31, | | Change % or Points |
|-------------------------------------|---|--------|--------------------------|
| | 2008 | 2007 | |
| Statutory NPW | \$ 80,198 | 87,747 | (9)% |
| Statutory NPE | 79,224 | 78,789 | 1 |
| Statutory combined ratio | 100.1% | 88.0 | 12.1 pts |
| % of total statutory commercial NPW | 23% | 24 | |

NPW for this line of business decreased in First Quarter 2008 compared to First Quarter 2007, while total policy counts increased 4% for the comparable periods. Renewal prices, including exposure, decreased 3.2% in First Quarter 2008 compared to a 2.1% decrease in First Quarter 2007.

The increase in the statutory combined ratio for this line is primarily due to:

Physical damage losses that were \$3.8 million or approximately 5 points higher in First Quarter 2008 compared to First Quarter 2007. These increases reflect normal volatility that is inherent in property line results.

No favorable prior year development in First Quarter 2008 compared to favorable prior year development of \$3 million in First Quarter 2007 that reduced the combined ratio by approximately 4 points in First Quarter 2007. During First Quarter 2008, accident year 2007 developed unfavorably because of an increase in claims severity; however, this activity was completely offset by favorable emergence related to prior accident years.

Renewal price decreases, as mentioned above, contributed approximately 3 points to the combined ratio in First Quarter 2008.

Commercial Property

| (\$ in thousands) | Unaudited Quarter ended March 31, | | Change % or Points |
|-------------------------------------|---|--------|--------------------------|
| | 2008 | 2007 | |
| Statutory NPW | \$ 48,244 | 51,067 | (6)% |
| Statutory NPE | 49,936 | 46,568 | 7 |
| Statutory combined ratio | 96.6% | 92.1 | 4.5 pts |
| % of total statutory commercial NPW | 14% | 14 | |

NPW for this line of business decreased in First Quarter 2008 compared to First Quarter 2007 due to: (i) decreased retention to approximately 76% in First Quarter 2008 compared to 79% in First Quarter 2007; (ii) renewal price decreases, including exposure, of 0.2% in First Quarter 2008 compared to renewal price increases of 1.6% in First Quarter 2007; and (iii) decreased direct new policy premium of 13% in First Quarter 2008 to \$10.3 million.

The statutory combined ratio on this line was impacted by increased severity in First Quarter 2008 and also by pricing, as mentioned above. Property losses, by their very nature, are volatile. Despite the volatility that we experienced in the quarter, results remained profitable at a 96.6% statutory combined ratio. In First Quarter 2008, catastrophe losses decreased by \$0.2 million to \$3.3 million compared to First Quarter 2007.

Table of Contents**Personal Lines Results**

| Personal Lines (\$ in thousands) | Unaudited Quarter ended March 31, | | Change % or Points |
|---|---|---------|--------------------------|
| | 2008 | 2007 | |
| GAAP Insurance Operations Results: | | | |
| NPW | \$ 49,754 | 46,929 | 6% |
| NPE | 51,296 | 51,002 | 1 |
| Less: | | | |
| Losses and loss expenses incurred | 39,990 | 38,034 | 5 |
| Net underwriting expenses incurred | 17,129 | 15,881 | 8 |
| Underwriting income (loss) | \$ (5,823) | (2,913) | (100)% |
| GAAP Ratios: | | | |
| Loss and loss expense ratio | 78.0% | 74.6 | 3.4 pts |
| Underwriting expense ratio | 33.4% | 31.1 | 2.3 |
| Combined ratio | 111.4% | 105.7 | 5.7 |
| Statutory Ratios:¹ | | | |
| Loss and loss expense ratio | 77.6% | 74.3 | 3.3 |
| Underwriting expense ratio | 30.2% | 31.7 | (1.5) |
| Combined ratio | 107.8% | 106.0 | 1.8 pts |

¹ The statutory ratios include our flood line of business, which is included in the Diversified Insurance Services segment on a GAAP basis and therefore excluded from the GAAP ratios. The total Personal Lines statutory combined ratio excluding flood was 112.0% for First Quarter

2008 compared
to 110.3% for
First Quarter
2007.

NPW increased in First Quarter 2008 compared to First Quarter 2007 due to:

Increased retention in our homeowners line of business of two points to 87%, and renewal rate increases in the range of 5% - 7% that were filed in New Jersey, Virginia and South Carolina and were effective subsequent to First Quarter 2007; and

Increased personal automobile business outside of New Jersey driven by average renewal rate increases of 13.1% in Pennsylvania effective August 1, 2007, and 8.5% in Maryland effective September 1, 2007. These changes applied to business written prior to the implementation of our Matrix[®] program in these states. To a lesser extent, we have also increased auto rates in four other states during First Quarter 2008.

These items were partially offset by a decline in NPW for our New Jersey personal automobile business of \$0.6 million to \$19.9 million for First Quarter 2008 compared to \$20.5 million for First Quarter 2007. The New Jersey personal automobile market has been impacted by the introduction of new competitors writing business in the state with rating plans that allow them to price accounts competitively without the legacy issue of repricing existing accounts through filed rate increases. In the third quarter of 2007, we completed the transition of our entire existing renewal inventory into our new pricing and tiering structure in New Jersey. This transition has caused a dislocation in this book of business due to the repricing of certain business at higher levels, some of which did not renew, as evidenced by a reduction in the number of New Jersey personal automobiles that we insure to 70,296 at March 31, 2008, from 74,709 at March 31, 2007.

