

SELECTIVE INSURANCE GROUP INC

Form 10-Q

August 01, 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: June 30, 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 the 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 June 30, 2008, there were 52,679,813 shares of common stock, par value \$2.00 per share, outstanding.



**SELECTIVE INSURANCE GROUP, INC.**  
Table of Contents

	Page No
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
<b><u>Item 1. Financial Statements</u></b>	
<u>Consolidated Balance Sheets as of June 30, 2008 (Unaudited) and December 31, 2007</u>	1
<u>Unaudited Consolidated Statements of Income for the Quarter and Six Months Ended June 30, 2008 and 2007</u>	2
<u>Unaudited Consolidated Statements of Stockholders' Equity for the Six Months Ended June 30, 2008 and 2007</u>	3
<u>Unaudited Consolidated Statements of Cash Flow for the Six Months Ended June 30, 2008 and 2007</u>	4
<u>Notes to Unaudited Interim Consolidated Financial Statements</u>	5
<b><u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	
<u>Forward-Looking Statements</u>	13
<u>Introduction</u>	13
<u>Critical Accounting Policies and Estimates</u>	13
<u>Financial Highlights of Results for Second Quarter 2008 and Six Months 2008</u>	14
<u>Results of Operations and Related Information by Segment</u>	15
<u>Financial Condition, Liquidity, and Capital Resources</u>	29
<u>Off-Balance Sheet Arrangements</u>	31
<u>Contractual Obligations and Contingent Liabilities and Commitments</u>	31
<u>Federal Income Taxes</u>	31
<b><u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u></b>	32
<b><u>Item 4. Controls and Procedures</u></b>	32
<b><u>PART II. OTHER INFORMATION</u></b>	
<b><u>Item 1. Legal Proceedings</u></b>	32

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds** 33

**Item 4. Submission of Matters to a Vote of Security Holders** 33

**Item 6. Exhibits** 33

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)	<b>Unaudited June 30, 2008</b>	<b>December 31, 2007</b>
<b>ASSETS</b>		
<b>Investments:</b>		
Fixed maturity securities, held-to-maturity at amortized cost (fair value of: \$4,071 2008; \$5,927 2007)	\$ 3,979	5,783
Fixed maturity securities, available-for-sale at fair value (amortized cost of: \$3,081,830 2008; \$3,049,913 2007)	3,044,378	3,073,547
Equity securities, available-for-sale at fair value (cost of: \$143,084 2008; \$160,390 2007)	212,838	274,705
Short-term investments at cost which approximates fair value	218,074	190,167
Equity securities, trading at fair value (cost of: \$17,982 2008)	23,196	
Other investments	206,410	188,827
<b>Total investments</b>	<b>3,708,875</b>	<b>3,733,029</b>
Cash and cash equivalents	16,402	8,383
Interest and dividends due or accrued	34,992	36,141
Premiums receivable, net of allowance for uncollectible accounts of: \$4,157 2008; \$3,905 2007	524,680	496,363
Other trade receivables, net of allowance for uncollectible accounts of: \$226 2008; \$244 2007	23,602	21,875
Reinsurance recoverable on paid losses and loss expenses	5,729	7,429
Reinsurance recoverable on unpaid losses and loss expenses	248,011	227,801
Prepaid reinsurance premiums	88,978	82,182
Current federal income tax	1,140	4,235
Deferred federal income tax	68,193	22,375
Property and equipment at cost, net of accumulated depreciation and amortization of: \$125,465 2008; \$117,832 2007	54,668	58,561
Deferred policy acquisition costs	225,645	226,434
Goodwill	33,637	33,637
Other assets	44,623	43,547
<b>Total assets</b>	<b>\$ 5,079,175</b>	<b>5,001,992</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>Liabilities:</b>		
Reserve for losses	\$ 2,262,310	2,182,572
Reserve for loss expenses	375,451	359,975
Unearned premiums	868,851	841,348
Senior convertible notes		8,740
Notes payable	273,865	286,151
Commissions payable	44,987	60,178

Accrued salaries and benefits	<b>84,166</b>	88,079
Other liabilities	<b>151,833</b>	98,906
Total liabilities	<b>4,061,463</b>	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: 94,986,691 2008; 94,652,930 2007

**189,973**

189,306

Additional paid-in capital

**208,067**

192,627

Retained earnings

**1,147,287**

1,105,946

Accumulated other comprehensive income

**15,270**

86,043

Treasury stock at cost (shares: 42,306,878 2008; 40,347,894 2007)

**(542,885)**

(497,879)

Total stockholders equity

**1,017,712**

1,076,043

Commitments and contingencies

Total liabilities and stockholders equity

**\$ 5,079,175**

5,001,992

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

1

Table of Contents

7

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

(in thousands, except per share amounts)	Quarter ended June 30,		Six Months ended June 30,	
	2008	2007	2008	2007
<b>Revenues:</b>				
Net premiums written	\$ 387,229	404,923	\$ 777,069	822,108
Net increase in unearned premiums and prepaid reinsurance premiums	(12,140)	(28,572)	(20,707)	(65,744)
Net premiums earned	375,089	376,351	756,362	756,364
Net investment income earned	38,515	40,642	76,381	80,505
Net realized gains	1,923	13,148	3,438	24,391
Diversified Insurance Services revenue	30,064	30,677	59,863	59,855
Other income	1,761	1,220	2,421	3,032
Total revenues	447,352	462,038	898,465	924,147
<b>Expenses:</b>				
Losses incurred	209,915	208,621	420,045	411,931
Loss expenses incurred	43,736	42,615	86,785	85,598
Policy acquisition costs	124,124	124,701	252,804	247,619
Dividends to policyholders	1,579	1,022	2,114	2,509
Interest expense	5,127	5,992	10,436	12,323
Diversified Insurance Services expenses	25,125	24,608	50,639	49,419
Other expenses	1,661	6,693	12,955	17,763
Total expenses	411,267	414,252	835,778	827,162
Income before federal income tax	36,085	47,786	62,687	96,985
<b>Federal income tax expense (benefit):</b>				
Current	12,883	14,726	24,018	30,337
Deferred	(5,449)	(2,826)	(10,485)	(6,490)
Total federal income tax expense	7,434	11,900	13,533	23,847
Net income	\$ 28,651	35,886	49,154	73,138
<b>Earnings per share:</b>				
Basic net income	\$ 0.55	0.69	0.94	1.38



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

Diluted net income	\$	<b>0.54</b>	0.64	<b>0.92</b>	1.26
Dividends to stockholders	\$	<b>0.13</b>	0.12	<b>0.26</b>	0.24

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)	Six Months Ended June 30,			
	2008		2007	
<b>Common stock:</b>				
Beginning of year	\$ 189,306		183,124	
Dividend reinvestment plan (shares: 40,645 2008; 36,097 2007)	81		72	
Convertible debentures (shares: 45,759 2008; 848,604 2007)	92		1,697	
Stock purchase and compensation plans (shares: 247,357 2008; 702,919 2007)	494		1,407	
End of period	<b>189,973</b>		186,300	
<b>Additional paid-in capital:</b>				
Beginning of year	192,627		153,246	
Dividend reinvestment plan	847		859	
Convertible debentures	645		9,831	
Stock purchase and compensation plans	13,948		16,857	
End of period	<b>208,067</b>		180,793	
<b>Retained earnings:</b>				
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	49,154	49,154	73,138	73,138
Cash dividends to stockholders (\$0.26 share 2008; \$0.24 per share 2007)	(14,023)		(13,216)	
End of period	<b>1,147,287</b>		1,045,939	
<b>Accumulated other comprehensive income:</b>				
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: \$(34,803) 2008; \$(14,592) 2007	(64,633)	(64,633)	(27,099)	(27,099)
Defined benefit pension plans, net of deferred income tax effect of: \$38 2008; \$101 2007	70	70	186	186

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

End of period	<b>15,270</b>	73,688	
Comprehensive (loss) income		<b>(15,409)</b>	46,225
<b>Treasury stock:</b>			
Beginning of year	<b>(497,879)</b>	(345,761)	
Acquisition of treasury stock (shares: 1,958,984 2008; 5,386,005 2007)	<b>(45,006)</b>	(137,592)	
End of period	<b>(542,885)</b>	(483,353)	
Total stockholders' equity	<b>\$ 1,017,712</b>	1,003,367	

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**

<i>(in thousands)</i>	<b>Six Months ended</b>	
	<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>
<b>Operating Activities</b>		
Net income	\$ 49,154	73,138
<i>Adjustments to reconcile net income to net cash provided by operating activities:</i>		
Depreciation and amortization	14,197	14,302
Share-based compensation expense	9,137	13,703
Net realized gains	(3,438)	(24,391)
Deferred tax	(10,485)	(6,490)
Unrealized loss on trading securities	1,631	
<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	75,033	109,858
Increase in unearned premiums, net of prepaid reinsurance and advance premiums	20,350	66,234
Decrease (increase) in net federal income tax recoverable	3,095	(3,840)
Increase in premiums receivable	(28,317)	(89,014)
(Increase) decrease in other trade receivables	(1,727)	608
Decrease (increase) in deferred policy acquisition costs	789	(12,229)
Decrease in interest and dividends due or accrued	1,212	696
Decrease in reinsurance recoverable on paid losses and loss expenses	1,700	59
Decrease in accrued salaries and benefits	(4,301)	(14,967)
Decrease in accrued insurance expenses	(20,756)	(8,588)
Purchase of trading securities	(5,813)	
Sale of trading securities	6,100	
Other-net	8,526	5,063
Net adjustments	66,933	51,004
Net cash provided by operating activities	116,087	124,142
<b>Investing Activities</b>		
Purchase of fixed maturity securities, available-for-sale	(239,887)	(231,392)
Purchase of equity securities, available-for-sale	(16,095)	(54,214)
Purchase of other investments	(25,976)	(33,580)
Purchase of short-term investments	(1,061,242)	(861,197)
Sale of fixed maturity securities, available-for-sale	80,056	51,717
Sale of short-term investments	1,033,334	922,902
Redemption and maturities of fixed maturity securities, held-to-maturity	1,818	628
Redemption and maturities of fixed maturity securities, available-for-sale	158,685	176,295

