

SAFETY INSURANCE GROUP INC

Form 10-Q

November 05, 2009

[Table of Contents](#)

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2009

OR

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

For the transition period from to

Commission File Number: 000-50070

SAFETY INSURANCE GROUP, INC.

(Exact name of registrant as specified in its charter)

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

Delaware

(State or other jurisdiction of incorporation or organization)

13-4181699

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

20 Custom House Street, Boston, Massachusetts 02110

(Address of principal executive offices including zip code)

(617) 951-0600

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

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

Large accelerated filer ☐

Non-accelerated filer ☐

Accelerated filer ☒

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 November 2, 2009, there were 15,051,435 shares of common stock with a par value of \$0.01 per share outstanding.

Table of Contents

SAFETY INSURANCE GROUP, INC.

Table of Contents

	Page
PART I.	FINANCIAL INFORMATION
Item 1.	Financial Statements
	<u>Consolidated Balance Sheets at September 30, 2009 and December 31, 2008 (Unaudited)</u>
	3
	<u>Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2009 and 2008 (Unaudited)</u>
	4
	<u>Consolidated Statements of Changes in Shareholders' Equity for the Nine Months Ended September 30, 2009 and 2008 (Unaudited)</u>
	5
	<u>Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended September 30, 2009 and 2008 (Unaudited)</u>
	6
	<u>Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2009 and 2008 (Unaudited)</u>
	7
	<u>Notes to Unaudited Consolidated Financial Statements</u>
	8
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>
	<u>Executive Summary and Overview</u>
	24
	<u>Critical Accounting Policies and Estimates</u>
	29
	<u>Results of Operations - Three and Nine Months Ended September 30, 2009 and 2008</u>
	37
	<u>Liquidity and Capital Resources</u>
	44
	<u>Forward-Looking Statements</u>
	46
Item 3.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>
	46
Item 4.	<u>Controls and Procedures</u>
	47
PART II.	OTHER INFORMATION
Item 1.	<u>Legal Proceedings</u>
	47
Item 1A.	<u>Risk Factors</u>
	47
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>
	48
Item 3.	<u>Defaults upon Senior Securities</u>
	48
Item 4.	<u>Submission of Matters to a Vote of Security Holders</u>
	48
Item 5.	<u>Other Information</u>
	48
Item 6.	<u>Exhibits</u>
	48
SIGNATURE	49
EXHIBIT INDEX	50

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Consolidated Balance Sheets****(Unaudited)****(Dollars in thousands, except share data)**

	September 30, 2009	December 31, 2008
Assets		
Investment securities available for sale:		
Fixed maturities, at fair value (amortized cost: \$989,753 and \$929,836)	\$ 1,026,818	\$ 920,171
Equity securities, at fair value (cost: \$9,645 and \$8,419)	9,806	8,040
Short-term securities, at amortized cost which approximates fair value		82,928
Total investment securities	1,036,624	1,011,139
Cash and cash equivalents	73,698	60,451
Accounts receivable, net of allowance for doubtful accounts	148,353	138,792
Accrued investment income	10,027	9,957
Taxes recoverable		5,300
Receivable from reinsurers related to paid loss and loss adjustment expenses	9,773	10,835
Receivable from reinsurers related to unpaid loss and loss adjustment expenses	67,443	76,489
Ceded unearned premiums	14,688	21,620
Deferred policy acquisition costs	50,755	46,687
Deferred income taxes	1,780	18,986
Equity and deposits in pools	29,019	23,578
Other assets	13,105	13,983
Total assets	\$ 1,455,265	\$ 1,437,817
Liabilities		
Loss and loss adjustment expense reserves	\$ 446,806	\$ 467,559
Unearned premium reserves	302,223	289,695
Accounts payable and accrued liabilities	38,903	51,111
Taxes payable	367	
Payable for securities purchased	15,710	
Payable to reinsurers	14,397	8,291
Other liabilities	16,625	17,790
Total liabilities	835,031	834,446
Commitments and contingencies (Note 7)		
Shareholders' equity		
Common stock: \$0.01 par value; 30,000,000 shares authorized; 16,614,554 and 16,464,530 shares issued	166	165
Additional paid-in capital	143,527	140,261
Accumulated other comprehensive income (loss), net of taxes	24,197	(6,528)
Retained earnings	502,056	476,989
Treasury stock, at cost; 1,564,548 and 232,013 shares	(49,712)	(7,516)
Total shareholders' equity	620,234	603,371
Total liabilities and shareholders' equity	\$ 1,455,265	\$ 1,437,817

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

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Consolidated Statements of Operations****(Unaudited)****(Dollars in thousands, except share and per share data)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net earned premiums	\$ 133,059	\$ 141,251	\$ 399,715	\$ 439,001
Net investment income	11,093	11,710	32,221	34,445
Net realized (losses) gains on investments	(20)	(1,047)	(337)	1,056
Finance and other service income	4,197	4,584	12,578	13,597
Total revenue	148,329	156,498	444,177	488,099
Losses and loss adjustment expenses	82,280	87,702	261,555	274,650
Underwriting, operating and related expenses	42,061	43,130	122,681	132,069
Interest expenses	23	22	66	59
Total expenses	124,364	130,854	384,302	406,778
Income before income taxes	23,965	25,644	59,875	81,321
Income tax expense	6,941	7,286	15,992	22,987
Net income	\$ 17,024	\$ 18,358	\$ 43,883	\$ 58,334
Earnings per weighted average common share:				
Basic	\$ 1.11	\$ 1.13	\$ 2.80	\$ 3.59
Diluted	\$ 1.11	\$ 1.12	\$ 2.79	\$ 3.58
Cash dividends paid per common share	\$ 0.40	\$ 0.40	\$ 1.20	\$ 1.20
Number of shares used in computing earnings per share:				
Basic	15,296,221	16,309,712	15,694,500	16,260,696
Diluted	15,314,552	16,348,525	15,713,733	16,310,448

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

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Consolidated Statements of Changes in Shareholders' Equity****(Unaudited)****(Dollars in thousands)**

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive (Loss)/Income, Net of Taxes	Retained Earnings	Treasury Stock	Total Shareholders' Equity
Balance at December 31, 2007	\$ 162	\$ 134,224	\$ 4,453	\$ 432,746	\$ (1,585)	\$ 570,000
Net income, January 1 to September 30, 2008				58,334		58,334
Other comprehensive loss, net of deferred federal income taxes			(16,698)			(16,698)
Exercise of options and unearned compensation on restricted stock, net of deferred federal income taxes	3	4,953				4,956
Dividends paid				(19,517)		(19,517)
Acquisition of treasury stock					(2,444)	(2,444)
Balance at September 30, 2008	\$ 165	\$ 139,177	\$ (12,245)	\$ 471,563	\$ (4,029)	\$ 594,631

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income/(Loss), Net of Taxes	Retained Earnings	Treasury Stock	Total Shareholders' Equity
Balance at December 31, 2008	\$ 165	\$ 140,261	\$ (6,528)	\$ 476,989	\$ (7,516)	\$ 603,371
Net income, January 1 to September 30, 2009				43,883		43,883
Other comprehensive income, net of deferred federal income taxes			30,725			30,725
Exercise of options and unearned compensation on restricted stock, net of deferred federal income taxes	1	3,266				3,267
Dividends paid				(18,816)		(18,816)
Acquisition of treasury stock					(42,196)	(42,196)
Balance at September 30, 2009	\$ 166	\$ 143,527	\$ 24,197	\$ 502,056	\$ (49,712)	\$ 620,234

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

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Consolidated Statements of Comprehensive Income****(Unaudited)****(Dollars in thousands)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net income	\$ 17,024	\$ 18,358	\$ 43,883	\$ 58,334
Other comprehensive income (loss), net of tax:				
Unrealized holding gains (losses) during the period, net of tax expense (benefit) of \$8,744, \$(5,052), \$16,426, and \$(8,621)	16,239	(9,382)	30,506	(16,011)
Reclassification adjustment for losses (gains) included in net income, net of tax expense (benefit) of \$7, \$367, \$118 and \$(369)	13	680	219	(687)
Unrealized gains (losses) on securities available for sale	16,252	(8,702)	30,725	(16,698)
Comprehensive income	\$ 33,276	\$ 9,656	\$ 74,608	\$ 41,636

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

Table of Contents

Safety Insurance Group, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(Unaudited)

(Dollars in thousands)

	Nine Months Ended September 30,	
	2009	2008
Cash flows from operating activities:		
Net income	\$ 43,883	\$ 58,334
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization, net	9,130	8,438
Provision (benefit) for deferred income taxes	662	(1,980)
Net realized losses (gains) on investments	337	(1,056)
Changes in assets and liabilities:		
Accounts receivable	(9,561)	(467)
Accrued investment income	(70)	627
Receivable from reinsurers	10,108	5,960
Ceded unearned premiums	6,932	4,814
Deferred policy acquisition costs	(4,068)	(2,725)
Other assets	(1,069)	(10,132)
Loss and loss adjustment expense reserves	(20,753)	(13,529)
Unearned premium reserves	12,528	1,344
Accounts payable and accrued liabilities	(12,210)	(11,980)
Payable to reinsurers	6,106	15,370
Other liabilities	(1,082)	(679)
Net cash provided by operating activities	40,873	52,339
Cash flows from investing activities:		
Fixed maturities purchased	(140,971)	(108,209)
Equity securities purchased	(4,708)	(5,147)
Proceeds from sales, paydowns and calls of fixed maturities	82,829	123,316
Proceeds from maturities of fixed maturities	10,022	21,156
Proceeds from sales of equity securities	3,164	3,135
Proceeds from maturities of short-term securities	82,996	
Fixed assets purchased	(217)	(5,223)
Net cash provided by investing activities	33,115	29,028
Cash flows from financing activities:		
Proceeds and excess tax benefits from exercise of stock options	271	2,065
Dividends paid to shareholders	(18,816)	(19,517)
Acquisition of treasury stock	(42,196)	(2,444)
Net cash used for financing activities	(60,741)	(19,896)
Net increase in cash and cash equivalents	13,247	61,471
Cash and cash equivalents at beginning of year	60,451	46,311
Cash and cash equivalents at end of period	\$ 73,698	\$ 107,782

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

Table of Contents

Safety Insurance Group, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands except per share and share data)

1. Basis of Presentation

The consolidated financial statements have been prepared on the basis of accounting principles generally accepted in the United States of America (GAAP). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates.