Table of Contents

The deterioration in the GAAP loss and loss expense ratio in First Quarter 2008 compared to First Quarter 2007 was primarily attributable to the following:

Increases in property losses of \$0.7 million, or 1.2 points, including increases in catastrophe losses of \$0.4 million, or 0.9 points; and

Insignificant prior year development in First Quarter 2008 compared to net favorable prior year loss and loss expense development of \$2 million, or 3.6 points, in First Quarter 2007.

The deterioration in the GAAP underwriting expense ratio in First Quarter 2008 compared to First Quarter 2007 was primarily driven by a \$3.6 million restructuring charge in First Quarter 2008, of which \$0.5 million was related to our Personal Lines business. As mentioned in the Financial Highlights section above, the restructuring charge, which added approximately 1.0 point to the Personal Lines GAAP underwriting ratio, reflects costs associated with our workforce reduction expense initiative in First Quarter 2008. While the restructuring will reduce labor costs, the GAAP underwriting expense ratio will not realize the benefit of this initiative until previously deferred labor costs are fully recognized in expense over the next twelve months. It is our expectation that as these higher labor costs are recognized, deferred policy acquisition costs as a percentage of our unearned premium balance will decline.

In order to address profitability concerns in our Personal Lines, we have developed an improvement plan that incorporates the following:

Automobile rate increases of 6.8% in New Jersey, which has been approved and will be effective May 15, 2008, 7.3% in Pennsylvania, which has been filed and we expect to be able to implement in July, and 6% in Maryland, which we expect to implement in August. Three additional auto rate increases are targeted for the second quarter of 2008. The New Jersey change applies to all business. The Pennsylvania and Maryland changes apply to business originally written prior to the implementation of our MATRIX[®] program and address regulatory restrictions on moving the renewal book into our new pricing methodology.

Homeowners rate increases of 6% in Illinois and 10% in Indiana, which have been approved and was effective May 1, 2008.

In August 2008, we will be able to receive the full indicated rate on all MATRIX[®] automobile renewal business, as these policies will no longer be subject to the 20% annual cap imposed by the New Jersey Department of Banking and Insurance.

Investments

Our investment portfolio consists primarily of fixed maturity securities (82%), but also contains equity securities (7%), short-term investments (6%), and other investments (5%). Our investment philosophy includes certain return and risk objectives for the fixed maturity and equity portfolios. The primary return objective of the fixed maturity portfolio is to maximize after-tax investment yield and income while balancing risk; a secondary objective is to meet or exceed a weighted-average benchmark of public fixed income indices. The return objective of the equity portfolio is to meet or exceed a weighted-average benchmark of public equity indices. We aim to structure our portfolio conservatively with a focus on: (i) asset diversification; (ii) investment quality; (iii) liquidity, particularly to meet the cash obligations of the Insurance Operations segment; (iv) consideration of taxes; and (v) preservation of capital.

| (\$ in thousands) | Unaudited Quarter ended March 31, | | Change % or Points |
|-----------------------------------|---|--------|--------------------------|
| | 2008 | 2007 | |
| Net investment income, before tax | \$ 37,866 | 39,863 | (5)% |
| Net investment income, after tax | 29,371 | 31,157 | (6) |

Edgar Filing: SELECTIVE INSURANCE GROUP INC - Form 10-Q

| | | | |
|--|------------------|-----------|-----------|
| Total invested assets | 3,691,622 | 3,592,015 | 3 |
| Effective tax rate | 22.4% | 21.8 | 0.6 pts |
| Annual after-tax yield on fixed maturity securities | 3.6 | 3.6 | pts |
| Annual after-tax yield on total investment portfolio | 3.2 | 3.5 | (0.3) pts |

Table of Contents

A decrease in net investment income, before tax, of \$2.0 million for First Quarter 2008 compared to First Quarter 2007 was primarily attributable to a \$1.9 million decrease in the fair value of our equity trading portfolio, which was established on January 1, 2008 upon our adoption of FAS 159 (see Note 4. Fair Value Measurements in Item 1.

Financial Information of this Form 10-Q for further details). The value of the investment portfolio reached \$3.7 billion at March 31, 2008, an increase of 3% compared to \$3.6 billion at March 31, 2007.

In First Quarter 2008, we determined that it was prudent to increase our minimum targeted cash and short-term investment balances due to the volatility in the financial markets, despite the opportunity cost associated with this decision. As a result, our average short-term balance of \$236 million in First Quarter 2008 is 17% higher than the \$202 million average balance in First Quarter 2007. In addition, First Quarter 2008 short-term investment balances were invested in a U.S. Treasury money market fund, which earns a lower yield than a money market fund, our traditional short-term investment vehicle. This decision was made to address potential liquidity concerns regarding the underlying investments generally held by money market funds.