Sale of equity securities, available-for-sale	<b>34,585</b>	60,321
Proceeds from other investments	<b>3,798</b>	8,558
Purchase of property and equipment	<b>(3,851)</b>	(6,365)
Net cash (used in) provided by investing activities	<b>(34,775)</b>	33,673
<b>Financing Activities</b>		
Dividends to stockholders	<b>(13,009)</b>	(12,023)
Acquisition of treasury stock	<b>(45,006)</b>	(137,592)
Principal payment of notes payable	<b>(12,300)</b>	(18,300)
Net proceeds from stock purchase and compensation plans	<b>4,457</b>	4,560
Excess tax benefits from share-based payment arrangements	<b>1,319</b>	2,656
Principal payments of convertible bonds	<b>(8,754)</b>	
Net cash used in financing activities	<b>(73,293)</b>	(160,699)
Net increase (decrease) in cash and cash equivalents	<b>8,019</b>	(2,884)
Cash and cash equivalents, beginning of year	<b>8,383</b>	6,443
Cash and cash equivalents, end of period	<b>\$ 16,402</b>	3,559

**Supplemental Disclosures of Cash Flows Information**

Cash paid during the period for:

Interest	<b>\$ 10,643</b>	12,573
Federal income tax	<b>19,600</b>	32,000
Supplemental schedule of non-cash financing activity:		
Conversion of convertible debentures	<b>169</b>	11,055

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 22 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**

The interim unaudited consolidated financial statements ( Financial Statements ) contained in this report 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.

The 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. The Financial Statements cover the second quarters ended June 30, 2008 ( Second Quarter 2008 ) and June 30, 2007 ( Second Quarter 2007 ) and the six-month periods ended June 30, 2008 ( Six Months 2008 ) and June 30, 2007 ( Six Months 2007 ). The 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, the 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 2008, the Financial Accounting Standards Board ( FASB ) issued FASB Staff Position ( FSP ) No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities* ( FSP 03-6-1 ). FSP 03-6-1 addresses the treatment of unvested share-based payment awards containing nonforfeitable rights to dividends or dividend equivalents in the calculation of earnings per share and is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. We are currently evaluating the impact of FSP 03-6-1 on our calculation of earnings per share.

In May 2008, the FASB issued FSP No. APB 14-1, *Accounting for Convertible Debt Instruments that may be Settled in Cash upon Conversion (Including Partial Cash Settlement)* ( FSP 14-1 ). FSP 14-1 applies to convertible debt instruments that, by their stated terms, may be completely or partially settled in cash (or other assets) upon conversion, unless the embedded conversion option is required to be separately accounted for as a derivative under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. FSP 14-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. We are currently evaluating the applicability of FSP 14-1 to our operations.

**Table of Contents**

In May 2008, the FASB issued Statement of Financial Accounting Standards No. 163, *Accounting for Financial Guarantee Insurance Contracts – an interpretation of FASB Statement No. 60* ( FAS 163 ). FAS 163 applies to financial guarantee insurance and reinsurance contracts that are: (i) issued by enterprises that are included within the scope of FASB Statement of Financial Accounting Standards No. 60, *Accounting and Reporting by Insurance Enterprises* ( FAS 60 ); and (ii) not accounted for as derivative instruments. FAS 163 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The adoption of FAS 163 is not expected to have an impact on our results of operations or financial condition.

In May 2008, the FASB issued Statement of Financial Accounting Standards No. 162, *The Hierarchy of Generally Accepted Accounting Principles* ( FAS 162 ). FAS 162 identifies the sources of generally accepted accounting principles and provides a framework, or hierarchy, for selecting the principles to be used in preparing financial statements for non-governmental entities in conformity with GAAP. This statement will be effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly In Conformity with Generally Accepted Accounting Principles*. The adoption of FAS 162 is not expected to have an impact on our results of operations or financial condition.

In June 2007, the Emerging Issues Task Force ( EITF ) of 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. EITF 06-11, was effective on a prospective basis beginning with dividends declared in fiscal years beginning after December 15, 2007, and we adopted it in the first quarter of 2008. The adoption of EITF 06-11 did not have a material impact on our results of operations or financial condition.

**NOTE 4. Investments****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 and we do not have the ability 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. 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:

	<b>Pre-Adoption Carrying/Fair Value at January 1, 2008</b>	<b>Impact of Fair Value Election Adoption</b>	<b>Post-Adoption Carrying/Fair Value at January 1, 2008</b>
(\$ in thousands)			
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

**Accumulated  
Other**

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



**Table of Contents**

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 adoption of FAS 157 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:

Description (\$ in thousands)	Fair Value Measurements at 6/30/08 Using			
	Assets Measured at Fair Value at 6/30/08	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Trading securities:				
Equity securities	\$ 23,196	23,196		
Available-for-sale securities:				
Fixed maturity securities	3,044,378	43,403	3,000,975	
Equity securities	212,838	212,838		
Short-term investments	218,074	218,074		
Other investments <sup>1</sup>	28,866		28,866	
Total	\$ 3,527,352	497,511	3,029,841	

<sup>1</sup> Alternative investments, included in Other investments in the Consolidated Balance Sheets, 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 Second Quarter and Six Months 2008, net investment income included \$0.3 million gain and \$1.6 million loss of fair value measurements, respectively, representing the change in market value on our trading securities.

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. We had no Level 3 fair market values as of June 30, 2008.

Net realized gains

During Second Quarter 2008, our net realized gains on available-for-sale fixed maturity securities included \$9.8 million of other-than-temporary impairment charges associated with seven asset-backed securities ( ABSs ), one residential mortgage-backed security ( RMBS ), and one corporate bond. The majority of these other-than-temporary impairment charges were associated with issuer-specific credit events that revolved around the performance of the underlying collateral, which had deteriorated in Second Quarter 2008. In general, these securities were experiencing increased conditional default rates and loss severities and, as a result, our stress test scenarios were indicating less of a margin to absorb losses going forward. Although the majority of these securities were insured or guaranteed by mono-line bond guarantors, recent downgrades of these guarantors have reduced our confidence in their ability to perform in the event of default. In addition, credit support for these securities has also begun to erode, thereby further increasing the potential for eventual loss. The lack of an underlying rating and collateral performance that had deteriorated over the past three months presented negative credit and pricing pressure; therefore, we could no longer reasonably assert that the recovery period, if any, would be temporary. As a result of our evaluation, we recorded other-than-temporary impairment charges of \$9.8 million, which resulted in a corresponding decrease in net realized gains from fixed maturities in Second Quarter and Six Months 2008.

**Table of Contents****NOTE 5. Reinsurance**

The following table contains a listing of 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 June 30,		Unaudited, Six Months ended June 30,	
	2008	2007	2008	2007
<b>Premiums written:</b>				
Direct	\$ 441,189	451,894	876,565	908,373
Assumed	2,577	3,322	7,247	7,806
Ceded	(56,537)	(50,293)	(106,743)	(94,071)
Net	\$ 387,229	404,923	777,069	822,108
<b>Premiums earned:</b>				
Direct	\$ 417,988	413,588	841,163	828,352
Assumed	7,422	7,810	15,146	16,180
Ceded	(50,321)	(45,047)	(99,947)	(88,168)
Net	\$ 375,089	376,351	756,362	756,364
<b>Losses and loss expenses incurred:</b>				
Direct	\$ 301,939	302,006	560,893	553,750
Assumed	5,295	5,694	10,312	12,365
Ceded	(53,583)	(56,464)	(64,375)	(68,586)
Net	\$ 253,651	251,236	506,830	497,529

Excluding flood losses, ceded losses and loss expenses incurred decreased \$6.0 million in Second Quarter 2008 and \$9.9 million in Six Months 2008 compared to the same periods in 2007 due to normal volatility in losses that are ceded to our reinsurers under our casualty and property excess of loss treaties.

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

National Flood Insurance Program (\$ in thousands)	Unaudited, Quarter ended June 30,		Unaudited, Six Months ended June 30,	
	2008	2007	2008	2007
Ceded premiums written	\$ (43,585)	(38,082)	\$ (81,363)	(70,101)
Ceded premiums earned	(37,558)	(32,155)	(74,065)	(63,036)
Ceded losses and loss expenses incurred	(45,429)	(42,311)	(50,217)	(44,574)

**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 \$3.5 million in Second Quarter 2008 and \$6.9 million in Six Months 2008 compared with \$4.5 million in Second Quarter 2007 and \$8.9 million in Six Months 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 June 30,		Unaudited, Six Months ended June 30,	
	2008	2007	2008	2007
<b>Insurance Operations:</b>				
Net premiums earned:				
Commercial automobile	\$ 77,758	78,814	156,982	157,603
Workers compensation	77,502	80,873	155,968	163,349
General liability	99,932	101,602	203,201	205,062
Commercial property	48,575	46,796	98,511	93,364
Business owners policy	14,383	13,034	28,525	25,875
Bonds	4,718	4,676	9,493	9,376
Other	164	171	329	348
Total commercial lines	323,032	325,966	653,009	654,977
Personal automobile	32,942	33,107	65,547	67,043
Homeowners	16,975	15,373	33,546	30,515
Other	2,140	1,905	4,260	3,829
Total personal lines	52,057	50,385	103,353	101,387
Total net premiums earned	375,089	376,351	756,362	756,364
Miscellaneous income	1,761	1,220	2,421	2,971
Total Insurance Operations revenues	376,850	377,571	758,783	759,335
<b>Investments:</b>				
Net investment income	38,515	40,642	76,381	80,505
Net realized gain on investments	1,923	13,148	3,438	24,391
Total investment revenues	40,438	53,790	79,819	104,896
<b>Diversified Insurance Services:</b>				
Human resource administration outsourcing	13,498	14,928	28,616	31,723
Flood insurance	14,013	13,656	26,110	24,066
Other	2,553	2,093	5,137	4,066