The consolidated financial statements include Safety Insurance Group, Inc. and its subsidiaries (the Company). The subsidiaries consist of Safety Insurance Company, Safety Indemnity Insurance Company, Safety Property and Casualty Insurance Company, Whiteshirts Asset Management Corporation (WAMC), and Whiteshirts Management Corporation, which is WAMC 's holding company. All intercompany transactions have been eliminated. Prior period amounts have been reclassified to conform to the current period presentation.

The financial information as of September 30, 2009 and for the three and nine months ended September 30, 2009 and 2008 is unaudited; however, in the opinion of the Company, the information includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the financial condition and results of operations for the periods. These unaudited consolidated financial statements may not be indicative of financial results for the full year and should be read in conjunction with the audited financial statements included in the Company 's annual report on Form 10-K filed with the U.S. Securities and Exchange Commission (SEC) on March 13, 2009.

The Company is a leading provider of personal lines property and casualty insurance focused primarily on the Massachusetts market. The Company 's principal product line is private passenger automobile insurance, which accounted for 71.7% of its direct written premiums in 2008. The Company operates through its insurance company subsidiaries, Safety Insurance Company, Safety Indemnity Insurance Company and Safety Property and Casualty Company (together referred to as the Insurance Subsidiaries).

The Company has evaluated subsequent events since the date of these consolidated financial statements through the issuance date of November 5, 2009.

2. Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Codification (ASC) 105, *Generally Accepted Accounting Principles* (prior authoritative literature - Statement of Financial Accounting Standard (FAS) No.168, *The FASB Accounting*

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

Standards Codification and the Hierarchy of Generally Accepted Accounting Principles). ASC 105 is now the single source of authoritative nongovernmental GAAP. ASC 105 reorganizes the thousands of GAAP pronouncements into roughly 90 accounting topics and displays them using a consistent structure. Also included is relevant SEC guidance organized using the same topical structure in separate sections. ASC 105 was effective for financial statements issued for reporting periods that end after September 15, 2009. As of September 30, 2009, all of the Company's disclosures in its consolidated financial statements are now referenced in accordance with ASC 105. The implementation of ASC 105 did not have an impact on the Company's consolidated results of operations or financial position as it does not change authoritative guidance.

ASC 820, *Fair Value Measurements and Disclosures* (prior authoritative literature - FAS No.157, *Fair Value Measurements*) defines fair value, sets out a framework for measuring fair value and requires additional disclosures about fair value measurements. This standard applies to fair value measurements already required or permitted by existing standards and was effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company adopted ASC 820 on January 1, 2008. The adoption of ASC 820 did not have an impact on the Company's consolidated results of operations or financial position. See Note 5, Investments, for further information regarding the Company's investments and fair value measurements.

ASC 825, *Financial Instruments* (prior authoritative literature - FAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115*) permits an entity to choose to measure many financial instruments and certain other items at fair value at specified election dates. Subsequent unrealized gains and losses on items

Table of Contents

Safety Insurance Group, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands except per share and share data)

for which the fair value option has been elected will be reported in earnings. ASC 825 was effective for fiscal years beginning after November 15, 2007. The Company has chosen not to elect the fair value option permitted by this statement.

ASC 260, *Other Presentation Matters - Participating Securities and the Two Class Method* (prior authoritative literature - Emerging Issues Task Force 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities*) addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting. ASC 260 requires that such instruments that hold unforfeitable rights to dividends or dividend equivalents, regardless of whether paid or unpaid, should be considered participating securities and accordingly, should be included in the calculation of earnings per share (EPS) under the two-class method instead of the treasury stock method. Under the Company's employee incentive compensation plan, restricted stock grantees have unforfeitable rights to dividends before the vesting period and are therefore, participating securities and treated as a separate class of securities in calculating earnings per share. The Company adopted ASC 260 effective January 1, 2009, and has since used the two-class method to calculate earnings per share. In accordance with the adoption provisions of ASC 260, all prior period earnings per share data has been adjusted retroactively to conform to the provisions of ASC 260. For the nine months ended September 30, 2008 basic EPS was reduced by \$0.05 cents per share and diluted EPS was reduced by \$0.04 cents per share from previously disclosed amounts. For the three months ending September 30, 2008, basic EPS was reduced by \$0.01 and diluted EPS was reduced by \$0.02 from previously disclosed amounts.

ASC 320, *Investments - Debt and Equity Securities* (prior authoritative literature - FASB Staff Position (FSP) FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*) requires entities to separate an other-than-temporary impairment of a debt security into two components when there are credit related losses associated with the impaired debt security for which management asserts that it does not have the intent to sell the security, and it is more likely than not that it will not be required to sell the security before recovery of its cost basis. The amount of the other-than-temporary impairment related to a credit loss is recognized in earnings, and the amount of the other-than-temporary impairment related to other factors is recorded in other comprehensive loss. ASC 320 is required to be adopted for periods ending after June 15, 2009. The Company adopted ASC 320 effective for its interim reporting period ending June 30, 2009. The adoption of ASC 320 did not have an impact on the Company's consolidated results of operations or financial position. For further information, see Note 5, Investments.

ASC 825, *Financial Instruments* (prior authoritative literature FSP FAS 107-1 and Accounting Principles Board 28-1, *Interim Disclosures about Fair Value of Financial Instruments*) requires disclosures about fair value of financial instruments in interim and annual financial statements and is effective for periods ending after June 15, 2009. The Company adopted ASC 825 effective for its interim reporting period ending June 30, 2009, and its adoption did not have an impact on the Company's consolidated financial condition or results of operations. For further information, see Note 5, Investments.

ASC 820, *Fair Value Measurements and Disclosures* (prior authoritative literature FSP FAS 157-4, *Determining Fair Value When Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions that are Not Orderly*) expands certain disclosure requirements and is effective for periods ending after June 15, 2009. The Company adopted ASC 820 effective for its interim period ending June 30, 2009, and its adoption did not have an impact on the Company's consolidated financial condition or results of operations.

ASC 855, *Subsequent Events* (prior authoritative literature FAS No. 165, *Subsequent Events*) establishes principles and requirements for subsequent events. ASC 855 is effective for interim and annual financial periods ending after June 15, 2009, and shall be applied prospectively. See Note 1 for the date through which the Company evaluated subsequent events.

3. Earnings per Weighted Average Common Share

Basic earnings per weighted average common share is calculated by dividing net income by the weighted average number of basic common shares outstanding during the period including unvested restricted shares which are considered participating securities. Diluted earnings per share amounts are based on the weighted average number of common shares including unvested restricted shares and the net effect of potentially dilutive common shares outstanding. At September 30, 2009 and 2008, the Company's potentially dilutive instruments were common shares under options of 225,003, and 242,866, respectively.

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Notes to Unaudited Consolidated Financial Statements****(Dollars in thousands except per share and share data)**

The following table sets forth the computation of basic and diluted EPS for the periods indicated.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net income as reported	\$ 17,024	\$ 18,358	\$ 43,883	\$ 58,334
Less dividends:				
Distributed to common shareholders	6,026	6,441	18,509	19,270
Distributed to participating security holders	111	94	307	247
Total undistributed earnings	\$ 10,887	\$ 11,823	\$ 25,067	\$ 38,817
Undistributed earnings to common shareholders	\$ 10,694	\$ 11,656	\$ 24,643	\$ 38,305
Undistributed earnings to participating security holders	\$ 193	\$ 167	\$ 424	\$ 512
Net income available to common shareholders for basic and diluted earnings per share	\$ 17,024	\$ 18,358	\$ 43,883	\$ 58,334
Weighted average number of common shares outstanding	15,017,392	16,079,387	15,428,696	16,046,111
Common equivalent shares - restricted stock	278,829	230,325	265,804	214,585
Weighted average common and common equivalent shares outstanding used to calculate basic earnings per share	15,296,221	16,309,712	15,694,500	16,260,696
Common equivalent shares - stock options	18,331	38,813	19,233	49,752
Weighted average common and common equivalent shares outstanding used to calculate diluted earnings per share	15,314,552	16,348,525	15,713,733	16,310,448
Basic earnings per share	\$ 1.11	\$ 1.13	\$ 2.80	\$ 3.59
Diluted earnings per share	\$ 1.11	\$ 1.12	\$ 2.79	\$ 3.58

Diluted EPS excludes stock options with exercise prices and exercise tax benefits greater than the average market price of the Company's common stock during the period because their inclusion would be anti-dilutive. There were 167,925 anti-dilutive stock options for both the three and nine months ended September 30, 2009. There were 168,925 anti-dilutive stock options for both the three and nine months ended September 30, 2008.

4. Stock-Based Compensation

Management Omnibus Incentive Plan

Long-term incentive compensation is provided under the Company's 2002 Management Omnibus Incentive Plan (the Incentive Plan) which provides for a variety of stock-based compensation awards, including nonqualified stock options, incentive stock options, stock appreciation rights and restricted stock (RS) awards.

The maximum number of shares of common stock with respect to which awards may be granted is 2,500,000. Shares of stock covered by an award under the Incentive Plan that are forfeited will again be available for issuance in connection with future grants of awards under the plan. At September 30, 2009 there were 920,434 shares available for future grant. The Board of Directors and the Compensation Committee intend to issue more awards under the Incentive Plan in the future.

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Notes to Unaudited Consolidated Financial Statements****(Dollars in thousands except per share and share data)**

A summary of stock based awards granted under the Incentive Plan during the nine months ended September 30, 2009 is as follows:

Type of Equity Awarded	Effective Date	Number of Awards Granted	Fair Value per Share (1)	Vesting Terms
RS	March 9, 2009	95,953	\$ 28.66	3 years, 30%-30%-40%
RS	March 9, 2009	4,000	\$ 28.66	No vesting period (2)
RS	March 19, 2009	38,046	\$ 33.24	5 years, 20% annually

-
- (1) The fair value per share of the restricted stock grant is equal to the closing price of our common stock on the grant date.
- (2) The shares cannot be sold, assigned, pledged, or otherwise transferred, encumbered or disposed of until the recipient is no longer a member of our Board of Directors.

Accounting and Reporting for Stock-Based Awards

ASC 718, *Compensation - Stock Compensation* (prior authoritative literature FAS 123R (revised 2004), *Share-Based Payment*) requires the Company to measure and recognize the cost of employee services received in exchange for an award of equity instruments. The Company adopted ASC 718 effective January 1, 2006. Under the provisions of ASC 718, share-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as an expense over the requisite service period (generally the vesting period of the equity grant).