We continue to maintain a conservative, diversified investment portfolio, with fixed maturity investments representing 82% of invested assets. Sixty four percent (64%) of the fixed maturities portfolio is rated AAA, while the portfolio has an average rating of AA+, S&P's second highest credit quality rating. The shift in the percentage of securities rated AAA to those rated AA since December 31, 2007 is primarily due to downgrades of mono-line insurers, which have adversely impacted the ratings on our municipal bond and asset-backed portfolios. At March 31, 2008, securities with insurance enhancement represented 29% of our fixed maturity securities portfolio. The underlying fixed maturity securities have an average credit rating of AA-, without the insurance enhancement. High credit quality continues to be a cornerstone of our investment strategy, as evidenced by the fact that almost 100% of the fixed maturity securities are investment grade. At March 31, 2008, non-investment grade securities (below BBB-) represented less than 1%, or approximately \$10.0 million, of the fixed maturity portfolio. Our mortgage-backed securities portfolio totaled \$675.1 million at March 31, 2008, with an average credit rating of AA+. We have minimal sub-prime mortgage exposure. Prior to investing in mortgage-backed securities, we analyze, among other credit factors, the underlying FICO credit scores and loan to value ratios.

The following table presents the Moody's Investor Service (Moody's) and S&P's ratings of the fixed maturities portfolio:

| Rating | Unaudited March 31, 2008 | Unaudited December 31, 2007 |
|----------------|---|--|
| Aaa/AAA | 64% | 69% |
| Aa/AA | 19% | 16% |
| A/A | 11% | 9% |
| Baa/BBB | 6% | 6% |
| Ba/BB or below | <1% | <1% |
| Total | 100% | 100% |

Our fixed maturity investment strategy is to make security purchases that are attractively priced in relation to perceived credit risks. We manage the interest rate risk associated with holding fixed maturity investments by monitoring and maintaining the average duration of the portfolio to achieve an adequate after-tax return without subjecting the portfolio to an unreasonable level of interest rate risk. We invest the fixed maturities portfolio primarily in intermediate-term securities to limit the overall interest rate risk of fixed maturity investments. Generally, the Insurance Subsidiaries have a duration mismatch between assets and liabilities. The duration of the fixed maturity portfolio, including short-term investments, is 3.8 years compared to a liability duration of approximately 3.4 years for the Insurance Subsidiaries. The current duration of the fixed maturities is within Selective's historical range and is monitored and managed to maximize yield and limit interest rate risk. The duration mismatch is managed with a laddered maturity structure and an appropriate level of short-term investments that avoids liquidation of

available-for-sale fixed maturities in the ordinary course of business. Liquidity is always a consideration when buying or selling securities but, because of the high quality and active market for the majority of securities in our investment portfolio, the securities sold have not diminished the overall liquidity of our portfolio. Our normal liquidity requirements have historically been met by operating cash flow from the Insurance Operations and Diversified Insurance Services segments. We expect future liquidity requirements to be met by these sources of funds or, if necessary, from the issuance of debt and equity securities and borrowings under our credit facility. Managing investment risk by adhering to these strategies is intended to protect the interests of our stockholders and the policyholders of our Insurance Subsidiaries, while enhancing our financial strength and underwriting capacity.

Table of Contents**Realized Gains and Losses**

Realized gains and losses are determined on the basis of the cost of specific investments sold and are credited or charged to income. Also included in realized gains and losses are write-downs for other-than-temporary impairment charges. Our Investments segment included net realized gains before tax of \$1.5 million in First Quarter 2008 compared to \$11.2 million in First Quarter 2007. In both quarters, the realized gains were principally from the sale of equity securities. During First Quarter 2008 and 2007, there were no impairment charges recorded. We maintain a high quality and liquid investment portfolio and the sale of the securities producing realized gains did not change the overall liquidity of the investment portfolio. Our general philosophy for sales of securities is to reduce our exposure to securities and sectors based upon economic evaluations and when the fundamentals for that security or sector have deteriorated. We typically have a long investment time horizon and the turnover is low, which has resulted in many securities accumulating large unrealized gains. Every purchase or sale is made with the intent of improving future investment returns.

The following table summarizes our net realized gains by investment type:

| (\$ in thousands) | Unaudited Quarter ended March 31, 2008 | Unaudited Quarter ended March 31, 2007 |
|--------------------------------------|---|---|
| Held-to-maturity fixed maturities | | |
| Gains | \$ 10 | |
| Available-for-sale fixed maturities | | |
| Gains | 533 | 216 |
| Losses | (1,154) | (305) |
| Available-for-sale equity securities | | |
| Gains | 2,597 | 11,690 |
| Losses | (471) | (358) |
| Total net realized gains | \$ 1,515 | 11,243 |

Our realized gains from equity securities in First Quarter 2007 were primarily due to the sale of several equity securities in an effort to reallocate various sector exposures.