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

Total Diversified Insurance Services revenues	<b>30,064</b>	30,677	<b>59,863</b>	59,855
<b>Total all segments</b>	<b>447,352</b>	462,038	<b>898,465</b>	924,086
Other income				61
<b>Total revenues</b>	<b>\$ 447,352</b>	462,038	<b>898,465</b>	924,147

**Table of Contents**

	<b>Unaudited, Quarter ended June 30,</b>		<b>Unaudited, Six Months ended June 30,</b>	
(\$ in thousands)	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Income before federal income tax</b>				
<b>Insurance Operations:</b>				
Commercial lines underwriting	\$ (85)	6,957	4,286	19,587
Personal lines underwriting	(3,166)	(7,102)	(8,989)	(10,015)
Underwriting (loss) income, before federal income tax	(3,251)	(145)	(4,703)	9,572
GAAP combined ratio	100.9%	100.0%	100.6%	98.7
Statutory combined ratio	98.7%	97.1%	98.5%	96.4
<b>Investments:</b>				
Net investment income	38,515	40,642	76,381	80,505
Net realized gain on investments	1,923	13,148	3,438	24,391
Total investment income, before federal income tax	40,438	53,790	79,819	104,896
<b>Diversified Insurance Services:</b>				
Income before federal income tax	4,939	6,069	9,224	10,436
<b>Total all segments</b>	<b>42,126</b>	<b>59,714</b>	<b>84,340</b>	<b>124,904</b>
Interest expense	(5,127)	(5,992)	(10,436)	(12,323)
General corporate expenses	(914)	(5,936)	(11,217)	(15,596)
<b>Income before federal income tax</b>	<b>\$ 36,085</b>	<b>47,786</b>	<b>62,687</b>	<b>96,985</b>

**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 Selective Insurance Company of America Welfare Benefits Plan. 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.

	<b>Retirement Income Plan Unaudited, Quarter ended June 30,</b>		<b>Postretirement Plan Unaudited, Quarter ended June 30,</b>	
(\$ in thousands)	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Components of Net Periodic Benefit Cost:</b>				
Service cost	\$ 1,758	1,788	80	81
Interest cost	2,441	2,184	135	125
Expected return on plan assets	(2,960)	(2,710)		
Amortization of unrecognized prior service cost	38	37	(8)	(8)
Amortization of unrecognized net loss	24	115		
Special termination benefit		900		100





**Table of Contents****NOTE 8. Comprehensive (Loss)/Income**

The components of comprehensive (loss)/income, both gross and net of tax, for Second Quarter 2008 and Second Quarter 2007 are as follows:

**Second Quarter 2008**

(in thousands)	<b>Gross</b>	<b>Tax</b>	<b>Net</b>
Net income	\$ 36,085	7,434	28,651
Components of other comprehensive loss:			
<i>Unrealized losses on securities:</i>			
Unrealized holding losses during the period	(56,493)	(19,773)	(36,720)
Less: Reclassification adjustment for gains included in net income	(1,923)	(673)	(1,250)
Net unrealized losses	(58,416)	(20,446)	(37,970)
<i>Defined benefit pension plans:</i>			
Reversal of amortization items:			
Net actuarial loss	24	8	16
Prior service cost	30	11	19
Defined benefit pension plans	54	19	35
Comprehensive loss	\$ (22,277)	(12,993)	(9,284)

**Second Quarter 2007**

(in thousands)	<b>Gross</b>	<b>Tax</b>	<b>Net</b>
Net income	\$ 47,786	11,900	35,886
Components of other comprehensive income:			
<i>Unrealized losses on securities:</i>			
Unrealized holding losses during the period	(23,571)	(8,250)	(15,321)
Less: Reclassification adjustment for gains included in net income	(13,148)	(4,602)	(8,546)
Net unrealized losses	(36,719)	(12,852)	(23,867)
<i>Defined benefit pension plans:</i>			
Reversal of amortization items:			
Net actuarial loss	113	40	73
Prior service cost	30	10	20
Defined benefit pension plans	143	50	93
Comprehensive income	\$ 11,210	(902)	12,112

The components of comprehensive (loss)/income, both gross and net of tax, for Six Months 2008 and Six Months 2007 are as follows:

**Six Months 2008**

(in thousands)	<b>Gross</b>	<b>Tax</b>	<b>Net</b>
Net income	\$ 62,687	13,533	49,154

Components of other comprehensive loss:

*Unrealized losses on securities:*

Unrealized holding losses during the period	<b>(96,008)</b>	<b>(33,603)</b>	<b>(62,405)</b>
Less: Reclassification adjustment for gains included in net income	<b>(3,428)</b>	<b>(1,200)</b>	<b>(2,228)</b>

Net unrealized losses	<b>(99,436)</b>	<b>(34,803)</b>	<b>(64,633)</b>
-----------------------	-----------------	-----------------	-----------------

*Defined benefit pension plans:*

Reversal of amortization items:

Net actuarial loss	<b>49</b>	<b>17</b>	<b>32</b>
Prior service cost	<b>59</b>	<b>21</b>	<b>38</b>

Defined benefit pension plans	<b>108</b>	<b>38</b>	<b>70</b>
-------------------------------	------------	-----------	-----------

Comprehensive loss	<b>\$ (36,641)</b>	<b>(21,232)</b>	<b>(15,409)</b>
--------------------	--------------------	-----------------	-----------------

**Table of Contents****Six Months 2007**

(in thousands)

	<b>Gross</b>	<b>Tax</b>	<b>Net</b>
Net income	\$ 96,985	23,847	73,138
Components of other comprehensive income:			
<i>Unrealized losses on securities:</i>			
Unrealized holding losses during the period	(17,300)	(6,055)	(11,245)
Less: Reclassification adjustment for gains included in net income	(24,391)	(8,537)	(15,854)
Net unrealized losses	(41,691)	(14,592)	(27,099)
<i>Defined benefit pension plans:</i>			
Reversal of amortization items:			
Net actuarial loss	227	80	147
Prior service cost	60	21	39
Defined benefit pension plans	287	101	186
Comprehensive income	\$ 55,581	9,356	46,225

**NOTE 9. Commitments and Contingencies**

At June 30, 2008, we had contractual obligations to invest up to an additional \$144 million in other investments that expire at various dates through 2023. There is no certainty that any such additional investment will be required.

**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: (i) liability insurers defending or providing indemnity for third-party claims brought against insureds; or (ii) insurers defending first-party coverage claims brought against them. We account for such activity through the establishment of unpaid loss and loss adjustment expense reserves. Our management expects 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 Second Quarter 2008 and Six Months 2008;
- 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 consolidated 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 Second Quarter 2008 and Six Months 2008**

<b>Financial Highlights</b> (\$ in thousands, except per share amounts)	<b>Unaudited</b>			<b>Unaudited</b>		
	<b>Quarter ended</b>	<b>Change</b>	<b>Six Months ended</b>	<b>Change</b>	<b>Six Months ended</b>	<b>Change</b>
	<b>June 30,</b>	<b>% or</b>	<b>June 30,</b>	<b>% or</b>	<b>June 30,</b>	<b>% or</b>
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
			<b>Points</b>		<b>Points</b>	
Revenues	<b>\$ 447,352</b>	462,038	(3)%	<b>\$ 898,465</b>	924,147	(3)%
Net income	<b>28,651</b>	35,886	(20)	<b>49,154</b>	73,138	(33)
Diluted net income per share	<b>0.54</b>	0.64	(16)	<b>0.92</b>	1.26	(27)
Diluted weighted-average outstanding shares	<b>53,064</b>	56,721	(6)	<b>53,461</b>	58,610	(9)
GAAP combined ratio	<b>100.9%</b>	100.0	0.9pts	<b>100.6%</b>	98.7	1.9pts
Statutory combined ratio	<b>98.7%</b>	97.1	1.6	<b>98.5%</b>	96.4	2.1
Annualized return on average equity	<b>11.1%</b>	14.1	(3.0)pts	<b>9.4%</b>	14.1	(4.7)pts

Net income decreased in Second Quarter and Six Months 2008 compared to the same periods last year due to:

Pre-tax net investment gains decreased \$11.2 million, to \$1.9 million, in Second Quarter 2008 and by \$21.0 million, to \$3.4 million, in Six Months 2008. These decreases reflect other-than-temporary impairment charges of \$9.8 million in Second Quarter 2008 due to significant market changes and collateral deterioration across the credit markets. Additionally, higher gains were recognized in the first quarter of 2007 as a result of the sale of various equity securities to reallocate sector exposures. For additional information regarding these other-than-temporary impairment charges, refer to the section below entitled, Investments.

A decrease in pre-tax underwriting results from our Insurance Operations segment of \$3.1 million, to an underwriting loss of \$3.3 million, in Second Quarter 2008, and \$14.3 million, to an underwriting loss of \$4.7 million, in Six Months 2008. These deteriorations were primarily driven by increased catastrophe losses related to 2008 storm activity in portions of our southern and mid-western regions coupled with reduced favorable prior year loss development. These items were partially offset by improvements in our workers compensation line of business from the execution of our strategic initiatives.

A decrease in pre-tax net investment income of \$2.1 million, to \$38.5 million, in Second Quarter 2008 and \$4.1 million, to \$76.4 million, in Six Months 2008 primarily due to lower returns on our other investments portfolio, partially offset by higher fixed maturity income as a result of a higher invested asset base. In addition, Six Months 2008 includes a \$1.6 million loss reflecting the reduction in the fair value of our equity trading portfolio.