As permitted by ASC 718, the Company elected the modified prospective transition method. Under the modified prospective transition method, (i) compensation expense for share-based awards granted prior to January 1, 2006 is recognized over the remaining service period using the compensation cost calculated for pro forma disclosure purposes under ASC 718 as adjusted to incorporate forfeiture assumptions under ASC 718, and (ii) compensation expense for all share-based awards granted subsequent to December 31, 2005 is based on the grant date fair value estimated in accordance with the provisions of ASC 718.

Stock Options

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

The fair value of stock options used to compute net income and earnings per share for the three and nine month periods ended September 30, 2009 and 2008 is the estimated fair value at grant date using the Black-Scholes option-pricing model with the following assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Expected dividend yield	1.36% - 1.87%	1.36% - 2.52%	1.36% - 2.16%	1.36% - 2.52%
Expected volatility	0.31 - 0.36	0.20 - 0.36	0.28 - 0.36	0.20 - 0.36
Risk-free interest rate	3.82% - 4.76%	3.23% - 4.76%	3.23% - 4.76%	3.23% - 4.76%
Expected holding period	6.5 - 7 years	6.5 - 7 years	6.5 - 7 years	6.5 - 7 years

Expected dividend yield is the Company's dividend yield on the measurement date and is based on the assumption that the current yield will continue in the future. Expected volatility is based on historical volatility of the Company's common stock as well as the volatility of a peer group of property and casualty insurers measured for a period equal to the expected holding period of the option. The risk-free interest rate is based upon the yield on the measurement date of a zero-coupon U.S. Treasury bond with a maturity period equal to the expected holding period of the option. The expected holding period is based upon the simplified method provided in SEC Staff Accounting Bulletin No. 107, *Share-Based Payment*, which utilizes the mid-points between the vesting dates and the expiration date of the option award to calculate the overall expected term. There were no stock options granted during the three and nine month periods ended September 30, 2009 and 2008.

[Table of Contents](#)
Safety Insurance Group, Inc. and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
(Dollars in thousands except per share and share data)

The following table summarizes stock option activity under the Incentive Plan for the nine months ended September 30, 2009.

	Shares Under Option	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at beginning of year	238,666	\$ 33.66		
Forfeited	(1,000)	\$ 42.85		
Exercised	(12,663)	\$ 15.75		
Outstanding at end of period	225,003	\$ 34.63	5.6 years	\$ 917
Exercisable at end of period	164,513	\$ 32.18	5.4 years	\$ 917

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based upon the Company's closing stock price of \$32.92 on September 30, 2009, which would have been received by the option holders had all option holders exercised their options as of that date. The range of exercise prices on stock options outstanding under the Incentive Plan was \$12.00 to \$42.85 at September 30, 2009 and 2008. The total intrinsic value of options exercised during the nine months ended September 30, 2009 and 2008 was \$217 and \$2,127, respectively.

A summary of the status of non-vested options as of September 30, 2009, is presented below.

	Number of Shares	Weighted Average Grant Date Exercise Price
Non-vested at beginning of year	118,035	\$ 37.06
Vested	(56,545)	\$ 32.47
Forfeited	(1,000)	\$ 42.85
Non-vested at end of period	60,490	\$ 41.26

As of September 30, 2009, there was \$556 of unrecognized compensation expense related to non-vested option awards that is expected to be recognized over a weighted average period of 1.0 years.

Cash received from options exercised was \$199 and \$1,352 for the nine months ended September 30, 2009, and 2008, respectively.

Restricted Stock

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

Restricted stock awarded to employees in the form of unvested shares is recorded at the market value of the Company's common stock on the grant date and amortized ratably as expense over the requisite service period.

The following table summarizes restricted stock activity under the Incentive Plan during the nine months ended September 30, 2009.

	Shares Under Restriction	Weighted Average Fair Value
Outstanding at beginning of the year	246,325	\$ 38.77
Granted	137,999	\$ 29.92
Vested and unrestricted	(84,857)	\$ 40.20
Forfeited	(638)	\$ 36.57
Outstanding at end of period	298,829	\$ 34.28

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Notes to Unaudited Consolidated Financial Statements****(Dollars in thousands except per share and share data)**

As of September 30, 2009, there was \$7,358 of unrecognized compensation expense related to non-vested restricted stock awards that is expected to be recognized over a weighted average period of 1.5 years. The total fair value of the shares that were vested and unrestricted during the nine months ended September 30, 2009 and 2008 was \$3,412 and \$2,733, respectively. For the nine months ended September 30, 2009 and 2008, the Company recorded compensation expense related to restricted stock of \$1,875 and \$1,673 net of income tax benefits of \$1,009 and \$901, respectively.

5. Investments

The gross unrealized gains and losses on investments in fixed maturity securities and equity securities, including interests in mutual funds, were as follows for the periods indicated:

	Cost or Amortized Cost	Gross Unrealized Gains	As of September 30, 2009		Estimated Fair Value
			Gross Unrealized Losses (3) Non-OTTI Unrealized Losses	OTTI Unrealized Losses	
U.S. Treasury securities and obligations of U.S. Government agencies(1)	\$ 319,268	\$ 13,873	\$ (152)	\$	\$ 332,989
Obligations of states and political subdivisions	477,327	21,533	(258)		498,602
Asset-backed securities (1)	93,958	931	(3,403)		91,486
Corporate and other securities	99,200	4,791	(250)		103,741
Subtotal, fixed maturity securities	989,753	41,128	(4,063)		1,026,818
Equity securities (2)	9,645	161			9,806
Totals	\$ 999,398	\$ 41,289	\$ (4,063)	\$	\$ 1,036,624

	Cost or Amortized Cost	Gross Unrealized Gains	As of December 31, 2008		Estimated Fair Value
			Gross Unrealized Losses (3) Non-OTTI Unrealized Losses	OTTI Unrealized Losses	
U.S. Treasury securities and obligations of U.S. Government agencies (1)	\$ 288,598	\$ 8,532	\$ (244)	\$	\$ 296,886
Obligations of states and political subdivisions	498,339	9,414	(6,132)		501,621
Asset-backed securities (1)	77,656		(17,122)		60,534
Corporate and other securities	65,243	420	(4,533)		61,130
Subtotal, fixed maturity securities	929,836	18,366	(28,031)		920,171
Equity securities (2)	8,419		(379)		8,040
Short term securities	82,928				82,928

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

Totals	\$	1,021,183	\$	18,366	\$	(28,410)	\$	1,011,139
--------	----	-----------	----	--------	----	----------	----	-----------

(1) Obligations of U.S. Government agencies include collateralized mortgage obligations issued, guaranteed and/or insured by the following issuers: Government National Mortgage Association (GNMA), Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA) and Small Business Administration (SBA). The total of these fixed maturity securities was \$307,808 and \$286,100 at amortized cost and \$321,378 and \$294,064 at fair value as of September 30, 2009 and December 31, 2008, respectively. As such, the asset-backed securities presented exclude such issuers already presented under U.S. Treasury securities and obligations of U.S. Government Agencies.

(2) Equity securities consist solely of interests in mutual funds held to fund the Company's executive deferred compensation plan.

(3) The Company's investment portfolio included 64 and 161 securities in an unrealized loss position at September 30, 2009 and December 31, 2008, respectively.

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Notes to Unaudited Consolidated Financial Statements****(Dollars in thousands except per share and share data)**

The amortized cost and the estimated fair value of fixed maturity securities, by maturity, are shown below for the periods indicated. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	As of September 30, 2009		As of December 31, 2008	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 41,317	\$ 42,050	\$ 10,572	\$ 10,678
Due after one year through five years	239,365	250,150	245,457	249,425
Due after five years through ten years	163,426	172,270	153,520	154,817
Due after ten years through twenty years	130,630	136,110	143,278	138,225
Due after twenty years	13,249	13,374	13,252	12,428
Asset-backed securities	401,766	412,864	363,757	354,598
Totals	\$ 989,753	\$ 1,026,818	\$ 929,836	\$ 920,171

The gross realized (losses) gains on sales of fixed maturity, short-term, and equity securities were as follows for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Gross realized gains				
Fixed maturity securities	\$ 151	\$ 123	\$ 151	\$ 2,251
Equity securities				
Short term securities			1	
Gross realized losses				
Fixed maturity securities	(171)	(1,052)	(171)	(1,077)
Equity securities		(118)	(318)	(118)
Short term securities				
Net realized (losses) gains on investments	\$ (20)	\$ (1,047)	\$ (337)	\$ 1,056

Proceeds from fixed maturities maturing were \$4,700 and \$3,481 for the three months ended September 30, 2009 and 2008, respectively.

Proceeds from fixed maturities maturing were \$10,022 and \$21,156 for the nine months ended September 30, 2009 and 2008, respectively.

In the normal course of business, the Company enters into transactions involving various types of financial instruments, including investments in fixed maturities and equity securities. Investment transactions have credit exposure to the extent that a counter party may default on an obligation to the Company. Credit risk is a consequence of carrying, trading and investing in securities. To manage credit risk, the Company focuses on higher quality fixed income securities, reviews the credit strength of all companies in which it invests, limits its exposure in any one investment and monitors the portfolio quality, taking into account credit ratings assigned by recognized statistical rating organizations.

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Notes to Unaudited Consolidated Financial Statements****(Dollars in thousands except per share and share data)**

The following tables as of September 30, 2009 and December 31, 2008 illustrate the gross unrealized losses included in the Company's investment portfolio and the fair value of those securities aggregated by investment category. The tables also illustrate the length of time that they have been in a continuous unrealized loss position.

	Less than 12 Months		As of September 30, 2009 12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
U.S. Treasury securities and obligations of U.S. Government agencies	\$ 23,057	\$ 116	\$ 667	\$ 36	\$ 23,724	\$ 152
Obligations of states and political subdivisions	255		18,448	258	18,703	258
Asset-backed securities			49,523	3,403	49,523	3,403
Corporate and other securities	1,987	9	6,422	241	8,409	250
Subtotal, fixed maturity securities	25,299	125	75,060	3,938	100,359	4,063
Equity securities						
Total temporarily impaired securities	\$ 25,299	\$ 125	\$ 75,060	\$ 3,938	\$ 100,359	\$ 4,063

	Less than 12 Months		As of December 31, 2008 12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
U.S. Treasury securities and obligations of U.S. Government agencies	\$ 4,300	\$ 9	\$ 9,770	\$ 235	\$ 14,070	\$ 244
Obligations of states and political subdivisions	116,605	4,524	32,220	1,608	148,825	6,132
Asset-backed securities	24,036	7,876	36,498	9,246	60,534	17,122
Corporate and other securities	21,503	931	16,307	3,602	37,810	4,533
Subtotal, fixed maturity securities	166,444	13,340	94,795	14,691	261,239	28,031
Equity securities	2,458	353	33	26	2,491	379
Total temporarily impaired securities	\$ 168,902	\$ 13,693	\$ 94,828	\$ 14,717	\$ 263,730	\$ 28,410

As of September 30, 2009, the Company held insured investment securities of approximately \$315,945, which represented approximately 30.5% of the Company's total investment portfolio. Approximately \$37,039 of these securities are pre-refunded, meaning that funds have been set aside in escrow to satisfy the future interest and principal obligations of the bond.