We realized gains and losses from the sale of available-for-sale fixed maturity and equity securities during First Quarter 2008 and First Quarter 2007. The following tables present the period of time that securities sold at a loss were continuously in an unrealized loss position prior to sale:

| Period of time in an unrealized loss position (\$ in millions) | Unaudited Quarter ended March 31, 2008 | | Unaudited Quarter ended March 31, 2007 | |
|---|---|--------------------------|---|--------------------------|
| | Fair Value on Sale Date | Realized Loss | Fair Value on Sale Date | Realized Loss |
| Fixed maturities: | | | | |
| 7 - 12 months | \$ 4.8 | 0.2 | | |
| Total fixed maturities | 4.8 | 0.2 | | |
| Equity Securities: | | | | |
| 0 - 6 months | 3.5 | 0.4 | 1.2 | 0.2 |
| 7 - 12 months | 0.1 | 0.1 | 0.3 | 0.2 |

Edgar Filing: SELECTIVE INSURANCE GROUP INC - Form 10-Q

| | | | | | |
|-------------------------|----|------------|------------|-----|-----|
| Total equity securities | | 3.6 | 0.5 | 1.5 | 0.4 |
| Total | \$ | 8.4 | 0.7 | 1.5 | 0.4 |

Table of Contents**Unrealized Losses**

The following table summarizes the aggregate fair value and gross pre-tax unrealized loss recorded in our accumulated other comprehensive income by asset class and by length of time for all available-for-sale securities that have continuously been in an unrealized loss position at March 31, 2008 and December 31, 2007:

| Period of time in an unrealized loss position (\$ in millions) | Unaudited | | December 31, 2007 | |
|--|-----------------------|------------------------|--------------------------|------------------------|
| | March 31, 2008 | Gross | Fair | Gross |
| | Fair Value | Unrealized Loss | Value | Unrealized Loss |
| Fixed maturities: | | | | |
| 0-6 months | \$ 485.8 | 20.7 | 219.2 | 8.0 |
| 7-12 months | 177.3 | 31.8 | 188.6 | 11.6 |
| Greater than 12 months | 159.4 | 7.1 | 340.5 | 5.7 |
| Total fixed maturities | 822.5 | 59.6 | 748.3 | 25.3 |
| Equities: | | | | |
| 0-6 months | 34.4 | 2.8 | 25.7 | 1.1 |
| 7-12 months | 1.1 | 0.3 | 1.1 | 0.4 |
| Total equity securities | 35.5 | 3.1 | 26.8 | 1.5 |
| Total | \$ 858.0 | 62.7 | 775.1 | 26.8 |

Although overall interest rates decreased in First Quarter 2008, the unrealized losses for fixed maturity securities increased, primarily due to the credit stress and dislocation in the capital markets, inflation worries and general uncertainty about the U.S. economy, all of which caused fixed maturity credit spreads to widen. In addition, some of our mortgage- and asset-backed securities are priced relative to certain credit-derivative indices, such as the Markit Group's CMBX for commercial mortgages and ABX for asset-backed securities. Recently, these indices have seen heavy speculation, which has driven credit-derivative spreads to widen to unprecedented levels. As the market became less liquid in First Quarter 2008, these very wide credit-derivative spreads were used to value our mortgage- and asset-backed securities, and have negatively impacted the value of these securities. As of March 31, 2008, there were 265 securities in an unrealized loss position. Broad changes in the overall market or interest rate environment generally do not lead to impairment charges and, therefore, based on our analyses, which include our review of the credit worthiness of the issuers, none of the 265 securities are considered other-than-temporarily impaired. The following table presents information regarding our available-for-sale fixed maturity securities that were in an unrealized loss position at March 31, 2008 by contractual maturity:

| Contractual Maturities (\$ in millions) | Amortized Cost | Fair Value |
|---|-----------------------|-------------------|
| One year or less | \$ 50.2 | 46.7 |
| Due after one year through five years | 401.0 | 379.3 |
| Due after five years through ten years | 339.5 | 317.1 |
| Due after ten years through fifteen years | 54.6 | 48.0 |
| Due after fifteen years | 36.8 | 31.4 |
| Total | \$ 882.1 | 822.5 |

Investments Outlook

As we look forward, we continue to see a number of risks on the horizon that could contribute to an extended period of uncertainty and downside volatility in the marketplace. Recession fears abound as negative economic predictions have become more frequent, and the U.S. slowdown has expanded from housing to retail sales, which has been affected by high energy and food costs. Banks remain cautious to extend credit to borrowers, which ultimately could have negative economic consequences, as shrinking credit availability typically leads to reduced economic activity. Although the credit crisis is not over, new Federal Reserve measures to ease liquidity have had some stabilizing effects. Federal Fund rates have been cut from 3.50% in January to the present 2.25%, a 1.25-point decrease over a 2-month time frame. Although problems remain in the securitization markets, a few new structured finance transactions have recently come to market.

Table of Contents

This year, we envision adding select municipal bonds to the fixed income portfolio if, on an absolute and risk-adjusted relative basis, they remain attractive. The municipal bond yield curve is very steep at this point, leading us to invest in longer dated securities to add incremental yield to the portfolio. However, we will remain disciplined in terms of looking at underlying credit quality.

With the presence of these risks, we are now more cautious regarding the equities markets than we were at the end of 2007. We will continue to manage through this period of uncertainty by investing in companies with more defensive characteristics, such as solid free cash flow, exposure to secular growth themes, strong balance sheets, and reasonable valuations. Other considerations are favorable long-term corporate performance and attractive relative historical valuations.

Our outlook for the alternative investment strategy continues to be positive over the longer-term. Investors with capital in these markets are finding assets for sale at attractive terms. However, in the near term, we expect the current credit crisis to continue to slow the pace of merger & acquisition activity, which we expect will work to reduce the returns that many private equity sponsors have historically been able to realize.