Partially offsetting the net income decreases above was a decrease in general corporate expenses related to employee long-term stock compensation awards in both Second Quarter and Six Months 2008 compared to the same periods last year reflecting, among other items, the decrease in the market value of our common stock within the comparable periods.

Diluted net income per share decreased in Second Quarter and Six Months 2008 compared to Second Quarter and Six Months 2007 due to the net income decreases described above, partially offset by the reduction in diluted weighted-average shares outstanding from actions taken under our capital management program. As part of our capital management program, in the twelve-month period ending June 30, 2008, we repurchased approximately 2.3 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.

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

Our Insurance Operations segment writes property and casualty insurance business through our Insurance Subsidiaries. Effective June 30, 2008, two of our Insurance Subsidiaries, Selective Insurance Company of the Southeast and Selective Insurance Company of South Carolina, changed their regulatory state of domicile from North Carolina and South Carolina, respectively, to Indiana. This change will help us achieve certain operational efficiencies that will generate ongoing savings of approximately \$2 million annually. Our Insurance Operations segment sells property and casualty insurance products and services primarily in 22 states in the Eastern and Midwestern United States through approximately 920 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.

**Summary of Insurance Operations**

All Lines (\$ in thousands)	Unaudited Quarter ended June 30,		Change % or Points	Unaudited Six Months ended June 30,		Change % or Points
	2008	2007		2008	2007	
<b>GAAP Insurance Operations Results:</b>						
NPW	\$ 387,229	404,923	(4)%	777,069	822,108	(5)%
NPE	375,089	376,351		756,362	756,364	
<b>Less:</b>						
Losses and loss expenses incurred	253,651	251,236	1	506,830	497,529	2
Net underwriting expenses incurred	123,110	124,238	(1)	252,121	246,754	2
Dividends to policyholders	1,579	1,022	55	2,114	2,509	(16)
Underwriting (loss) income	\$ (3,251)	(145)	n/m%	(4,703)	9,572	(149)%
<b>GAAP Ratios:</b>						
Loss and loss expense ratio	67.6%	66.8	0.8pts	67.0%	65.8	1.2pts
Underwriting expense ratio	32.9%	32.9		33.3%	32.6	0.7
Dividends to policyholders ratio	0.4%	0.3	0.1	0.3%	0.3	
Combined ratio	100.9%	100.0	0.9	100.6%	98.7	1.9
<b>Statutory Ratios:<sup>1</sup></b>						
Loss and loss expense ratio	66.9%	66.0	0.9	66.4%	65.2	1.2
Underwriting expense ratio	31.4%	30.8	0.6	31.8%	30.9	0.9
Dividends to policyholders ratio	0.4%	0.3	0.1	0.3%	0.3	

Combined ratio	<b>98.7%</b>	97.1	1.6pts	<b>98.5%</b>	96.4	2.1pts
----------------	--------------	------	--------	--------------	------	--------

<sup>1</sup> The statutory ratios include the 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 is 99.5% for Second Quarter 2008 and 99.2% for Six Months 2008 compared to 98.1% for Second Quarter 2007 and 97.1% for Six Months 2007.

NPW decreased in Second Quarter and Six Months 2008 compared to Second Quarter and Six Months 2007 due to the highly competitive insurance marketplace and the slowing economy. These factors are evidenced as follows:

Reductions in new business of \$17.6 million, to \$74.3 million, in Second Quarter 2008, and \$28.0 million, to \$149.0 million, in Six Months 2008 compared to the same periods last year. Reductions in endorsement and audit activity of \$9.8 million, to a net return of premium of \$3.6 million, in Second Quarter 2008 and \$16.3 million, to a net return of premium of \$5.2 million, in Six Months 2008 compared to the same periods last year. Previously, these transactions typically resulted in additional premium due to the growth of the insured businesses over the course of the policy period.

**Table of Contents**

These decreases were partially offset by:

Increased net renewals of \$13.2 million, to \$331.1 million, in Second Quarter 2008 and \$7.6 million, to \$660.8 million, in Six Months 2008 compared to the same periods last year. These renewals include relatively flat Commercial Lines retention of 78% in Second Quarter and Six Months 2008 and Second Quarter and Six Months 2007, and renewal price decreases, including exposure, of 1% in Second Quarter 2008 and 0.7% in Six Months 2008 compared to decreases, of 0.5% in Second Quarter 2007 and 0.1% in Six Months 2007. In response to the highly competitive marketplace, our agents are actively managing our books of business by renewing accounts as much as 60 days in advance of the policy expiration date.

Increased Personal Lines NPW due to higher rates on both homeowners and personal automobile premiums. For additional information regarding Personal Lines rate filings, see the section below entitled, Personal Lines Results.

As the decreases in NPW have not yet been fully recognized into income, NPE is flat in Second Quarter and Six Months 2008 compared to the same periods last year.

The GAAP loss and loss expense ratio increased 0.8 points in Second Quarter 2008 compared to Second Quarter 2007 reflecting: (i) a 1.7-point increase due to higher catastrophe losses related to storm activity in portions of our southern and mid-western regions; and (ii) a 0.8-point increase related to less favorable prior year loss development than the previous year. These items were partially offset by improvements in our workers compensation line of business from the execution of our strategic initiatives, coupled with a decrease in non-catastrophe property losses due to normal volatility of losses in the commercial property line of business.

The 1.2-point increase in the GAAP loss and loss expense ratio in Six Months 2008 compared to Six Months 2007 includes: (i) a 0.8-point increase related to higher catastrophe losses; (ii) a 0.6-point increase related to less favorable prior year loss development primarily in our commercial automobile line of business; and (iii) increased losses from the first quarter of 2008 on the physical damage portion of our commercial automobile line of business that added 0.6 points to the loss and loss expense ratio. Partially offsetting these items are improvements in the workers compensation line of business.

In our continual efforts to manage our claims process and reduce our loss and loss expense ratio, we have instituted a number of initiatives that are focused on best practices in the following areas:

- Claims automation;
- Claims quality and control;
- Litigation management;
- Compliance and bill review; and
- Salvage and subrogation.

We anticipate that these initiatives will reduce cycle time and improve workflows, resulting in the quicker establishment of case reserves, thus leading to lower ultimate loss costs through reduced legal and loss adjustment expenses. In the near term, the quicker establishment of loss reserves inflates our severity statistics, but the longer-term benefit is a refined management of the claims process.

The increase in the GAAP underwriting expense ratio in Six Months 2008 compared to Six Months 2007 was primarily attributable to a pre-tax restructuring charge of \$3.6 million, or 0.5 points, in the first quarter of 2008 related to our workforce reduction initiative.

We continue to manage our expenses through the following cost containment initiatives: (i) closely monitoring labor costs as reflected in our reduced headcount year-over-year and the above-mentioned restructuring; (ii) targeted changes to our agency commission program implemented in July 2008 and expected to generate a \$7 million pre-tax savings; and (iii) the re-domestication of two of our insurance subsidiaries effective June 30, 2008, achieve operational efficiencies with an anticipated annual pre-tax savings of \$2 million annually. However, improvements in the underwriting expense ratio resulting from the



above initiatives could potentially be offset by reduced premium levels.

**Table of Contents*****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. Since 2006, the commercial lines sector of the industry has experienced a softening market. This softening market was evident in the first quarter of 2008, when premiums within the U.S. property/casualty insurance industry declined by 2.2% according to U.S. Property/Casualty 1<sup>st</sup> Quarter Financial Review from A.M. Best, dated June 30, 2008. The premium decline is attributed to pricing pressure and broader policy terms, coupled with weaker economic conditions driven by soaring energy prices, the sluggish housing market, the credit crunch, and a weaker job market. Standard & Poor's (S&P) indicated its 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. Within our commercial lines of business, the pricing trends observed in the first quarter have continued to intensify during the second quarter. We believe that these trends will continue within the commercial lines sector throughout the remainder of 2008.

S&P maintained a stable outlook regarding the U.S. personal lines marketplace in their mid-year update, noting an anticipated increase in merger and acquisition activity, while stating concerns over the long-term sustainability of earnings considering competitive market conditions, a softer pricing cycle, reserve development that is expected to shift towards strengthening, and loss cost inflation that is expected to outpace premium growth. In our Personal Lines business, the growth in NPW and the reduction in combined ratios in 2008 reflect greater pricing accuracy from our new automated MATRIX<sup>®</sup> system, targeted rate increases across our Personal Lines footprint, and lower expenses due to the Personal Lines restructuring in Second Quarter 2007.

In an effort to grow our business profitably in the current commercial and personal lines market conditions, we have implemented a clearly defined plan to improve risk selection and mitigate higher frequency and severity trends to complement our strong agency relationships and unique field-based model. Some of the tools we use to lower frequency and severity are our business analytics initiatives, including knowledge management and predictive modeling, safety management, managed care, and enhanced claims review.

We have also 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. During Six Months 2008, the Insurance Subsidiaries added more than 60 independent insurance agencies, bringing our total agency count to approximately 920 as of June 30, 2008. These independent insurance agencies are serviced by approximately 100 field-based AMSs who make 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 our business analytics tools. Technology that allows for the seamless placement of business into our systems includes our One & Done<sup>®</sup> small business system and our xSELeRate<sup>®</sup> straight-through processing system. Premiums of \$275,271 per workday were processed through our One & Done<sup>®</sup> small business system in Second Quarter 2008, up 10% from Second Quarter 2007. We have set a multi-year small business growth target of \$350,000 in One & Done<sup>®</sup> 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. Although overall commercial lines new business was down 21%, our One & Done<sup>®</sup> new business was up 16% for the Six Months 2008 compared to Six Months 2007.