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Notes to Unaudited Consolidated Financial Statements****(Dollars in thousands except per share and share data)**

The following table shows the Company's insured investment securities that are backed by financial guarantors including pre-refunded securities as of September 30, 2009. The Company does not have any direct investment holdings in a financial guarantee insurance company.

Financial Guarantor	As of September 30, 2009		
	Total	Pre-refunded Securities	Exposure Net of Pre-refunded Securities
Municipal bonds			
Ambac Assurance Corporation	\$ 48,077	\$ 8,472	\$ 39,605
Financial Guaranty Insurance Company	279	279	
Financial Security Assurance, Inc.	112,784	19,493	93,291
National Public Finance Guaranty Corporation	147,499	8,795	138,704
	308,639	37,039	271,600
Other asset-backed securities			
Ambac Assurance Corporation	3,592		3,592
Financial Guaranty Insurance Company	2,394		2,394
Syncora Corporation (XL Capital Assurance)	1,320		1,320
	7,306		7,306
Total	\$ 315,945	\$ 37,039	\$ 278,906

The following table shows the Company's insured investments by Moody's rating where it is available both with and without the impact of the insurance guarantee as of September 30, 2009.

Rating	As of September 30, 2009	
	Rating With Insurance	Rating Without Insurance
Aaa	\$ 4,007	\$ 4,007
Aa1	10,656	10,656
Aa2	33,338	33,338
Aa3	141,977	83,335
A1	51,063	85,868
A2	23,267	36,286
A3	23,184	27,712
Baa1	279	279
Baa2	3,592	3,592
Ba2		6,290
	\$ 291,363	\$ 291,363

Other-Than-Temporary Impairments

ASC 320, *Investments – Debt and Equity Securities* (prior authoritative literature - FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*) requires entities to separate an other-than-temporary impairment (OTTI) of a debt security into two components when there are credit related losses associated with the impaired debt security for which the Company asserts that it does not have the intent to sell the security, and it is more likely than not that it will not be required to sell the security before recovery of its cost basis. Prior to April 1, 2009, the Company had to determine whether it had the intent and ability to hold the investment for a sufficient period of time for the value to recover. When the analysis of the above factors resulted in the Company's conclusion that declines in market values were other-than-temporary, the cost of the securities was written down to market value and the reduction in value was reflected as a realized loss.

Table of Contents

Safety Insurance Group, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands except per share and share data)

Effective under ASC 320, the amount of the OTTI related to a credit loss is recognized in earnings, and the amount of the OTTI related to other factors is recorded as a component of other comprehensive income (loss). In instances where no credit loss exists but it is more likely than not that the Company will have to sell the debt security prior to the anticipated recovery, the decline in market value below amortized cost is recognized as an OTTI in earnings. In periods after the recognition of an OTTI on debt securities, the Company accounts for such securities as if they had been purchased on the measurement date of the OTTI at an amortized cost basis equal to the previous amortized cost basis less the OTTI recognized in earnings. For debt securities for which OTTI was recognized in earnings, the difference between the new amortized cost basis and the cash flows expected to be collected will be accreted or amortized into net investment income.

As of September 30, 2009, with the exception of one security which represented 0.1% of the Company's total investment in fixed income securities, the Company's fixed income securities portfolio was comprised entirely of investment grade corporate fixed maturity securities, U.S. Government and Agency securities, states and political subdivision securities, and asset-backed securities (i.e., all securities received a rating assigned by Moody's Investors Service, Inc. of Baa or higher, except the few securities not rated by Moody's.) The Company holds no subprime mortgage debt securities. All of the Company's holdings in mortgage-backed securities are either U.S. Government or Agency guaranteed or are rated Aaa.

The unrealized losses in the Company's fixed income portfolio as of September 30, 2009 were reviewed for potential permanent asset impairments. The Company obtained specific qualitative analysis regarding certain debt securities held at September 30, 2009 with a material (20% or greater) unrealized loss for four or more consecutive quarters. Specific qualitative analysis was also performed for any additional securities appearing on our Watch List. Qualitative analysis considered such factors as the financial condition and the near term prospects of the issuer, whether the debtor is current on its contractually obligated interest and principal payments, changes to the rating of the security by a rating agency and the historical volatility of the fair value of the security.

The qualitative analysis performed by the Company concluded that the unrealized losses recorded on the fixed maturity investment portfolio at September 30, 2009 resulted from fluctuations in market interest rates and other temporary market conditions as opposed to fundamental changes in the credit quality of the issuers of such securities. Therefore, decreases in fair values of the Company's securities are viewed as being temporary.

During the three and nine months ended September 30, 2009, there was no significant deterioration in the credit quality of any of the Company's holdings. During the three and nine months ended September 30, 2008, there was a significant deterioration in the issuer's financial condition of one of Company's holdings, American International Group, Inc. Accordingly in the third quarter of 2008, the Company recorded an other-than-temporary impairment charge of \$1,032 for this security. The Company sold this security during the quarter ended September 30, 2009 and recognized an additional loss of \$14.

Based upon the qualitative analysis performed, the Company's decision to hold these securities, the Company's current level of liquidity and its positive operating cash flows, management believes it is more likely than not that it will not be required to sell any of its securities before the

anticipated recovery in the fair value to its amortized cost basis.

ASC 320, *Investments - Debt and Equity Securities* (prior authoritative literature - FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*) requires that the Company record, as of the beginning of the interim period of adoption, a cumulative effect adjustment to reclassify the noncredit component of a previously recognized OTTI from retained earnings to other comprehensive income (loss). At September 30, 2009 and December 31, 2008, there were no amounts included in accumulated other comprehensive income related to securities which were considered by the Company to be permanently impaired.

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Notes to Unaudited Consolidated Financial Statements****(Dollars in thousands except per share and share data)****Net Investment Income**

The components of net investment income were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Interest and dividends on fixed maturities	\$ 11,351	\$ 11,467	\$ 32,843	\$ 34,168
Dividends on equity securities	38	79	109	201
Interest on short-term securities	3		74	
Interest on cash and cash equivalents	47	492	198	1,072
Total investment income	11,439	12,038	33,224	35,441
Investment expenses	346	328	1,003	996
Net investment income	\$ 11,093	\$ 11,710	\$ 32,221	\$ 34,445

Fair Value Measurements

ASC 820, *Fair Value Measurements and Disclosure* (prior authoritative literature - FAS157, *Fair Value Measurements*) provides a revised definition of fair value establishes a framework for measuring fair value and expands financial statement disclosure requirements for fair value information. Under ASC 820, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants (an exit price). ASC 820 establishes a fair value hierarchy that distinguishes between inputs based on market data from independent sources (observable inputs) and a reporting entity's internal assumptions based upon the best information available when external market data is limited or unavailable (unobservable inputs). The fair value hierarchy in ASC 820 prioritizes fair value measurements into three levels based on the nature of the inputs as follows:

Level 1 Valuations based on quoted prices in active markets for identical assets and liabilities;

Level 2 Valuations based on observable inputs that do not meet the criteria for Level 1, including quoted prices in inactive markets and quoted prices in active markets for similar, but not identical instruments; and

Level 3 Valuations based on unobservable inputs.

Fair values for the Company's fixed maturity securities are based on prices provided by its custodian bank and its investment manager. Both the custodian bank and the investment manager use a variety of independent, nationally recognized pricing services to determine market valuations. If the pricing service cannot provide fair value determinations, the Company obtains non-binding price quotes from broker-dealers. A minimum of two quoted prices is obtained for the majority of fixed maturity securities in the Company's investment portfolio. The Company's custodian bank is its primary provider of quoted prices from third-party pricing services and broker-dealers. To provide reasonable assurance of the validity of each price or quote, a secondary third-party pricing service or broker-dealer quote is obtained from the Company's investment manager. An examination of the pricing data is then performed for each security. If the variance between the primary and secondary price quotes for a security is within an accepted tolerance level, the quoted price obtained from the Company's custodian bank is used in the Company's financial statements for the security. If the variance between the primary and secondary price quotes exceeds an accepted tolerance level, the Company obtains a quote from an alternative source, if possible, and documents and resolves any differences between the pricing sources. In addition, the Company may request that its investment manager and their traders provide input as to which vendor is providing prices that their traders believe are reflective of fair value for the security. Following this process, the Company may decide to value the security in its financial statements using the secondary or alternative source if it believes that pricing is more reflective of the security's value than the primary pricing provided by its custodian bank. The Company analyzes market valuations received to verify reasonableness, to understand the key assumptions used and their sources, and to determine an appropriate ASC 820 fair value hierarchy level based upon trading activity and the observability of market inputs. Based on this evaluation and investment class analysis, each price is classified into Level 1, 2 or 3.

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Notes to Unaudited Consolidated Financial Statements****(Dollars in thousands except per share and share data)**

The Company's Level 1 securities consist of equity securities whose values are based on quoted prices in active markets for identical assets. The Company's Level 2 securities are comprised of securities whose fair value was determined using observable market inputs. Fair values for securities for which quoted market prices were unavailable were estimated based upon reference to observable inputs such as benchmark interest rates, market comparables, and other relevant inputs. On January 1 and September 30, 2009, the Company's Level 3 securities consisted of one asset-backed security whose price was based solely on a single broker quote which was deemed to be obtained through unobservable inputs.

In order to ensure the fair value determination is representative of an exit price (consistent with ASC 820), the Company's procedures for validating quotes or prices obtained from third-parties include, but are not limited to, obtaining a minimum of two price quotes for each fixed maturity security if possible, as discussed above, the periodic testing of sales activity to determine if there are any significant differences between the market price used to value the security as of the balance sheet date and the sales price of the security for sales that occurred around the balance sheet date, and the periodic review of reports provided by its investment manager regarding those securities with ratings changes and securities placed on the Company's Watch List. In addition, valuation techniques utilized by pricing services and prices obtained from external sources are reviewed by the Company's external investment manager, whose investment professionals are familiar with the securities being priced and the markets in which they trade to ensure the fair value determination is representative of an exit price (consistent with ASC 820).