Diversified Insurance Services Segment

The Diversified Insurance Services operations consist of two core functions: human resource administration outsourcing (HR Outsourcing) and flood insurance. We believe these operations are within markets that continue to offer opportunity for growth. These operations contributed \$0.05 per diluted share in both First Quarter 2008 and First Quarter 2007. Contributions from the Diversified Insurance Services segment, particularly the flood business, continue to mitigate insurance pricing cycles and the adverse impact that catastrophe losses have on our Insurance Operations segment. We evaluate the performance of these operations based on several measures, including, but not limited to, results of operations in accordance with GAAP, with a focus on our return on revenue (net income divided by revenues). The results for this segment's continuing operations are as follows:

| (\$ in thousands) | Unaudited Quarter ended March 31, | | Change % or Points |
|-----------------------------|---|--------|--------------------------|
| | 2008 | 2007 | |
| HR Outsourcing | | | |
| Revenue | \$ 15,118 | 16,795 | (10)% |
| Pre-tax profit | 737 | 1,258 | (41) |
| Flood Insurance | | | |
| Revenue | 12,097 | 10,410 | 16 |
| Pre-tax profit | 2,060 | 2,002 | 3 |
| Other | | | |
| Revenue | 2,584 | 1,973 | 31 |
| Pre-tax profit | 1,488 | 1,107 | 34 |
| Total | | | |
| Revenue | 29,799 | 29,178 | 2 |
| Pre-tax profit | 4,285 | 4,367 | (2) |
| After-tax profit | 2,813 | 2,903 | (3) |
| After-tax return on revenue | 9.4% | 10.0 | (0.6) pts |

HR Outsourcing

HR Outsourcing revenue declined in First Quarter 2008 compared to First Quarter 2007 primarily as a result of a reduction in worksite lives. As of March 31, 2008, our worksite lives were down 10% to 24,017, compared to 26,689 as of March 31, 2007, due to the economic downturn and the loss of worksite lives from the acquisition of three large HR Outsourcing clients by companies that manage their own payroll and human resources activities.

Pre-tax profit decreased in our HR Outsourcing business in First Quarter 2008 compared to First Quarter 2007 mainly due to pricing pressure on our workers compensation product and reduced worksite lives. Workers compensation rates have been reduced by Florida regulators by 18.4% for 2008, after a 15.7% rate decrease that was effective January 1, 2007 for voluntary industrial classes. In the fourth quarter of 2007, we reduced our internal workforce at this operation by 11% to better align expenses with production.

Table of Contents

Flood Insurance

Our Flood revenues are primarily derived from two activities: (i) fees associated with servicing policy premium; and (ii) fees associated with handling claims. Revenue increases of 16% in First Quarter 2008 compared to First Quarter 2007 were mainly attributable to the increase in servicing in-force flood premium, which increased 19% to \$148.6 million as of March 31, 2008 compared to March 31, 2007. Revenues associated with handling flood claims increased slightly to \$0.2 million in First Quarter 2008 compared to \$0.1 million in First Quarter 2007.

The pre-tax profit remained relatively flat in First Quarter 2008 compared to First Quarter 2007 primarily due to increased commissions to agents that largely offset the increase in revenues noted above.

Diversified Insurance Services Outlook

Consistent with trends in the professional employer industry that are pointing to flat to negative worksite lives growth and the current economic downturn, we expect client sales for our HR Outsourcing products to continue to be difficult.

The viability of the National Flood Insurance Program's (NFIP) reinsurance program under the Write-Your-Own (WYO) Program is an essential component of our Diversified Insurance Services operations. The following changes will be made to this program in 2008:

Effective May 5, 2008, the claims handling fee that will be paid to us by the NFIP will be:
(i) 1% of direct premiums written; and (ii) 1.5% of incurred losses. The percentage of direct premiums written will be paid to us even in non-catastrophe years. Currently, the program calls for payment of claims handling fees in the amount of 3.3% of incurred losses.

Effective June 1, 2008, the fee paid to us by the NFIP in relation to servicing premium will be reduced 0.5 points to 29.7%.

The current WYO program is set to expire on September 30, 2008, but there are several bills pending in the U.S. Congress under which the program may be revised. These bills contain substantial proposed changes to the NFIP and WYO Program, which may be favorable or unfavorable for us. It is presently unclear as to the impact this legislation, if enacted, would have on our operations.

Financial Condition, Liquidity, and Capital Resources

Capital resources and liquidity reflects our ability to generate cash flows from business operations, borrow funds at competitive rates, and raise new capital to meet operating and growth needs.

Liquidity

Liquidity is a measure of our ability to generate sufficient cash flows to meet the short-term and long-term cash requirements of our business operations. Our cash and short-term investments position at March 31, 2008 was \$222.4 million, up from \$198.6 million at December 31, 2007. In First Quarter 2008, we determined that it was prudent to increase our minimum targeted cash and short-term investment balances due to the volatility in the financial markets, even though there is an opportunity cost associated with this decision. In addition, First Quarter 2008 short-term investment balances were invested in a U.S. Treasury money market fund, which earns a lower yield than a money market fund, our traditional short-term investment vehicle. This decision was made to address potential liquidity concerns regarding the underlying investments generally held by money market funds.