We also continue to pursue our organic growth strategy. In June 2008, we entered our 22nd primary state, Tennessee, where we completed our initial appointment of 10 agencies and started writing Commercial Lines business. We expect to start writing Personal Lines business in late 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 June 30,		Change % or Points	Unaudited Six Months ended June 30,		Change % or Points
	2008	2007		2008	2007	
<b>GAAP Insurance Operations Results:</b>						
NPW	\$ <b>331,038</b>	351,469	(6)%	<b>671,124</b>	721,725	(7)%
NPE	<b>323,032</b>	325,966	(1)	<b>653,009</b>	654,977	
<b>Less:</b>						
Losses and loss expenses incurred	<b>216,133</b>	212,065	2	<b>429,322</b>	420,323	2
Net underwriting expenses incurred	<b>105,405</b>	105,922		<b>217,287</b>	212,558	2
Dividends to policyholders	<b>1,579</b>	1,022	55	<b>2,114</b>	2,509	(16)
Underwriting (loss) income	\$ <b>(85)</b>	6,957	(101)%	<b>4,286</b>	19,587	(78)%
<b>GAAP Ratios:</b>						
Loss and loss expense ratio	<b>66.9%</b>	65.1	1.8pts	<b>65.7%</b>	64.2	1.5pts
Underwriting expense ratio	<b>32.6%</b>	32.5	0.1	<b>33.3%</b>	32.5	0.8
Dividends to policyholders ratio	<b>0.5%</b>	0.3	0.2	<b>0.3%</b>	0.4	(0.1)
Combined ratio	<b>100.0%</b>	97.9	2.1	<b>99.3%</b>	97.1	2.2
<b>Statutory Ratios:</b>						
Loss and loss expense ratio	<b>66.5%</b>	64.6	1.9	<b>65.3%</b>	63.8	1.5
Underwriting expense ratio	<b>31.8%</b>	31.0	0.8	<b>32.2%</b>	30.7	1.5
Dividends to policyholders ratio	<b>0.5%</b>	0.3	0.2	<b>0.3%</b>	0.4	(0.1)
Combined ratio	<b>98.8%</b>	95.9	2.9pts	<b>97.8%</b>	94.9	2.9pts

NPW decreased in Second Quarter and Six Months 2008 compared to the same periods last year due to the highly competitive insurance marketplace and the slowing economy. These factors are evidenced in total Commercial Lines new business, which decreased \$20.1 million, to \$62.6 million, in Second Quarter 2008 and \$33.1 million, to \$126.2 million, in Six Months 2008. In addition, endorsement and audit activity decreased by \$9.8 million, to a net premium return of \$4.1 million in Second Quarter 2008 and \$16.2 million, to a net premium return of \$5.9 million, in Six Months 2008.

Partially offsetting these NPW decreases is net renewal activity that increased by \$13.1 million, to \$285.7 million, in Second Quarter 2008 and \$7.3 million, to \$575.3 million, in Six Months 2008 compared to the same periods last year. These renewals include relatively flat retention of 78% in Second Quarter and Six Months 2008 and Second Quarter and Six Months 2007 and commercial lines renewal price decreases, including exposure, of 1.0% in Second Quarter 2008 and 0.7% in Six Months 2008 compared to decreases of

0.5% in Second Quarter 2007 and 0.1% in Six Months 2007. In response to the highly competitive marketplace, our agents are actively managing our books of business by renewing accounts as much as 60 days in advance of the policy expiration date.

The GAAP loss and loss expense ratio increased 1.8 points in Second Quarter 2008 compared to Second Quarter 2007 reflecting: (i) a 1.9-point increase in catastrophe losses related to storm activity in portions of our southern and mid-western regions; and (ii) a 1.2-point increase related to less favorable prior year loss development. These items were partially offset by improvements in our workers compensation line of business from the execution of our strategic initiatives, coupled with a decrease in non-catastrophe property loss due to normal volatility of losses in the commercial property line of business.

The increase in the GAAP loss and loss expense ratio in Six Months 2008 compared to Six Months 2007 includes: (i) a 0.9-point increase related to higher catastrophe losses; (ii) a 0.6-point increase related to decreased favorable prior year loss development; and (iii) a 0.7-point increase due to normal volatility in the physical damage portion of our commercial automobile line of business. Partially offsetting these items are improvements in our workers compensation line of business.

The higher GAAP underwriting expense ratio in Six Months 2008 compared to Six Months 2007 was primarily driven by a \$3.6 million restructuring charge in the first quarter of 2008, of which \$3.1 million was related to our Commercial Lines business. The restructuring charge, which added approximately 0.5 points to the Commercial Lines GAAP underwriting ratio, reflects costs associated with our workforce reduction expense initiative in the first quarter of 2008.

**Table of Contents**

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

General Liability

(\$ in thousands)	Unaudited Quarter ended June 30,		Change % or Points	Unaudited Six Months ended June 30,		Change % or Points
	2008	2007		2008	2007	
Statutory NPW	\$ 105,042	110,348	(5)%	216,325	229,039	(6)%
Statutory NPE	99,932	101,602	(2)	203,201	205,062	(1)
Statutory combined ratio % of total statutory commercial NPW	103.3%	100.1	3.2pts	100.2%	97.5	2.7pts
	32%	31		32%	32	

NPW for this line of business decreased in Second Quarter and Six Months 2008 compared to the same periods last year, primarily driven by decreases in new business premiums of \$6.5 million, to \$17.9 million, in Second Quarter 2008 and \$9.4 million, to \$36.8 million, in Six Months 2008. Despite significant competition in our middle market and large account business, overall policy counts for this line increased 5% in Second Quarter and Six Months 2008 from the same periods in 2007. Retention on this line remained stable at approximately 76% in Second Quarter and Six Months 2008 and Second Quarter and Six Months 2007, reflecting moderate growth in our small account business, which we define as policies with premiums less than \$25,000.

Pricing pressure and higher loss costs continue to challenge profitability in this line of business. However, we continue to concentrate on maintaining our underwriting discipline, 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 June 30,		Change % or Points	Unaudited Six Months ended June 30,		Change % or Points
	2008	2007		2008	2007	
Statutory NPW	\$ 78,753	90,259	(13)%	159,053	183,910	(14)%
Statutory NPE	77,501	80,884	(4)	155,968	163,372	(5)
Statutory combined ratio % of total statutory commercial NPW	98.6%	102.2	(3.6)pts	96.5%	100.2	(3.7)pts
	24%	26		24%	25	

In Second Quarter and Six Months 2008, NPW on this line decreased, primarily as the result of: (i) competitive pressure from mono-line workers compensation writers, mainly on the upper end of our middle market business and our large account business; (ii) a one-point decrease in retention to 78%; and (iii) lower renewal prices, including exposure, which decreased 0.1% in Second Quarter 2008, compared to an increase of 2.5% in Second Quarter 2007, and increased 0.4% in Six Months 2008 compared to an increase of 2.6% in Six Months 2007. Policy counts increased by 4% in both Second Quarter and Six Months 2008. Due to the fact that we are writing more, smaller premium policies and the average policy premium for this line decreased approximately 12% in Second Quarter 2008 and 13% in Six Months 2008. NPE decreases in Second Quarter and Six Months 2008 compared to the same periods last year are attributable to NPW decreases during the last twelve months.

**Table of Contents**

The improvement in the statutory combined ratio of 3.6 points in Second Quarter 2008 and 3.7 points in Six Months 2008 compared to the same periods last year reflects: (i) favorable prior year statutory development of approximately \$3 million, or 3.9 points, in Second Quarter 2008 and \$7 million, or 4.5 points in Six Months 2008 compared to no significant prior year statutory development in Second Quarter 2007 and approximately \$2 million, or 1.2 points, in Six Months 2007; and (ii) the ongoing progress resulting from the execution of our multi-faceted workers compensation strategy, which incorporates our business analytics tools and underwriting process improvements that enable us to retain and write more of our agents' best accounts.

**Commercial Automobile**

(\$ in thousands)	Unaudited Quarter ended June 30,		Change % or Points	Unaudited Six Months ended June 30,		Change % or Points
	2008	2007		2008	2007	
Statutory NPW	\$ 78,483	82,781	(5)%	158,682	170,528	(7)%
Statutory NPE	77,758	78,814	(1)	156,982	157,603	
Statutory combined ratio % of total statutory commercial NPW	96.2%	84.1	12.1pts	98.2%	86.1	12.1pts
	24%	23		23%	24	

NPW for this line of business decreased in Second Quarter and Six Months 2008 compared to the same periods last year due primarily due to lower new business premiums in this line of business, which were \$12.4 million in Second Quarter 2008, down \$4.4 million or 26%, and \$24.6 million in Six Months 2008, down \$6.9 million or 22%. Retention on this line of business was down one point to 80% in both Second Quarter and Six Months 2008. As with the general liability line, 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 4% in Second Quarter and Six Months 2008 compared to the same periods in 2007.

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

No significant prior year development in Second Quarter or Six Months 2008 compared to favorable prior year development of approximately \$7 million, or 8.9 points, in Second Quarter 2007 and approximately \$10 million, or 6.3 points in Six Months 2007 due to lower than anticipated severity in accident years 2004 through 2006.

Physical damage losses that were \$0.7 million, or 1 point, higher in Second Quarter 2008 and \$4.5 million, or 2.9 points, higher in Six Months 2008 compared to the same periods last year. These increases reflect normal volatility that is inherent in property line results.

Renewal price decreases on this line, which is our most competitive line of business, including exposure, of 3.1% in Second Quarter 2008 and 3.2% in Six Months 2008 compared to 3.0% in Second Quarter 2007 and 2.6% in Six Months 2007.