Approximately 99.8% of the Company's portfolio was priced based upon quoted market prices or other observable inputs as of September 30, 2009. There were no significant changes to the valuation process during the third quarter of 2009.

As of September 30, 2009 and December 31, 2008, no quotes or prices obtained were adjusted by management. All broker quotes obtained were non-binding.

The following tables summarize our total fair value measurements and the fair value measurements based on Level 3 inputs for investments for the periods indicated.

	Total	As of September 30, 2009		
		Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
U.S. Treasury securities and obligations of U.S. Government agencies	\$ 332,989	\$	\$ 332,989	\$
Obligations of states and political subdivisions	498,602		498,602	
Asset-backed securities	91,486		89,092	2,394
Corporate and other securities	103,741		103,741	
Equity securities	9,806	9,806		
Total investment securities	\$ 1,036,624	\$ 9,806	\$ 1,024,424	\$ 2,394

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

	As of December 31, 2008			
	Total	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
U.S. Treasury securities and obligations of U.S. Government agencies	\$ 296,886	\$	\$ 296,886	\$
Obligations of states and political subdivisions	501,621		501,621	
Asset-backed securities	60,534		58,692	1,842
Corporate and other securities	61,130		61,130	
Equity securities	8,040	8,040		
Short term securities	82,928		82,928	
Total investment securities	\$ 1,011,139	\$ 8,040	\$ 1,001,257	\$ 1,842

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Notes to Unaudited Consolidated Financial Statements****(Dollars in thousands except per share and share data)**

The following table summarizes the changes in the Company's Level 3 fair value measurements for the three months ended September 30, 2009.

		Asset-Backed Securities
Balance at July 1, 2009	\$	1,842
Net gains and losses included in earnings		
Net gains included in other comprehensive income		552
Purchases and sales		
Transfers in (out) of Level 3		
Balance at September 30, 2009	\$	2,394
Amount of total losses included in earnings attributable to the change in unrealized losses related to assets still held at September 30, 2009	\$	

The following table summarizes the changes in the Company's Level 3 fair value measurements for the nine months ended September 30, 2009.

		Asset-Backed Securities
Balance at January 1, 2009	\$	1,842
Net gains and losses included in earnings		
Net gains included in other comprehensive income		552
Purchases and sales		
Transfers in (out) of Level 3		
Balance at September 30, 2009	\$	2,394
Amount of total losses included in earnings attributable to the change in unrealized losses related to assets still held at September 30, 2009	\$	

Transfers in and out of Level 3 would be attributable to changes in the ability to observe significant inputs in determining fair value exit pricing. As noted in the tables above, no transfers were made in or out of Level 3 inputs during the three and nine months ended September 30, 2009.

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Notes to Unaudited Consolidated Financial Statements****(Dollars in thousands except per share and share data)****6. Loss and Loss Adjustment Expense Reserves**

The following table sets forth a reconciliation of beginning and ending reserves for losses and LAE, as shown in the Company's consolidated financial statements for the periods indicated:

	Nine Months Ended September 30,	
	2009	2008
Reserves for losses and LAE at beginning of year	\$ 467,559	\$ 477,720
Less reinsurance recoverable on unpaid losses and LAE	(76,489)	(84,290)
Net reserves for losses and LAE at beginning of year	391,070	393,430
Incurred losses and LAE, related to:		
Current year	291,612	297,554
Prior years	(30,057)	(22,904)
Total incurred losses and LAE	261,555	274,650
Paid losses and LAE related to:		
Current year	158,475	155,614
Prior years	114,787	126,080
Total paid losses and LAE	273,262	281,694
Net reserves for losses and LAE at end of period	379,363	386,386
Plus reinsurance recoverables on unpaid losses and LAE	67,443	77,805
Reserves for losses and LAE at end of period	\$ 446,806	\$ 464,191

At the end of each period, the reserves were re-estimated for all prior accident years. The Company's prior year reserves decreased by \$30,057 and \$22,904 for the nine months ended September 30, 2009 and 2008, respectively, and resulted from re-estimations of prior years ultimate loss and LAE liabilities. The decrease in prior years reserves during the 2009 period is primarily composed of reductions of \$15,706 in the Company's retained automobile reserves, \$8,780 in reserves assumed from Commonwealth Automobile Reinsurers (CAR), and \$4,139 in the Company's retained homeowners reserve. The decrease in prior year reserves during the 2008 period is primarily composed of reductions of \$14,681 in the Company's retained automobile reserves and \$6,334 in reserves assumed from CAR.

The Company's private passenger automobile line of business prior year reserves decreased by \$20,699 for the nine months ended September 30, 2009. The decrease was primarily due to improved retained private passenger results of \$10,975 for the accident years 2004 through 2008, and improved assumed CAR results for the private passenger automobile pool of \$7,168 for accident years 2005 through 2008. The Company's private passenger automobile line of business prior year reserves decreased by \$19,124 for the nine months ended September 30, 2008. The decrease was primarily due to improved retained private passenger results of \$12,527 for accident years 2002 through 2007, and improved assumed CAR results for the private passenger automobile pool of \$5,392 for accident years 2004 through 2007. The improved retained private passenger results were primarily due to fewer incurred but not yet reported claims than previously estimated and better than previously estimated severity on the Company's established bodily injury and property damage case reserves. The improved CAR results were due primarily to improved CAR private passenger loss ratios as published and reported by the CAR Loss Reserving Committee.

Due to the nature of the risks that the Company underwrites and has historically underwritten, management does not believe that it has an exposure to asbestos or environmental pollution liabilities.

7. Commitments and Contingencies

Various claims, generally incidental to the conduct of normal business, are pending or alleged against the Company from time to time. In the opinion of management, based in part on the advice of legal counsel, the ultimate resolution of such claims will not have a material adverse effect on the Company's consolidated financial statements. However, if estimates of the ultimate resolutions of those proceedings are revised, liabilities related to those proceedings could be adjusted in the near term.

Table of Contents

Safety Insurance Group, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands except per share and share data)

Massachusetts law requires that insurers licensed to do business in Massachusetts participate in the Massachusetts Insurers Insolvency Fund (Insolvency Fund). Members of the Insolvency Fund are assessed a proportionate share of the obligations and expenses of the Insolvency Fund in connection with an insolvent insurer. It is anticipated that there will be additional assessments from time to time relating to various insolvencies. Although the timing and amounts of any future assessments are not known, based upon existing knowledge, management's opinion is that such future assessments will not have a material effect upon the financial position of the Company.

In addition, on November 21, 2008, the Massachusetts Office of the Attorney General (the AG) delivered a civil investigative demand (the CID) to Safety Insurance Company, one of the Company's operating subsidiaries. The CID directed the Company to produce certain information related to its policies and practices in connection with underwriting insurance policies on motorcycles and adjusting total loss claims under such policies. Management understands that certain other insurance companies are also being investigated by the AG related to their policies and practices related to motorcycle insurance.

The focus of the AG's attention appears to be on the insured values determined by us for purposes of charging premiums for physical damage insurance coverage. In 2008, coverage for motorcycles represented 1.9% of the Company's total private passenger automobile insurance. The Company has been cooperating with the AG and responding to the CID and various related additional requests for information by the AG since that time.

In connection with the matters addressed by the CID, the AG delivered a letter to Safety Insurance Company dated February 2, 2009, in which the AG stated that it has reason to believe that Safety Insurance Company has violated the Massachusetts Consumer Protection Act , G.L. c. 93A, §2, by engaging in unfair and deceptive acts and practices regarding motorcycle insurance. Specifically, the AG stated it has reason to believe that the Company overcharged its customers for motorcycle insurance and engaged in related unfair claims settlement practices. By issuing this letter the AG has met a statutory prerequisite to filing a civil complaint under the Massachusetts Consumer Protection Act against the Company.

The Company is engaged in ongoing discussions with the AG with respect to the matters raised in the February 2, 2009 letter. In management's opinion, while this matter may be material to the Company's operating results for any particular period if an unfavorable outcome results, it will not have a material adverse effect on its overall financial condition.

8. Debt

On August 14, 2008, we entered into an Amended and Restated Revolving Credit Agreement (the New Credit Agreement) with RBS Citizens, NA (RBS Citizens). The New Credit Agreement amended and restated the terms of our existing Revolving Credit Agreement with RBS Citizens prior to its expiration date of August 17, 2008. The New Credit Agreement extends the maturity date to August 14, 2013 and provides a \$30,000

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

revolving credit facility with an accordion feature allowing for future expansion of the committed amount up to \$50,000. Loans under the credit facility bear interest at the Company's option at either (i) the LIBOR rate plus 1.25% per annum or (ii) the higher of RBS Citizens prime rate or 0.5% above the federal funds rate plus 1.25% per annum. Interest only is payable prior to maturity.

The Company's obligations under the credit facility are secured by pledges of its assets and the capital stock of its operating subsidiaries. The credit facility is guaranteed by the Company's non-insurance company subsidiaries. The credit facility contains covenants including requirements to maintain minimum risk based capital ratios and statutory surplus of Safety Insurance Company as well as limitations or restrictions on indebtedness, liens, and other matters. Among other covenants, the credit facility restricts the Company's payment of dividends (i) if a default under the credit facility is continuing or would result therefrom or (ii) in an amount in excess of 50% of the Company's prior year's net income, as determined in accordance with GAAP. As of September 30, 2009, the Company was in compliance with all such covenants. In addition, the credit facility includes customary events of default, including a cross-default provision permitting the lenders to accelerate the facility if the Company (i) defaults in any payment obligation under debt having a principal amount in excess of \$10,000 or (ii) fails to perform any other covenant permitting acceleration of all such debt.

The Company had no amounts outstanding on its credit facility at September 30, 2009 and December 31, 2008. The credit facility commitment fee included in interest expenses was computed at a rate of 0.25% on the \$30,000 commitment at September 30, 2009 and 2008.

Table of Contents

Safety Insurance Group, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands except per share and share data)

9. Income Taxes

Federal income tax expense for the three and nine months ended September 30, 2009 and 2008 has been computed using estimated effective tax rates. These rates are revised, if necessary, at the end of each successive interim period to reflect the current estimates of the annual effective tax rates.