Sources of cash consist of dividends from our subsidiaries, the issuance of debt and equity securities, and the sale of our common stock under our employee and agent stock purchase plans. However, our ability to receive dividends from our subsidiaries is restricted. Dividends from our Insurance Subsidiaries are subject to the approval and/or review of the insurance regulators in their respective domiciliary states under insurance holding company acts, and are generally payable only from earned surplus as reported in the statutory annual statements of those subsidiaries as of the preceding December 31st. Based on the 2007 unaudited statutory financial statements, the Insurance Subsidiaries are permitted to pay to Selective Insurance Group, Inc., in 2008, ordinary dividends in the aggregate amount of approximately \$139.4 million. For additional information regarding dividend restrictions, refer to Note 9,

Indebtedness and Note 10, Stockholders' Equity in Item 8. Financial Statements and Supplementary Data of our 2007

Annual Report.

Table of Contents

Our Insurance Subsidiaries generate cash flows primarily from insurance float, which is created by collecting premiums and earning investment income before losses are paid. The period of the float can extend over many years. To provide liquidity while maintaining consistent investment performance, we ladder our fixed maturity investments so that some issues are always maturing and providing a source of predictable cash flow for claim payments in the ordinary course of business. The duration of the fixed maturity portfolio, including short-term investments, was 3.8 years as of March 31, 2008, while the liabilities of our Insurance Subsidiaries have a duration of 3.4 years. In addition, the Insurance Subsidiaries purchase reinsurance coverage for protection against any significantly large claims or catastrophes that may occur during the year.

Another potential source of cash flows is our syndicated line of credit agreement with Wachovia Bank, National Association, as administrative agent. Under this agreement, we have access to a \$50 million credit facility, which can be increased to \$75 million with the consent of all lending parties. At March 31, 2008, no balances were outstanding under this credit facility.

Selective HR Solutions (Selective HR), our HR Outsourcing business, generates cash flows from its operations. Dividends from Selective HR are restricted by its operating needs and professional employer organization licensing requirements that it maintain a current ratio of at least 1:1. The current ratio, which Selective HR generally maintains just above 1:1, provides an indication of a company's ability to meet its short-term obligations and is calculated by dividing current assets by current liabilities. Selective HR provided dividends to Selective Insurance Group, Inc. of \$0.9 million in First Quarter 2008 and \$1.4 million in First Quarter 2007.

Dividends on shares of our common stock are declared and paid at the discretion of our Board of Directors based on our operating results, financial condition, capital requirements, contractual restrictions, and other relevant factors. Our ability to declare dividends is restricted by covenants contained in the notes payable we issued on May 4, 2000 (the 2000 Senior Notes). All such covenants were met during First Quarter 2008 and First Quarter 2007. For further information regarding our notes payable, see Note 9, Indebtedness, included in Item 8. Financial Statements and Supplementary Data of our 2007 Annual Report. At March 31, 2008, the amount available for dividends to holders of our common stock, in accordance with the restrictions of the 2000 Senior Notes, was \$318.0 million. Book value per share decreased slightly to \$19.62 as of March 31, 2008 from \$19.81 as of December 31, 2007. Our ability to continue to pay dividends to our stockholders is also dependent in large part on the ability of our Insurance Subsidiaries and Selective HR to pay dividends. Restrictions on the ability of our subsidiaries, particularly the Insurance Subsidiaries, to declare and pay dividends, could materially affect our ability to pay principal and interest on indebtedness and dividends on common stock.

We have historically met our liquidity requirements through dividends from our subsidiaries and by issuing debt and equity securities. We expect to meet our liquidity requirements by these sources in the future. The Insurance Subsidiaries have historically met their liquidity requirements from insurance premiums and investment income. These items have historically provided more than sufficient funds to pay losses, operating expenses, and dividends.

Capital Resources

Capital resources provide protection for policyholders, furnish the financial strength to support the business of underwriting insurance risks, and facilitate continued business growth. At March 31, 2008, we had stockholders' equity of \$1,045.7 million and total debt of \$286.2 million. In addition, we have an irrevocable trust valued at \$13.2 million to provide for the repayment of notes having maturities in 2008.

Our cash requirements include, but are not limited to, principal and interest payments on various notes payable and dividends to stockholders, payment of claims, payment of commitments under limited partnership agreements and capital expenditures, as well as other operating expenses, which include agents' commissions, labor costs, premium taxes, general and administrative expenses, and income taxes. For further details regarding our cash requirements, refer to the section below titled Contractual Obligations and Contingent Liabilities and Commitments.

Table of Contents

As active capital managers, we continually monitor our cash requirements and the amount of capital resources that we maintain at the holding company and operating subsidiary levels. As part of our long-term capital strategy, we strive to maintain a 25% debt-to-capital ratio and a premiums to surplus ratio sufficient to maintain an A+ (Superior) financial strength A.M. Best rating for our Insurance Subsidiaries. Based on our analysis and market conditions, we may take a variety of actions, including, but not limited to, contributing capital to our subsidiaries in our Insurance Operations and Diversified Insurance Services segments, issuing additional debt and/or equity securities, repurchasing shares of our common stock, or increasing stockholders' dividends. In First Quarter 2008, we repurchased approximately 1.0 million shares of our common stock under our authorized share repurchase program at a cost of \$24.5 million. As of March 31, 2008, there were 2.5 million shares remaining under the current repurchase authorization that extends through July 26, 2009.