**Commercial Property**

(\$ in thousands)	Unaudited Quarter ended June 30,		Change % or Points	Unaudited Six Months ended June 30,		Change % or Points
	2008	2007		2008	2007	
Statutory NPW	\$ 48,986	49,431	(1)%	97,230	100,498	(3)%
Statutory NPE	48,575	46,796	4	98,511	93,364	6
Statutory combined ratio	94.4%	94.0	0.4pts	95.5%	93.1	2.4pts
	15%	14		14%	14	

% of total statutory commercial

NPW

NPW for this line of business decreased in Second Quarter and Six Months 2008 compared to Second Quarter and Six Months 2007 due to new business premium decreases of \$0.8 million, to \$11.6 million, in Second Quarter 2008 and \$2.3 million, to \$22.6 million, in Six Months 2008 coupled with a one point decrease in retention to 77% in Second Quarter and Six Months 2008. NPE increases in Second Quarter and Six Months 2008 compared to the same periods last year are attributable to NPW increases during the last twelve months.

**Table of Contents**

The statutory combined ratio increases in both Second Quarter and Six Months 2008 compared to the same periods last year are attributable to catastrophe losses of \$9.0 million in Second Quarter 2008 and \$12.3 million in Six Months 2008 related to storm activity in our southern and mid-western regions compared to catastrophe losses of \$4.4 million in Second Quarter 2007 and \$7.9 million in Six Months 2007. Second Quarter 2008 catastrophe losses were partially offset by decreases in non-catastrophe property losses, reflecting the normal volatility inherent in this line of business.

**Personal Lines Results**

<b>Personal Lines</b> (\$ in thousands)	<b>Unaudited</b> <b>Quarter ended</b> <b>June 30,</b>		<b>Change</b> <b>% or</b> <b>Points</b>	<b>Unaudited</b> <b>Six Months ended</b> <b>June 30,</b>		<b>Change</b> <b>% or</b> <b>Points</b>
	<b>2008</b>	<b>2007</b>		<b>2008</b>	<b>2007</b>	
<b>GAAP Insurance Operations Results:</b>						
NPW	\$ 56,191	53,454	5%	105,945	100,383	6%
NPE	52,057	50,385	3	103,353	101,387	2
<b>Less:</b>						
Losses and loss expenses incurred	37,518	39,171	(4)	77,508	77,206	
Net underwriting expenses incurred	17,705	18,316	(3)	34,834	34,196	2
Underwriting loss	\$ (3,166)	(7,102)	55%	(8,989)	(10,015)	10%
<b>GAAP Ratios:</b>						
Loss and loss expense ratio	72.1%	77.7	(5.6)pts	75.0%	76.1	(1.1)pts
Underwriting expense ratio	34.0%	36.4	(2.4)	33.7%	33.7	
Combined ratio	106.1%	114.1	(8.0)	108.7%	109.8	(1.1)
<b>Statutory Ratios:<sup>1</sup></b>						
Loss and loss expense ratio	70.4%	75.1	(4.7)	74.0%	74.7	(0.7)
Underwriting expense ratio	27.7%	30.4	(2.7)	28.8%	31.0	(2.2)
Combined ratio	98.1%	105.5	(7.4)pts	102.8%	105.7	(2.9)pts

<sup>1</sup> The statutory ratios include the 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 is 103.5% for Second Quarter 2008 and 107.6% for Six Months 2008 compared to 112.7% for Second Quarter 2007 and 111.4% for Six Months 2007.

NPW increased in Second Quarter and Six Months 2008 compared to Second Quarter and Six Months 2007 primarily due to:

Rate actions on our personal automobile line of business, including average renewal rates of 7-13% in various states, including a 6.8% increase in New Jersey that was effective in May 2008.

Rate actions on our homeowners line of business, including average renewal rate increases of 4.5% in New Jersey that was effective in April 2007, as well as increases in various other states of 5-7%.

Policy count increases of 3% in Second Quarter 2008 and 4% in Six Months 2008 compared the same periods last year.

Increased retention in our homeowners line of business of one point to 87% in Six Months 2008 compared to Six Months 2007.

As of June 30, 2008, New Jersey personal automobile business represented 38% of total Personal Lines premium compared to 42% as of June 30, 2007.

The decrease in the GAAP loss and loss expense ratio in Second Quarter and Six Months 2008 compared to the same periods in the prior year was driven by premium increases in the respective periods coupled with the following for the Second Quarter 2008: (i) no significant prior year development in Second Quarter 2008 compared to unfavorable prior year development of approximately \$1 million in Second Quarter 2007, which increased the GAAP loss and loss expense ratio in Second Quarter 2007 by 2.1 points; and (ii) a decrease in property losses of \$0.7 million, or 2.1 points, in Second Quarter 2008 compared to Second Quarter 2007.

## **Table of Contents**

The GAAP underwriting expense ratio improved in Second Quarter 2008 compared to Second Quarter 2007 primarily due to costs associated with the reorganization of the Personal Lines Department in May of 2007 that reduced the staffing level by 31 employees. This reorganization added 2.6 points to the underwriting expense ratio in Second Quarter 2007.

The GAAP underwriting expense ratio remained flat in Six Months 2008 compared to Six Months 2007. The impact of costs associated with the 2007 reorganization of the Personal Lines Department, which added 1.3 points to the underwriting ratio in Six Months 2007, was partially offset by the impact of the restructuring charge in the first quarter of 2008 related to our workforce reduction initiative. This 2008 restructuring charge, which amounted to approximately \$0.5 million for Personal Lines, added approximately 0.5 points to the Personal Lines GAAP underwriting ratio in Six Months 2008.

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

Two automobile rate increases of approximately 6.5% each in New Jersey, effective in May and October 2008. These rate increases apply to all automobile business written in New Jersey. In addition to the New Jersey increases, we have filed or implemented other rate increases in various other states for our automobile business that range between 5-17%. Some of these increases apply to all automobile business in such states and some only apply to automobile business written prior to the implementation of MATRIX®.

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

Homeowners rate increases of 5.0% in New Jersey were filed in Second Quarter 2008.

Additionally, we have filed or implemented other rate actions include implemented or filed increases in various other states for our homeowners business that range between 6-14%.

## **Reinsurance**

We have successfully completed negotiations of our July 1, 2008 excess of loss treaties with highlights as follows:

### **Property Excess of Loss**

The Property Excess of Loss treaty was renewed with a \$28.0 million limit in excess of a \$2.0 million retention, a \$5 million increase from the prior treaty of \$23.0 million limit in a excess of a \$2.0 million retention.

The per occurrence cap on the second layer was increased to \$40.0 million from \$22.5 million, bringing the total per occurrence limit for the program to \$64.0 million compared to the \$46.5 million limit in the expiring treaty.

The annual aggregate limit for the second \$20.0 million in excess of \$10.0 million layer was also increased, by an additional reinstatement, to \$80.0 million. The first layer continues to have unlimited reinstatements.

### **Casualty Excess of Loss**

The Casualty Excess of Loss treaty ( Casualty Treaty ) was restructured effective July 1, 2008 into one treaty encompassing all casualty lines, including workers compensation. As a result, the Workers Compensation Only treaty was not renewed at July 1, 2008. The current program provides the following coverage:

The first layer was expanded from a workers compensation only layer to now include all lines, which significantly reduces uncertainty surrounding losses in that layer. This layer provides coverage up to 65% of \$3.0 million in excess of a \$2.0 million retention.

The next four layers provide coverage up to 100% of \$45.0 million in excess of a \$5.0 million retention.

The sixth layer provides coverage up to 75% of \$40.0 million in excess of a \$50.0 million retention.

Consistent with the prior year, the Casualty Treaty excludes nuclear, biological, chemical, and radiological terrorism losses. Annual aggregate terrorism limits, net of co-participation including a \$40.0 million in excess of \$50.0 million layer, is \$175.8 million for all losses.

The cost of layers above \$5 million has decreased 2% to \$10 million. On a fiscal year basis, the ceded premium for the entire casualty program will be approximately \$10 million above the expiring premium due to the significant extension in coverage. The overall impact of the restructured program will be to improve insurance operations by about \$2.0 million with lower investment income being offset due to higher ceded premium.

**Table of Contents****Investments**

Our investment portfolio consists primarily of fixed maturity investments (82%), but also contains equity securities (6%), short-term investments (6%), and other investments (6%). Our investment philosophy includes certain return and risk objectives for the fixed maturity and equity portfolios. The primary fixed maturity portfolio return objective 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 equity portfolio return objective 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 June 30,		Change % or Points	Unaudited Six Months ended June 30,		Change % or Points
	2008	2007		2008	2007	
Net investment income before tax	\$ 38,515	40,642	(5)%	76,381	80,505	(5)%
Net investment income after tax	30,082	31,788	(5)	59,453	62,945	(6)
Total invested assets				3,708,875	3,541,366	5
Effective tax rate	21.9%	21.8	0.1pts	22.2%	21.8	0.4pts
Annual after-tax yield on fixed maturity securities				3.6%	3.6	
Annual after-tax yield on investment portfolio				3.2%	3.5	(0.3)

The decreases in net investment income, before tax, of \$2.1 million for Second Quarter 2008 and \$4.1 million in Six Months 2008 compared to Second Quarter and Six Months 2007 were primarily attributable to decreased returns on the alternative investment portion of our other investments portfolio of \$3.8 million, to \$0.3 million, in Second Quarter 2008 and \$4.3 million, to \$2.2 million, in Six Months 2008 due, in part, to the slowing of merger and acquisition activity in the current credit tightening environment. Partially offsetting the reduced alternative investment return is increased income on our fixed maturity security portfolio due to a higher invested asset base. In addition, Six Months 2008 includes a \$1.6 million reduction in the fair value of our equity trading portfolio.