ASC 740, *Income Taxes* (prior authoritative literature - FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes-an Interpretation of FASB Statement 109*), was adopted by the Company on January 1, 2007. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. ASC 740 requires that the Company determine whether the benefits of its tax positions have a more likely than not chance of being sustained upon audit based upon the technical merits of the tax position. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. As a result of the implementation of ASC 740, the Company recognized no adjustment to its consolidated balance sheet or statement of operations. The Company believes that the positions taken on its income tax returns for open tax years will be sustained upon examination by the Internal Revenue Service (IRS). Therefore, the Company has not recorded a liability under ASC 740.

During the three and nine months ended September 30, 2009, there were no material changes to the amount of the Company's unrecognized tax benefits or to any assumptions regarding the amount of its ASC 740 liability.

As of September 30, 2009 and December 31, 2008, the Company was no longer subject to examination of its U.S. federal tax returns for years prior to 2006. The Company is not currently under examination by the IRS. During the year 2009, the Massachusetts Department of Revenue concluded its review of the 2005 and 2006 tax periods. The resulting audit adjustments were immaterial to the Company's financial position.

10. Share Repurchase Program

On August 3, 2007, the Board of Directors approved a share repurchase program of up to \$30,000 of the Company's outstanding common shares. On March 24, 2009, the Board of Directors increased this existing share repurchase program by authorizing repurchase of up to \$60,000 of the Company's outstanding common shares. Under the program, the Company may repurchase shares of its common stock for cash in public or private transactions, in the open market or otherwise, at management's discretion. The timing of such repurchases and actual number of shares repurchased will depend on a variety of factors including price, market conditions and applicable regulatory and corporate requirements. The program does not require the Company to repurchase any specific number of shares and may be modified, suspended or terminated at any time without prior notice.

During the nine months ended September 30, 2009, the Company purchased 1,332,535 of its common shares on the open market under the program at a cost of \$42,196. At December 31, 2008, the Company had purchased 232,013 of its common shares on the open market under the program at a cost of \$7,516.

Table of Contents

Item 2.

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion should be read in conjunction with our accompanying consolidated financial statements and notes thereto, which appear elsewhere in this document. In this discussion, all dollar amounts are presented in thousands, except share and per share data.

The following discussion contains forward-looking statements. We intend statements which are not historical in nature to be, and are hereby identified as forward-looking statements to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. In addition, the Company's senior management may make forward-looking statements orally to analysts, investors, the media and others. This safe harbor requires that we specify important factors that could cause actual results to differ materially from those contained in forward-looking statements made by or on behalf of us. We cannot promise that our expectations in such forward-looking statements will turn out to be correct. Our actual results could be materially different from and worse than our expectations. See Forward-Looking Statements below for specific important factors that could cause actual results to differ materially from those contained in forward-looking statements

Executive Summary and Overview

In this discussion, Safety refers to Safety Insurance Group, Inc. and our Company, we, us and our refer to Safety Insurance Group, Inc. and its consolidated subsidiaries. Our subsidiaries consist of Safety Insurance Company (Safety Insurance), Safety Indemnity Insurance Company (Safety Indemnity), Safety Property and Casualty Insurance Company (Safety P&C), Whiteshirts Asset Management Corporation (WAMC), and Whiteshirts Management Corporation, which is WAMC's holding company.

We are a leading provider of private passenger automobile insurance in Massachusetts. In addition to private passenger automobile insurance (which represented 71.7% of our direct written premiums in 2008), we offer a portfolio of other insurance products, including commercial automobile (13.2% of 2008 direct written premiums), homeowners (11.6% of 2008 direct written premiums), dwelling fire, umbrella and business owner policies (totaling 3.5% of 2008 direct written premiums). Operating virtually exclusively in Massachusetts through our insurance company subsidiaries, Safety Insurance, Safety Indemnity, and Safety P&C, (together referred to as the Insurance Subsidiaries), we have established strong relationships with 827 independent insurance agents in 969 locations throughout Massachusetts. We have used these relationships and our extensive knowledge of the Massachusetts market to become the second largest private passenger automobile and third largest commercial automobile insurance carrier in Massachusetts, capturing an approximate 11.4% and 11.2% share, respectively, of the Massachusetts private passenger and commercial automobile markets in 2009, according to the Commonwealth Automobile Reinsurers (CAR) Cession Volume Analysis Report of November 2, 2009, based on automobile exposures. These statistics total, for each vehicle insured, the number of months during the year insurance for that vehicle is in effect, to arrive at an aggregate number of car-months for each insurer; this aggregate number, divided by 12, equals the insurer's number of car-years, a measure we refer to in this discussion as automobile exposures.

Our Insurance Subsidiaries began writing private passenger automobile and homeowners insurance in New Hampshire on October 15, 2008. For the nine months ended September 30, 2009, we wrote approximately 824 policies and \$676 in direct written premiums in New Hampshire.

Massachusetts Automobile Insurance Market

We have been subject to extensive regulation in the private passenger automobile insurance industry in Massachusetts, which represented 71.7% of our direct written premiums in 2008. Owners of registered automobiles in Massachusetts are required to maintain minimum automobile insurance coverage. Prior to April 1, 2008, the Commissioner of Insurance (the "Commissioner") had fixed and established the maximum rates that could be charged for private passenger automobile insurance. Prior to April 1, 2008, as a servicing carrier of CAR, we were required to issue a policy to all qualified applicants. CAR operates at an underwriting deficit. This deficit is allocated among every Massachusetts automobile insurance company, including us, based on a complex formula that takes into consideration a company's voluntary market share, the rate at which it cedes business to CAR, and the company's utilization of a credit system CAR has designed to encourage carriers to reduce their use of CAR. In addition, based on our market share, prior to April 1, 2009 we had been assigned certain licensed producers by CAR that were unable to obtain a voluntary contract with another insurer. We call these agents Exclusive Representative Producers, or ERPs.

On July 16, 2007, the Commissioner issued two decisions that significantly changed how private passenger automobile insurance is regulated in Massachusetts. In the first decision, the Commissioner approved and set a time table for the

Table of Contents

implementation of new CAR rules pursuant to which the current reinsurance program run by CAR has been replaced with an assigned risk plan, the Massachusetts Automobile Insurance Plan (MAIP). Under these new rules, as of April 1, 2009 we no longer are assigned ERPs whose business we must insure (subject to the option of ceding it to CAR) and instead, we are assigned individual policies by CAR. The MAIP began with business effective on or after April 1, 2008 for new business and those risks that have 10 or more Safe Driver Points. Beginning April 1, 2009, all business was eligible for MAIP except those risks that have no violations or accidents in the preceding three year period (so called Clean in three risks). The last policy effective date on which any risk could be ceded to CAR in accordance with the current reinsurance program was March 31, 2009. We are not able at this time to determine what effect these new CAR rules will have on our business.

The Commissioner's decision to implement an assigned risk plan brought to a close a lengthy period of regulatory and judicial consideration of the Massachusetts private passenger residual market.

In the second decision referenced above, the Commissioner announced that she would not fix and establish the maximum premium rates that can be charged for private passenger automobile insurance policies issued or renewed after April 1, 2008. In a letter accompanying the decision, the Commissioner stated that in place of the fixed and established system, she would institute a system that introduces competitive pricing to the Massachusetts private passenger automobile insurance market, which the Commissioner has described as managed competition (Managed Competition). On October 5, 2007, the Commissioner issued a Competitive Rating Regulation; 211 CMR 79.00: Private Passenger Motor Vehicle Insurance Rates that describes the technical details of Managed Competition (the Regulation). The Regulation governs the rate filing that an insurer can file.

In addition, the Regulation prohibits the following rating and underwriting factors:

- *Rating Factors:* Insurers are prohibited from using credit information, sex, marital status, race, creed, national origin, religion, occupation, income, education, home ownership and age (except to produce the reduction in rates for insureds age 65 and over).
- *Underwriting Factors:* Insurers are prohibited from refusing to issue or renew a private passenger auto insurance policy based on credit information, sex, marital status, race, creed, national origin, religion, age, occupation, income, principal place of garaging, education and home ownership.

The Commissioner has issued a number of bulletins addressing issues related to the implementation of Managed Competition (the Rating Bulletins). Rating Bulletins 2008-11 and 2009-13 limits voluntary market rates to a level no higher than the rates in the residual market. Rating Bulletin 2008-17 describes how companies may place risks among company affiliates within an insurer group.

We are not able at this time to determine what effect these bulletins will have on our business over the long term.

CAR runs a reinsurance pool for commercial automobile policies and beginning January 1, 2006, CAR implemented a Limited Servicing Carrier Program (LSC) for ceded commercial automobile policies. CAR approved Safety Insurance and five other servicing carriers through a Request for Proposal to process ceded commercial automobile business, which is spread equitably among the six servicing carriers. Each Massachusetts commercial automobile insurer must bear a portion of the losses of the commercial reinsurance pool that is serviced by the six servicing carriers in the LSC program. Subject to the Commissioner's review, CAR sets the premium rates for commercial automobile policies reinsured through

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

CAR and this reinsurance pool can generate an underwriting result that is a profit or deficit based upon CAR's rate level. This underwriting result is allocated among every Massachusetts commercial automobile insurance company, including us, based on a company's commercial automobile voluntary market share.

CAR also runs a reinsurance pool for Taxi, Limousine and Car Service risks (the Taxi/Limo Program). On April 25, 2007, Safety submitted through a Request for Proposal a bid to process a portion of the Taxi/Limo Program. CAR approved Safety as one of the two servicing carriers for this program beginning January 1, 2008.

As noted above, in 2007 and previous years, the Commissioner set the maximum premium rates that could be charged and minimum commissions that had to be paid to agents for private passenger automobile insurance. Beginning in 2007, the effective date of the Commissioner's rate decision was April 1st as compared to January 1st of 2006 and prior rate decisions. The 2006 rates were in effect from January 1, 2006 until March 31, 2007. The Commissioner announced on December 15, 2006, an 11.7% statewide average private passenger automobile insurance rate decrease for 2007, compared to an 8.7% decrease for 2006. Coinciding with the 2007 rate decision, the Commissioner also approved a 13.0% commission rate which agents receive for selling private passenger automobile insurance, as a percentage of premiums, compared to a commission rate of 11.8% in 2006.