Ratings

We are rated by major rating agencies, which provide opinions of our financial strength, operating performance, strategic position, and ability to meet policyholder obligations. We believe that our ability to write insurance business is most influenced by our rating from A.M. Best, which currently rates us A+ (Superior), their second highest of fifteen ratings, and has been our rating for 46 consecutive years. The financial strength reflected by our A.M. Best rating is a competitive advantage in the marketplace and influences where independent insurance agents place their business. A downgrade from A.M. Best, could: (i) affect our ability to write new business with customers and/or agents, some of whom are required (under various third party agreements) to maintain insurance with a carrier that maintains a specified A.M. Best minimum rating; (ii) be an event of default under our line of credit; or (iii) make it more expensive for us to access capital markets. In the third quarter of 2007, S&P's Insurance Rating Services reaffirmed our financial strength rating of A+. This reaffirmation cited our strong competitive position with close ties to our agents, strong operating performance, very strong operating company capitalization, and good financial flexibility. The financial strength of our insurance business has been rated, A2 by Moody's since 2001 and A+ by Fitch Ratings since 2004. Our Moody's and S&P financial strength ratings affect our ability to access capital markets, and our interest rate under our line of credit varies based upon Selective Insurance Group, Inc.'s debt ratings from Moody's and S&P. There can be no assurance that our ratings will continue for any given period of time or that they will not be changed. It is possible that positive or negative ratings actions by one or more of the rating agencies may occur in the future. We review our financial debt agreements for any potential rating triggers that could dictate a material change in terms if our credit ratings were to change.

Off-Balance Sheet Arrangements

At March 31, 2008 and December 31, 2007, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or for other contractually narrow or limited purposes. As such, we are not exposed to any financing, liquidity, market, or credit risk that could arise if we had engaged in such relationships.

Contractual Obligations and Contingent Liabilities and Commitments

Our future cash payments associated with loss and loss expense reserves, and contractual obligations pursuant to operating leases for office space and equipment, and notes payable have not materially changed since December 31, 2007. We expect to have the capacity to repay and/or refinance these obligations as they come due.

At March 31, 2008, we have contractual obligations that expire at various dates through 2022 to invest up to an additional \$146.5 million in other investments. There is no certainty that any such additional investment will be required. We have issued no material guarantees on behalf of others and have no trading activities involving non-exchange traded contracts accounted for at fair value. We have no material transactions with related parties other than those disclosed in Note 18, Related Party Transactions included in Item 8. Financial Statements and Supplementary Data of our 2007 Annual Report.

Federal Income Taxes

Total federal income tax expense decreased \$5.8 million for First Quarter 2008 to \$6.1 million, compared to \$11.9 million for First Quarter 2007. The decrease was attributable to decreased pre-tax income from our Insurance Operations segment. Our effective tax rate differs from the federal corporate rate of 35% primarily as a result of

tax-advantaged investment income. The effective tax rate for First Quarter 2008 was 23%, compared with 24% for First Quarter 2007.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in the information about market risk set forth in our 2007 Annual Report.

ITEM 4. CONTROLS AND PROCEDURES

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (Exchange Act), as of the end of the period covered by this report. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, our disclosure controls and procedures are: (i) effective in recording, processing, summarizing, and reporting information on a timely basis that we are required to disclose in the reports that we file or submit under the Exchange Act; and (ii) effective in ensuring that information that we are required to disclose in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. No changes in our internal control over financial reporting (as such term is defined in Rule 13a-15(f) of the Exchange Act) occurred during First Quarter 2008 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In the ordinary course of conducting business, we are named as defendants in various legal proceedings. Most of these proceedings are claims litigation involving our Insurance Subsidiaries as either (a) liability insurers defending or providing indemnity for third-party claims brought against insureds or (b) insurers defending first-party coverage claims brought against us. We account for such activity through the establishment of unpaid loss and loss adjustment expense reserves. We expect that the ultimate liability, if any, with respect to such ordinary-course claims litigation, after consideration of provisions made for potential losses and costs of defense, will not be material to our consolidated financial condition, results of operations, or cash flows.

Our Insurance Subsidiaries are also from time to time involved in other legal actions, some of which assert claims for substantial amounts. These actions include, among others, putative state class actions seeking certification of a state or national class. Such putative class actions have alleged, for example, improper reimbursement of medical providers paid under workers compensation and personal and commercial automobile insurance policies. Our Insurance Subsidiaries are also from time to time involved in individual actions in which extra-contractual damages, punitive damages, or penalties are sought, such as claims alleging bad faith in the handling of insurance claims. We believe that we have valid defenses to these cases. We expect that the ultimate liability, if any, with respect to such lawsuits, after consideration of provisions made for estimated losses, will not be material to our consolidated financial condition. Nonetheless, given the large or indeterminate amounts sought in certain of these actions, and the inherent unpredictability of litigation, an adverse outcome in certain matters could, from time to time, have a material adverse effect on our consolidated results of operations or cash flows in particular quarterly or annual periods.