We continue to maintain a conservative, diversified investment portfolio, with fixed maturity investments representing 82% of invested assets. The portfolio has an average S&P rating of AA+. The following table presents the Moody's Investor Service (Moody's) and S&P's ratings of our fixed maturities portfolio:

Rating	Unaudited June 30, 2008	December 31, 2007
Aaa/AAA	51%	69%
Aa/AA	33%	16%
A/A	11%	9%
Baa/BBB	5%	6%
Ba/BB or below	<1%	<1%
Total	100%	100%

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 ABS

portfolios. At June 30, 2008, municipal securities with insurance enhancement represented 27% of our fixed maturity securities portfolio and the average credit rating of the underlying securities was AA-. High credit quality continues to be a cornerstone of our investment strategy, as almost 100% of the fixed maturity securities in our portfolio are investment grade. At June 30, 2008, non-investment grade securities (below BBB-) represented less than 1%, or approximately \$8 million, of our fixed maturity portfolio. Our mortgage-backed securities portfolio totaled \$679.2 million at June 30, 2008, with an average credit rating of AA+. Within our investment portfolio, we define sub prime exposure as exposure to direct and indirect investments in non-agency residential mortgages with average FICO® scores below 650. Our bond portfolio, as of June 30, 2008, included one security with a cost and market value of \$1.5 million that has a FICO® score below 650. Our RMBS, residential asset-backed securities ( RABS ) and commercial mortgage-backed securities ( CMBS ) portfolios also include \$68.9 million of Alternative A securities ( Alt-A ) rated AAA by S&P and \$5.4 million in Alt-A collateralized debt obligations ( CDOs ) rated A-.

**Table of Contents**

To manage and mitigate exposure, we perform analysis on mortgage-backed securities both at the time of purchase and as part of the ongoing portfolio evaluation. This analysis includes review of average FICO<sup>®</sup> scores, loan-to-value ratios, geographic spread of the assets securing the bond, delinquencies in payments for the underlying mortgages, gains/losses on sales as well as other information that aids in determination of the health of the underlying assets. We also consider overall credit environment, economic conditions, total projected return on the investment, and overall asset allocation of the portfolio in our decisions to purchase or sell structured securities.

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 our 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 borrowings under our credit facility or the issuance of debt and equity securities. Managing investment risk by adhering to these strategies is intended to protect the interests of the policyholders of our Insurance Subsidiaries and our stockholders, while enhancing our financial strength and underwriting capacity.

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

	<b>Unaudited Quarter ended June 30, 2008</b>	<b>Unaudited Quarter ended June 30, 2007</b>	<b>Unaudited Six Months ended June 30, 2008</b>	<b>Unaudited Six Months ended June 30, 2007</b>
(\$ in thousands)				
Held-to-maturity fixed maturities				
Gains	\$		10	
Losses				
Available-for-sale fixed maturities				
Gains	525	139	1,058	355
Losses	(13,144)	(703)	(14,298)	(1,008)
Available-for-sale equity securities				
Gains	15,100	13,774	17,697	25,464
Losses	(558)	(62)	(1,029)	(420)
Total net realized gains	\$ 1,923	13,148	3,438	24,391

Our realized gains from equity securities in Second Quarter and Six Months 2008 were primarily due to the sale of certain long-term equity investments in an effort to reallocate various portfolio and sector exposures.

Our realized losses from fixed maturities in Second Quarter and Six Months 2008 include other-than-temporary impairment charges. The determination that a security has incurred an other-than-temporary decline in value requires the judgment of management and consideration of the fundamental condition of the issuer, its near-term prospects and all the relevant facts and circumstances. For additional information on our periodic evaluation for other-than-temporary impairment, refer to "Critical Accounting Policies and Estimates" contained in Item 7.

Management's Discussion and Analysis of Financial Condition and Results of Operations section of our 2007 Annual Report.

**Table of Contents**

During Second Quarter 2008, our realized losses on available-for-sale fixed maturity securities included \$9.8 million of other-than-temporary impairment charges associated with seven ABSs, one RMBS, and one corporate bond. We also had \$2.8 million in realized losses in connection with the sale of two ABSs. The majority of these other-than-temporary impairment charges, as well as the two securities that were sold, were associated with issuer-specific credit events that revolved around the performance of the underlying collateral, which had materially deteriorated during Second Quarter 2008. In general, these securities were experiencing increased conditional default rates and loss severities, and as a result, our stress test scenarios were indicating less of a margin to absorb losses going forward. Although the majority of these securities were insured or guaranteed by mono-line bond guarantors, recent downgrades have reduced our confidence in their ability to perform in the event of default. In addition, credit support for these securities has also begun to erode, thereby further increasing the potential for eventual loss. The lack of an underlying rating and collateral performance that had deteriorated over the past three months presented negative credit and pricing pressure; therefore, we could no longer reasonably assert that the recovery period, if any, would be temporary. As a result of our evaluation, we recorded other-than-temporary impairment charges of \$9.8 million, which resulted in the corresponding increase in realized losses from fixed maturities in Second Quarter and Six Months 2008.

Despite the issues surrounding the securities above, we maintain a high quality and liquid investment portfolio and the sale of securities that produced realized gains or impairment charges that produced realized losses 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 tables present the period of time that available-for-sale fixed maturity and equity securities sold at a loss were continuously in an unrealized loss position prior to sale:

<b>Period of time in an unrealized loss position</b> (\$ in millions)	<b>Unaudited Quarter ended June 30, 2008</b>		<b>Unaudited Quarter ended June 30, 2007</b>	
	<b>Fair Value on Sale Date</b>	<b>Realized Loss</b>	<b>Fair Value on Sale Date</b>	<b>Realized Loss</b>
Fixed maturities:				
0 6 months	\$ 16.7	0.3	13.8	0.2
7 12 months	3.8	0.2	5.3	0.1
Greater than 12 months	2.2	2.8	10.2	0.2
Total fixed maturities	22.7	3.3	29.3	0.5
Equity securities:				
0 6 months	0.1	0.1	1.4	0.1
7 12 months	3.1	0.4		
Greater than 12 months				
Total equity securities	3.2	0.5	1.4	0.1
Total	\$ 25.9	3.8	30.7	0.6
	<b>Unaudited</b>		<b>Unaudited</b>	



<b>Period of time in an unrealized loss position</b> (\$ in millions)	<b>Six Months ended June 30, 2008</b>		<b>Six Months ended June 30, 2007</b>	
	<b>Fair Value on Sale Date</b>	<b>Realized Loss</b>	<b>Fair Value on Sale Date</b>	<b>Realized Loss</b>
Fixed maturities:				
0 6 months	\$ 16.7	0.3	13.8	0.2
7 12 months	8.6	0.4	5.3	0.1
Greater than 12 months	2.2	2.8	10.2	0.2
Total fixed maturities	27.5	3.5	29.3	0.5
Equity securities:				
0 6 months	3.6	0.5	2.6	0.3
7 12 months	3.2	0.5	0.3	0.2
Total equity securities	6.8	1.0	2.9	0.5
Total	\$ 34.3	4.5	32.2	1.0

**Table of Contents****Unrealized Losses**

The following table summarizes the aggregate fair value and gross pre-tax unrealized losses 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 June 30, 2008 and December 31, 2007:

Period of time in an unrealized loss position (\$ in millions)	Unaudited June 30, 2008		December 31, 2007	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Fixed maturities:				
0 6 months	\$ 921.4	18.4	219.2	8.0
7 12 months	157.1	23.8	188.6	11.6
Greater than 12 months	232.0	26.5	340.5	5.7
Total fixed maturities	1,310.5	68.7	748.3	25.3
Equities:				
0 6 months	25.0	1.6	25.7	1.1
7 12 months	16.9	2.9	1.1	0.4
Total equity securities	41.9	4.5	26.8	1.5
Total	\$ 1,352.4	73.2	775.1	26.8

Unrealized losses for fixed maturity securities and equities increased, primarily due to the credit stress which caused credit spreads to widen, dislocation in the capital markets, inflation worries, and general uncertainty about the U.S. economy. As of June 30, 2008, there were 413 securities in our portfolio in an unrealized loss position, including certain securities that were priced at a significant discount to cost due to the uncertainties in the marketplace. However, broad changes in the overall market or interest rate environment generally do not lead to impairment charges and, therefore, based on our analyses, which includes our review of the credit worthiness of the issuers, coupled with our ability and intent to hold the securities throughout their anticipated recovery periods, none of these securities are considered other-than-temporarily impaired.

However, in spite of our continued belief that unrealized losses on certain securities are not necessarily predictive of the ultimate performance of the underlying collateral, future write-downs may be necessary in light of unprecedented market and liquidity disruptions.

We have no available-for-sale fixed maturity securities, with fair values continuously less than 85% of their amortized costs for more than nine months as of June 30, 2008. The following tables present information regarding the severity of unrealized losses and, for those securities with a fair value of less than 85% of their amortized cost, information regarding the duration of the unrealized loss position as of June 30, 2008:

Fair Value as a percentage of Amortized Cost (\$ in millions)	Unrealized (Loss) Gain	Fair Value
85% but less than 100% of amortized cost	\$ (32.3)	1,222.1
75% but less than 85% of amortized cost	(7.7)	34.3
Less than 75% of amortized cost	(28.7)	54.1
Gross unrealized losses on fixed maturity securities	(68.7)	1,310.5
Gross unrealized gains on fixed maturity securities	31.2	1,733.9

Net unrealized losses on fixed maturity securities	\$	(37.5)	3,044.4
<b>Duration of Unrealized Loss Position</b> (\$ in millions)		<b>75% but less than 85% of Amortized Cost</b>	<b>Less than 75% of Amortized Cost</b>
0 3 months	\$	(2.5)	(3.6)
4 6 months		(5.2)	(11.9)
7 9 months			(13.2)
Gross unrealized losses	\$	(7.7)	(28.7)

**Table of Contents**

In addition, the following table presents information regarding our available-for-sale fixed maturities that were in an unrealized loss position at June 30, 2008 by contractual maturity:

<b>Contractual Maturities</b> (\$ in millions)	<b>Amortized Cost</b>	<b>Fair Value</b>
One year or less	\$ 75.0	72.2
Due after one year through five years	507.9	485.1
Due after five years through ten years	665.6	634.4
Due after ten years through fifteen years	114.4	105.3
Due after fifteen years	16.3	13.5
Total	\$ 1,379.2	1,310.5

**Investments Outlook**

The escalating credit crisis and interest rate volatility continued into Second Quarter 2008 as more economic indicators point to an extended period of economic slowdown or recession. The Federal Funds rate was reduced by 25 basis points, to 2%, in April 2008 and future rate actions are uncertain in light of inflationary concerns. The difficult economy may lead to increased corporate loan default rates and there is the possibility of a global recession, as economic growth in Japan and Europe is expected to soften.