Table of Contents

Under Managed Competition, we decreased our rates an average 6.7% in 2008. We filed and were approved for modifications in our rates effective April 1, 2009 that expected no change in our average total rates. We began using three rating tiers effective April 1, 2009. A Companion Policy Client Tier, which is policyholders that have a non private passenger automobile policy with us, will receive a rate decrease of 2.5%. A Loyal Automobile Client Tier, which is policyholders who have been insured with Safety two or more years, will see no rate change. A New Insurance Client Tier, which is policyholders that do not qualify for the other two tiers, will have a rate increase of 2.5%. We also filed and have been approved for a 2.9% rate increase in our rates effective October 1, 2009. Our rates include a 13.0% commission rate for agents.

For the nine months ended September 30, 2009, our average private passenger automobile premium per exposure decreased by 5.7% from the nine months ended September 30, 2008. The table below shows the filed and approved average Massachusetts private passenger automobile premium rate changes and the resulting changes in our average premium per automobile exposure. The 5.7% decrease in average premium per personal automobile exposure is the result of our rounded account pricing strategy introduced under Managed Competition that began April 1, 2008, which has preferred pricing for policyholders that insure an automobile and home with us, and standard pricing for stand-alone automobile policies. More automobile policyholders than we originally estimated have insured both their automobile and home with us, and thus are eligible for our account discount of 10%.

Massachusetts Private Passenger Automobile Rates

Year	Average Rate Change (1)	Safety Change in Average Premium per Automobile Exposure (2)
2009	0.0%	(5.7)%
2008	(6.7)%	(7.9)%
2007	(11.7)%	(5.5)%
2006	(8.7)%	(6.8)%
2005	(1.7)%	0.1%
2004	2.5%	6.1%
2003	2.7%	6.9%
2002	0.0%	5.2%
2001	(8.3)%	0.0%
2000	0.7%	7.4%
1999	0.7%	10.9%

(1) Source: Commissioner rate decisions for 1998 – 2007, and Safety Insurance for 2008 and 2009. The 11.7% average rate decrease in 2007 was in effect for the period April 1, 2007 through March 31, 2008. Under Managed Competition, the 6.7% average rate decrease in 2008 was effective for the period April 1, 2008 through March 31, 2009.

(2) Source: Safety Insurance.

Statutory Accounting Principles

Our results are reported in accordance with GAAP, which differ from amounts reported in accordance with statutory accounting principles (SAP) as prescribed by insurance regulatory authorities. Specifically, under GAAP:

- Policy acquisition costs such as commissions, premium taxes and other variable costs incurred in connection with writing new and renewal business are capitalized and amortized on a pro rata basis over the period in which the related premiums are earned, rather than expensed as incurred, as required by SAP.
- Certain assets are included in the consolidated balance sheets whereas, under SAP, such assets are designated as non admitted assets, and charged directly against statutory surplus. These assets consist primarily of premium receivables that are outstanding over ninety days, federal deferred tax assets in excess of statutory limitations, furniture, equipment, leasehold improvements and prepaid expenses.
- Amounts related to ceded reinsurance are shown gross of ceded unearned premiums and reinsurance recoverables, rather than netted against unearned premium reserves and loss and loss adjustment expense reserves, respectively, as required by SAP.
- Fixed maturities securities, which are classified as available-for-sale, are reported at current fair values, rather than at amortized cost, or the lower of amortized cost or market, depending on the specific type of security, as required by SAP.

Table of Contents

- The differing treatment of income and expense items results in a corresponding difference in federal income tax expense. Changes in deferred income taxes are reflected as an item of income tax benefit or expense, rather than recorded directly to surplus as regards policyholders, as required by SAP. Admittance testing may result in a charge to unassigned surplus for non-admitted portions of deferred tax assets. Under GAAP reporting, a valuation allowance may be recorded against the deferred tax asset and reflected as an expense.

Insurance Ratios

The property and casualty insurance industry uses the combined ratio as a measure of underwriting profitability. The combined ratio is the sum of the loss ratio (losses and loss adjustment expenses incurred as a percent of net earned premiums) plus the expense ratio (underwriting expenses as a percent of net written premiums, if calculated on a SAP basis, or net earned premiums, if calculated on a GAAP basis). The combined ratio reflects only underwriting results, and does not include income from investments or finance and other service income. Underwriting profitability is subject to significant fluctuations due to competition, catastrophic events, weather, economic and social conditions and other factors.

Our statutory insurance ratios are outlined in the following table.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Statutory Ratios:				
Loss Ratio	61.8%	62.1%	65.4%	62.6%
Expense Ratio	31.3%	31.7%	30.0%	30.0%
Combined Ratio	93.1%	93.8%	95.4%	92.6%

Under GAAP, the loss ratio is computed in the same manner as under SAP, but the expense ratio is determined by matching underwriting expenses to the period over which net premiums were earned, rather than to the period that net premiums were written.

Our GAAP insurance ratios are outlined in the following table.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
GAAP Ratios:				
Loss Ratio	61.8%	62.1%	65.4%	62.6%
Expense Ratio	31.6%	30.5%	30.7%	30.1%
Combined Ratio	93.4%	92.6%	96.1%	92.7%

Stock-Based Compensation

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

Long-term incentive compensation is provided under the our 2002 Management Omnibus Incentive Plan (the Incentive Plan) which provides for a variety of stock-based compensation awards, including nonqualified stock options, incentive stock options, stock appreciation rights and restricted stock (RS) awards.

The maximum number of shares of common stock with respect to which awards may be granted is 2,500,000. Shares of stock covered by an award under the Incentive Plan that are forfeited will again be available for issuance in connection with future grants of awards under the plan. At September 30, 2009, there were 920,434 shares available for future grant. The Board of Directors and the Compensation Committee intend to issue more awards under the Incentive Plan in the future.

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

Table of Contents

A summary of stock based awards granted under the Incentive Plan during the nine months ended September 30, 2009 is as follows:

Type of Equity Awarded	Effective Date	Number of Awards Granted	Fair Value per Share (1)	Vesting Terms
RS	March 9, 2009	95,953	\$ 28.66	3 years, 30%-30%-40%
RS	March 9, 2009	4,000	\$ 28.66	No vesting period (2)
RS	March 19, 2009	38,046	\$ 33.24	5 years, 20% annually

- (1) The fair value per share of the restricted stock grant is equal to the closing price of our common stock on the grant date.
- (2) The shares cannot be sold, assigned, pledged, or otherwise transferred, encumbered or disposed of until the recipient is no longer a member of our Board of Directors.

Reinsurance

We reinsure with other insurance companies a portion of our potential liability under the policies we have underwritten, thereby protecting us against an unexpectedly large loss or a catastrophic occurrence that could produce large losses, primarily in our homeowners line of business. We use various software products to measure our exposure to catastrophe losses and the probable maximum loss to us for catastrophe losses such as hurricanes. The models include estimates for our share of the catastrophe losses generated in the residual market for property insurance by the Massachusetts Property Insurance Underwriting Association (FAIR Plan). In the aftermath of Hurricane Katrina in 2005, the reinsurance market has seen from the various software modelers, increases in the estimate of damage from hurricanes in the southern and northeast portions of the United States due to revised estimations of increased hurricane activity and increases in the estimation of demand surge in the periods following a significant event. We continue to adjust our reinsurance programs as a result of the changes to the models. As of January 1 2009, our catastrophe reinsurance provides gross per occurrence reinsurance coverage up to \$350,000. As a result of the changes to the models, and our revised reinsurance program, our catastrophe reinsurance protects us in the event of a 140-year storm (that is, a storm of a severity expected to occur once in a 140-year period). All of our reinsurers have an A.M. Best rating of A (Excellent) or better except for PARIS RE which is rated A- (Excellent).

We are a participant in CAR, a state-established body that runs the residual market reinsurance programs for both private passenger and commercial automobile insurance in Massachusetts under which premiums, expenses, losses and loss adjustment expenses on ceded business are shared by all insurers writing automobile insurance in Massachusetts. We also participate in the FAIR Plan in which premiums, expenses, losses and loss adjustment expenses on homeowners business that cannot be placed in the voluntary market are shared by all insurers writing homeowners insurance in Massachusetts. The FAIR Plan has grown dramatically over the past few years as insurance carriers have reduced their exposure to coastal property. The FAIR Plan's exposure to catastrophe losses increased and as a result, the FAIR Plan decided to buy reinsurance to reduce their exposure to catastrophe losses. On July 1, 2009, the FAIR Plan purchased \$1,100,000 of catastrophe reinsurance for property losses in excess of \$180,000. At September 30, 2009, we had no material amounts recoverable from any reinsurer, excluding the residual markets described above.

On March 10, 2005, our Board of Directors adopted a resolution that prohibits Safety from purchasing finite reinsurance (reinsurance that transfers only a finite or limited amount of risk to the reinsurer) without approval by the Board. To date, the Company has never purchased a finite reinsurance contract.

Effects of Inflation

We do not believe that inflation has had a material effect on our consolidated results of operations, except insofar as inflation may affect interest rates.

Table of Contents

Critical Accounting Policies and Estimates

Loss and Loss Adjustment Expense Reserves.

Significant periods of time can elapse between the occurrence of an insured loss, the reporting to us of that loss and our final payment of that loss. To recognize liabilities for unpaid losses, we establish reserves as balance sheet liabilities. Our reserves represent estimates of amounts needed to pay reported and unreported losses and the expenses of investigating and paying those losses, or loss adjustment expenses. Every quarter, we review our previously established reserves and adjust them, if necessary.

When a claim is reported, claims personnel establish a case reserve for the estimated amount of the ultimate payment. The amount of the reserve is primarily based upon an evaluation of the type of claim involved, the circumstances surrounding each claim and the policy provisions relating to the loss. The estimate reflects the informed judgment of such personnel based on general insurance reserving practices and on the experience and knowledge of the claims person. During the loss adjustment period, these estimates are revised as deemed necessary by our claims department based on subsequent developments and periodic reviews of the cases.

In accordance with industry practice, we also maintain reserves for estimated losses incurred but not yet reported (IBNR). IBNR reserves are determined in accordance with commonly accepted actuarial reserving techniques on the basis of our historical information and experience. We review and make adjustments to incurred but not yet reported reserves quarterly.

When reviewing reserves, we analyze historical data and estimate the impact of various loss development factors, such as our historical loss experience and that of the industry, trends in claims frequency and severity, our mix of business, our claims processing procedures, legislative enactments, judicial decisions, legal developments in imposition of damages, and changes and trends in general economic conditions, including the effects of inflation. A change in any of these factors from the assumption implicit in our estimate can cause our actual loss experience to be better or worse than our reserves, and the difference can be material. There is no precise method, however, for evaluating the impact of any specific factor on the adequacy of reserves, because the eventual development of reserves is affected by many factors.