Table of Contents**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The following table provides information regarding our purchases of our common stock in First Quarter 2008:

| Period | Total Number of Shares Purchased ¹ | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Program | Maximum Number of Shares that May Yet Be Purchased Under the Announced Program ² |
|---------------------|--|------------------------------------|--|--|
| January 1-31, 2008 | 3,645 | 22.31 | | 3,519,300 |
| February 1-29, 2008 | 966,461 | 24.05 | 812,683 | 2,706,617 |
| March 1-31, 2008 | 226,557 | 23.83 | 205,782 | 2,500,835 |
| Total | 1,196,663 | 24.00 | 1,018,465 | |

¹ During First Quarter 2008, 159,027 shares were purchased from employees in connection with the vesting of restricted stock and 19,171 shares were purchased in connection with the exercise of stock options. All of these repurchases were made in connection with satisfying tax withholding obligations with respect to those employees. These shares were not purchased as part of the publicly announced program. The shares were

purchased at the current market prices of our common stock on the dates of the purchases.

- ² On July 24, 2007, the Board of Directors authorized a stock repurchase program of up to 4.0 million shares, which is scheduled to expire on July 26, 2009.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Our 2008 Annual Meeting of Stockholders was held on April 24, 2008. Voting was conducted in person and by proxy as follows:

- (a) Stockholders voted to elect the following five (5) Class III directors, each to serve until the 2011 annual meeting of stockholders or until a successor has been duly elected and qualified, as follows:

| | For | Withheld |
|----------------------|------------|-----------------|
| Paul D. Bauer | 45,616,416 | 431,375 |
| John C. Burville | 45,578,845 | 468,946 |
| Joan M. Lamm-Tennant | 45,474,158 | 573,633 |
| Michael J. Morrissey | 45,416,461 | 631,330 |
| Ronald L. O Kelley | 45,616,963 | 430,828 |

Continuing directors whose terms do not expire until the 2009 annual meeting of stockholders are: A. David Brown, William M. Kearns, Jr., S. Griffin McClellan III, and J. Brian Thebault. Continuing directors whose terms do not expire until the 2010 annual meeting of stockholders are: W. Marston Becker, Gregory E. Murphy, and William M. Rue.

- (b) Stockholders voted to ratify the appointment of KPMG LLP as independent public accountants for the fiscal year ending December 31, 2008 as follows: 45,428,027 shares voted for this proposal; 312,819 shares voted against it; and 306,945 shares abstained.

Table of Contents

ITEM 6. EXHIBITS

(a) Exhibits:

Exhibit No.

- * 10.18i Employment Agreement between Selective Insurance Company of America and John J. Marchioni dated as of March 1, 2007 and Amendment No. 1 to Employment Agreement dated as of April 15, 2008.
- * 10.18j Employment Agreement between Selective Insurance Company of America and Mary T. Porter dated as of January 1, 2007 and Amendment No. 1 to Employment Agreement dated as of April 15, 2008.
- * 10.18k Employment Agreement between Selective Insurance Company of America and Eduard J. Pulkstenis dated as of January 1, 2007 and Amendment No. 1 to Employment Agreement dated as of April 15, 2008.
- * 11 Statement Re: Computation of Per Share Earnings.
- * 31.1 Rule 13a-14(a) Certification of the Chief Executive Officer of Selective Insurance Group, Inc. (Section 302 of the Sarbanes-Oxley Act of 2002).
- * 31.2 Rule 13a-14(a) Certification of the Chief Financial Officer of Selective Insurance Group, Inc. (Section 302 of the Sarbanes-Oxley Act of 2002).
- * 32.1 Certification of Chief Executive Officer of Selective Insurance Group, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- * 32.2 Certification of Chief Financial Officer of Selective Insurance Group, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed herewith

Table of Contents

SIGNATURES

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, thereunto duly authorized.

SELECTIVE INSURANCE GROUP, INC.

Registrant

By: /s/ Gregory E. Murphy

May 2, 2008

Gregory E. Murphy
Chairman of the Board, President and Chief Executive Officer

By: /s/ Dale A. Thatcher

May 2, 2008

Dale A. Thatcher
Executive Vice President, Chief Financial Officer and Treasurer

Table of Contents

EXHIBIT INDEX

Exhibit No.

- * 10.18i Employment Agreement between Selective Insurance Company of America and John J. Marchioni dated as of March 1, 2007 and Amendment No. 1 to Employment Agreement dated as of April 15, 2008.
- * 10.18j Employment Agreement between Selective Insurance Company of America and Mary T. Porter dated as of January 1, 2007 and Amendment No. 1 to Employment Agreement dated as of April 15, 2008.
- * 10.18k Employment Agreement between Selective Insurance Company of America and Eduard J. Pulkstenis dated as of January 1, 2007 and Amendment No. 1 to Employment Agreement dated as of April 15, 2008.
- * 11 Statement Re: Computation of Per Share Earnings.
- * 31.1 Rule 13a-14(a) Certification of the Chief Executive Officer of Selective Insurance Group, Inc. (Section 302 of the Sarbanes-Oxley Act of 2002).
- * 31.2 Rule 13a-14(a) Certification of the Chief Financial Officer of Selective Insurance Group, Inc. (Section 302 of the Sarbanes-Oxley Act of 2002).
- * 32.1 Certification of Chief Executive Officer of Selective Insurance Group, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- * 32.2 Certification of Chief Financial Officer of Selective Insurance Group, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed herewith