For fixed maturity securities, yield and income generation remain the key drivers to our investment strategy and our overall philosophy is to invest with a long-term horizon and a buy-and-hold principle. Reliance on independent investment research to avoid potential difficulties will continue to be a key driver behind our investment decisions. The continued volatility in fixed income spreads may provide attractive investment opportunities, particularly in the municipal bond sector.

With all these risks present, we are increasingly cautious in the equities markets and will continue to manage through this period of uncertainty by investing in companies with more defensive characteristics, such as strong balance sheets and reasonable valuations. Other considerations are favorable long-term corporate performance and attractive relative historical valuations.

Our long-term outlook for our other investments portfolio continues to be positive, particularly relative to other traditional asset classes of stocks, bonds, and cash. Investors with available cash are finding assets for sale at very attractive terms in these difficult markets. However, in the near term, we expect the current credit crisis to curb merger and acquisition activity, which will reduce the returns that many private equity sponsors have been able to realize over the past few years. The expected slowdown in merger and acquisition activity and the corresponding reduction in distributions to private equity investors have begun to materialize. Long-term, we believe these conditions create a favorable investment environment, as risk has been repriced and financial discipline will be restored to the financial markets.

**Table of Contents*****Diversified Insurance Services Segment***

The Diversified Insurance Services operations consist of two core functions: (i) human resource administration outsourcing ( HR Outsourcing ); and (ii) flood insurance. These operations contributed \$0.06 per diluted share in Second Quarter 2008 compared to \$0.07 per diluted share in Second Quarter 2007, and \$0.11 per diluted share in Six Months 2008 compared to \$0.12 per diluted share in Six Months 2007. 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		% Change or Points	Unaudited Six Months ended		% Change or Points
	June 30, 2008	2007		June 30, 2008	2007	
<b>HR Outsourcing</b>						
Revenue	\$ 13,498	14,928	(10)%	\$ 28,616	31,723	(10)%
Pre-tax profit	841	1,341	(37)	1,577	2,599	(39)
<b>Flood Insurance</b>						
Revenue	14,013	13,656	3	26,110	24,066	8
Pre-tax profit	2,983	3,765	(21)	5,042	5,767	(13)
<b>Other</b>						
Revenue	2,553	2,093	22	5,137	4,066	26
Pre-tax profit	1,115	963	16	2,605	2,070	26
<b>Total</b>						
Revenue	30,064	30,677	(2)	59,863	59,855	
Pre-tax profit	4,939	6,069	(19)	9,224	10,436	(12)
After-tax profit	3,270	4,019	(19)	6,083	6,923	(12)
After-tax return on revenue	10.9%	13.1	(2.2)pts	10.2%	11.6	(1.4)pts

**HR Outsourcing**

HR Outsourcing revenue declined in Second Quarter and Six Months 2008 compared to Second Quarter and Six Months 2007, primarily as a result of a reduction in worksite employees. As of June 30, 2008, our worksite employees were down 9% to 24,660, compared to 27,215 as of June 30, 2007, due to the current economic downturn.

Pre-tax profit decreased in our HR Outsourcing business in Second Quarter and Six Months 2008 compared to the same periods in the prior year are 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.

**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 3% in Second Quarter 2008 and 8% in Six Months 2008 compared to the same periods last year were mainly attributable to the increase in servicing in-force flood premium, which increased 17% to \$153.9 million as of June 30, 2008 compared to June 30, 2007. Partially offsetting this increase are: (i) a 0.5-point reduction, to 29.7%, in fees paid to us by the National Flood Insurance Program ( NFIP ) in relation to servicing premium, which was effective June 1, 2008; and (ii) a reduction in claims handling fees paid to us by the NFIP, effective June 1, 2008. The current structure includes fees of 1% of direct premiums written, which are paid even in non-catastrophe

years, coupled with 1.5% of incurred losses. Prior to June 1, 2008, we received claims handling fees equal to 3.3% of incurred losses. Revenues associated with handling flood claims decreased to \$0.9 million in Second Quarter 2008 compared to \$1.4 million in Second Quarter 2007 and \$1.0 million in Six Months 2008 compared to \$1.4 million in Six Months 2007.

The decrease in pre-tax profit in Second Quarter and Six Months 2008 compared to Second Quarter and Six Months 2007 is primarily due to: (i) the decrease in revenues associated with handling flood claims as mentioned above; and (ii) increased commissions to agents.

*Diversified Insurance Services Outlook*

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

**Table of Contents**

The viability of the NFIP's reinsurance program under the Write-Your-Own (WYO) Program is an essential component of our Diversified Insurance Services operations. 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 reflect 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 June 30, 2008 was \$234.5 million, up from \$198.6 million at December 31, 2007. Earlier this year, 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.

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 audited statutory financial statements, and in light of the Second Quarter 2008 re-domestication of Selective Insurance Company of the Southeast and Selective Insurance Company of South Carolina to Indiana, the Insurance Subsidiaries are permitted to pay to Selective Insurance Group, Inc., in 2008, ordinary dividends in the aggregate amount of approximately \$140.8 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.

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 June 30, 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 \$50.0 million credit facility, which can be increased to \$75.0 million with the consent of all lending parties. At June 30, 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 a professional employer organization licensing requirement 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 Selective Insurance Group, Inc. with dividends of \$0.9 million in Six Months 2008 and \$2.6 million in Six Months 2007.

**Table of Contents**

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 Second Quarter 2008 and Second 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 June 30, 2008, the amount available for dividends to holders of our common stock, in accordance with the restrictions of the 2000 Senior Notes, was \$318.5 million. 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. Book value per share decreased to \$19.32 as of June 30, 2008 from \$19.81 as of December 31, 2007.

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 June 30, 2008, we had stockholders' equity of \$1,017.7 million and total debt of \$273.9 million.

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 entitled *Contractual Obligations and Contingent Liabilities and Commitments*.

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, and increasing stockholders' dividends. In Six Months 2008, we repurchased approximately 1.8 million shares of our common stock under our authorized share repurchase program at a cost of \$40.5 million. As of June 30, 2008, there were 1.7 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 was reaffirmed in Second Quarter 2008 as A+ (Superior), their second highest of fifteen ratings. We have been rated A or higher by A.M. Best for the past 75 years, with our current rating of A+ (Superior) being in place for the last 47 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.





**Table of Contents**

Our ratings by other major rating agencies are as follows:

S&P's Insurance Rating Services' our A+ financial strength rating was reaffirmed in the third quarter of 2007.

Moody's our A2 financial strength rating and our positive outlook was received in the third quarter of 2006

Fitch Ratings' our A+ rating was reaffirmed in Second Quarter 2008.

The reaffirmation by S&P cited our strong competitive position with close ties to our agents, strong operating performance, very strong operating company capitalization, and good financial flexibility. Our S&P financial strength rating and Moody's rating also affect our ability to access capital markets. In addition, our interest rate under our line of credit varies based upon Selective Insurance Group, Inc.'s debt ratings from S&P and Moody's.

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 June 30, 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 June 30, 2008, we have contractual obligations that expire at various dates through 2023 to invest up to an additional \$144.0 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 \$4.5 million for Second Quarter 2008 to \$7.4 million, and \$10.3 million for Six Months 2008 to \$13.5 million, compared to Second Quarter and Six Months 2007, respectively. The decrease was attributable to decreased pre-tax income from our Insurance Operations and Investments segments. 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 Second Quarter 2008 was 20.6%, compared with 24.9% for Second Quarter 2007 and 21.6% for Six Months 2008 compared to 24.6% for Six Months 2007. These decreases are primarily the result of reduced net investment gains, which are taxed at 35%, during Second Quarter and Six Months 2008 compared to the same periods last year.

**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 Second Quarter 2008 or Six Months 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: (i) liability insurers defending or providing indemnity for third-party claims brought against insureds; or (ii) 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 Selective Insurance Group, Inc.'s purchases of its common stock in Second Quarter 2008:

Period	Total Number of Shares Purchased <sup>1</sup>	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 <sup>2</sup>
April 1 30, 2008	4,105	23.08		2,500,835
May 1 31, 2008	569,641	21.24	563,765	1,937,070
June 1 30, 2008	188,575	21.69	188,304	1,748,766
<b>Total</b>	<b>762,321</b>	<b>21.36</b>	<b>752,069</b>	

<sup>1</sup> Second Quarter 2008 included 9,877 shares purchased from employees in connection with the vesting of restricted stock and 375 shares purchased from employees in connection with stock option exercises. These repurchases were made in connection with satisfying tax withholding obligations with respect to those employees. These shares, which were purchased at the current market value of Selective Insurance Group, Inc.'s common stock

on the dates of purchase, were not purchased as part of the publicly announced program.

- <sup>2</sup> On July 24, 2007, the Board of Directors authorized a stock repurchase program of up to 4 million shares, which is scheduled to expire on July 26, 2009.

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

Selective Insurance Group, Inc.'s 2008 Annual Meeting of Stockholders was held on April 24, 2008. The results of the voting, which was conducted in person and by proxy, were included in Item 4 Submission of Matters to a Vote of Security Holders on Form 10-Q for the period ended March 31, 2008.

**ITEM 6. EXHIBITS**

(a) Exhibits:

- | Exhibit No.      |   |
|------------------|---|
| * 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

August 1, 2008

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

By: /s/ Dale A. Thatcher

August 1, 2008

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

**Table of Contents**

**EXHIBIT INDEX**

Exhibit No.	Description
* 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