Management determines our loss and LAE reserves estimate based upon the analysis of our actuaries. A reasonable estimate is derived by selecting a point estimate within a range of indications as calculated by our actuaries using generally accepted actuarial techniques. The key assumption in most actuarial analysis is that past patterns of frequency and severity will repeat in the future, unless a significant change in the factors described above takes place. Our key factors and resulting assumptions are the ultimate frequency and severity of claims, based upon the most recent ten years of claims reported to the Company, and the data CAR reports to us to calculate our share of the residual market, as of the date of the applicable balance sheet. For each accident year and each coverage within a line of business our actuaries calculate the ultimate losses incurred. Our total reserves are the difference between the ultimate losses incurred and the cumulative loss and loss adjustment payments made to date. Our IBNR reserves are calculated as the difference between our total reserves and the outstanding case reserves at the end of the accounting period. To determine ultimate losses, our actuaries calculate a range of indications and select a point estimation using such actuarial techniques as:

- *Paid Loss Indications:* This method projects ultimate loss estimates based upon extrapolations of historic paid loss trends. This method tends to be used on short tail lines such as automobile physical damage.

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

- *Incurred Loss Indications:* This method projects ultimate loss estimates based upon extrapolations of historic incurred loss trends. This method tends to be used on long tail lines of business such as automobile liability and homeowner's liability.
- *Bornhuetter-Ferguson Indications:* This method projects ultimate loss estimates based upon extrapolations of an expected amount of IBNR, which is added to current incurred losses or paid losses. This method tends to be used on small, immature, or volatile lines of business, such as our BOP and umbrella lines of business.
- *Bodily Injury Code Indications:* This method projects ultimate loss estimates for our private passenger and commercial automobile bodily injury coverage based upon extrapolations of the historic number of accidents and the historic number of bodily injury claims per accident. Projected ultimate bodily injury claims are then segregated into expected claims by type of injury (e.g. soft tissue injury vs. hard tissue injury) based on past experience. An ultimate severity, or average paid loss amounts, is estimated based upon extrapolating historic trends. Projected ultimate loss estimates using this method are the aggregate of estimated losses by injury type.

Such techniques assume that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting our ultimate losses, total reserves and resulting IBNR reserves. It is possible that the final outcome may fall above or below these amounts as a result of a number of factors, including immature data, sparse data, or

Table of Contents

significant growth in a line of business. Using these methodologies our actuaries established a range of reasonably possible estimations for net reserves of approximately \$338,675 to \$383,887 as of September 30, 2009. In general, the low and high values of the ranges represent reasonable minimum and maximum values of the indications based on the techniques described above. The Company's selected point estimate of net loss and LAE reserves based upon the analysis of our actuaries was \$379,363 as of September 30, 2009.

The following table presents the point estimation of the recorded reserves and the range of estimations by line of business for net loss and LAE reserves as of September 30, 2009.

Line of Business	Low	Recorded	High
Private passenger automobile	\$ 231,283	\$ 260,956	\$ 261,405
Commercial automobile	50,680	56,970	57,448
Homeowners	39,143	41,469	44,414
All other	17,569	19,968	20,620
Total	\$ 338,675	\$ 379,363	\$ 383,887

For our private passenger automobile, commercial automobile and homeowners lines of business as of September 30, 2009, due to the relatively long time we have been writing these lines of insurance and our stable long-term trends in frequency and severity, the range of reserves is relatively narrow. For our all other lines of business as of September 30, 2009, due to the relatively short time we have been writing these lines of business, the sparse amount of data and the resulting immature history available for our analysis, the range of reserves is relatively wide. We have recorded reserves closer to the high in the ranges of our projections.

The following table presents our total net reserves and the corresponding case reserves and IBNR reserves by line of business as of September 30, 2009.

Line of Business	Case	IBNR	Total
Private passenger automobile	\$ 219,538	\$ 15,439	\$ 234,977
CAR assumed private passenger auto	17,640	8,339	25,979
Commercial automobile	33,717	7,291	41,008
CAR assumed commercial automobile	8,515	7,447	15,962
Homeowners	17,279	8,027	25,306
FAIR Plan assumed homeowners	5,150	11,013	16,163
All other	9,969	9,999	19,968
Total net reserves for losses and LAE	\$ 311,808	\$ 67,555	\$ 379,363

Our IBNR reserves for CAR assumed private passenger and commercial automobile business are 32.1% and 46.7%, respectively, of our total reserves for CAR assumed private passenger and commercial automobile business as of September 30, 2009 due to the reporting delays in the information we receive from CAR, as described further in the section on *CAR Loss and Loss Adjustment Expense Reserves*.

Table of Contents

The following table presents information by line of business for our total net reserves and the corresponding retained (i.e. direct less ceded) reserves and assumed reserves as of September 30, 2009.

Line of Business	Retained	Assumed	Net
Private passenger automobile	\$ 234,977		
CAR assumed private passenger automobile		\$ 25,979	
Net private passenger automobile			\$ 260,956
Commercial automobile	41,008		
CAR assumed commercial automobile		15,962	
Net commercial automobile			56,970
Homeowners	25,306		
FAIR Plan assumed homeowners		16,163	
Net homeowners			41,469
All other	19,968		19,968
Total net reserves for losses and LAE	\$ 321,259	\$ 58,104	\$ 379,363

CAR Loss and Loss Adjustment Expense Reserves

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

We are a participant in CAR and assume a significant portion of losses and LAE on business ceded by the industry participants to CAR. We estimate reserves for assumed losses and LAE that have not yet been reported to us by CAR. Our estimations are based upon the same factors we use for our own reserves, plus additional factors due to the nature of and the information we receive from CAR.

The CAR deficit, which consists of premium ceded to CAR less CAR losses and LAE, is allocated among every automobile insurance company writing business in Massachusetts based on a complex formula (the Participation Ratio) that takes into consideration a company's voluntary market share, the amount of business it cedes to CAR and credits the company earns under a system CAR has designed to encourage carriers to voluntarily write business in selected under-priced classes and territories.

We receive a Settlement of Balances report from CAR that reports our share of CAR premium, losses and LAE on a lagged basis, seventy-five days after the end of every quarter. CAR-published financial data is always at least one quarter behind the financial data we report. For example, when we reported our financial results for the year ended December 31, 2008, we had nine months of reported 2008 CAR financial data, and we had to estimate and record as IBNR reserves what CAR would report to us for the last three months of the year.

We receive our final calendar year Participation Ratio report from CAR eight months after the end of that year, and thus we have to estimate for six quarters our share of the CAR deficit. For example, for the year ended December 31, 2008, we had to estimate our 2008 policy year CAR Participation Ratio beginning with the first quarter of 2008 through the second quarter of 2009.

Because of the lag in CAR estimates, and in order to try to validate to the extent possible the information CAR does provide, we must try to estimate the effects of the actions of our competitors in order to establish our Participation Ratio. Before final Participation Ratios are available, we estimate the size of CAR and the resulting deficit based on historical analysis of CAR results and estimations of our competitors' current cession strategies. Even after our final Participation Ratio is available from CAR, we must continue to estimate the size of CAR and the resulting deficit based upon data published by CAR and our own continuing analysis. As a result, changes in our reserves for CAR may continue to occur until all claims are finally settled. The Loss Reserving Committee at CAR meets 70 days after the end of each quarter to estimate the CAR deficit for all active policy years and publishes estimations, which we use to estimate our share of the deficit. The estimation that CAR calculates is based on data it collects from 19 servicing carriers which settle, reserve and report claims using a variety of methods. Any delays or errors in the collection of this data could have a significant impact on the accuracy of CAR's estimations.

Although we rely to a significant extent in setting our reserves on the information CAR provides, we are cautious in our use of that information, both because of the delays described above and because the CAR estimates incorporate data CAR receives from all other CAR servicing carriers in Massachusetts. We do not have direct access to that data or firsthand knowledge of how those carriers are currently conducting their operations. As a result, we are cautious in recording CAR reserves for the calendar years for which we have to estimate our Participation Ratio and these reserves are subject to significant judgments and estimates.

Table of Contents

The portion of reserves based upon CAR estimates for private passenger automobile line of business has declined over time as a result of the institution of the MAIP and phase-out of the private passenger automobile CAR reinsurance pool, as described elsewhere in this report.

Sensitivity Analysis

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

Establishment of appropriate reserves is an inherently uncertain process. There can be no certainty that currently established reserves based on our key assumptions regarding frequency and severity in our lines of business, or our assumptions regarding our share of the CAR loss will prove adequate in light of subsequent actual experience. To the extent that reserves are inadequate and are strengthened, the amount of such increase is treated as a charge to earnings in the period that the deficiency is recognized. To the extent that reserves are redundant and are released, the amount of the release is a credit to earnings in the period the redundancy is recognized. For the nine months ended September 30, 2009, a 1 percentage-point change in the loss and LAE ratio would result in a change in reserves of \$3,997. Each 1 percentage-point change in the loss and loss expense ratio would have had a \$2,598 effect on net income, or \$0.17 per diluted share.

Our assumptions consider that past experience, adjusted for the effects of current developments and anticipated trends, are an appropriate basis for establishing our reserves. Our individual key assumptions could each have a reasonable possible range of plus or minus 5 percentage-points for each estimation, although there is no guarantee that our assumptions will not have more than a 5 percentage point variation. The following sensitivity tables present information for each of our primary lines of business on the effect each 1 percentage-point change in each of our key assumptions on unpaid frequency and severity could have on our retained (i.e., direct minus ceded) loss and LAE reserves and net income for the nine months ended September 30, 2009. In evaluating the information in the table, it should be noted that a 1 percentage-point change in a single assumption would change estimated reserves by 1 percentage-point. A 1 percentage-point change in both our key assumptions would change estimated reserves within a range of plus or minus 2 percentage-points.

Table of Contents

	-1 Percent Change in Frequency	No Change in Frequency	+1 Percent Change in Frequency
Private passenger automobile retained loss and LAE reserves			
-1 Percent Change in Severity			
Estimated decrease in reserves	\$ (4,700)	\$ (2,350)	\$
Estimated increase in net income	3,055	1,528	
No Change in Severity			
Estimated (decrease) increase in reserves	(2,350)		2,350
Estimated increase (decrease) in net income	1,528		(1,528)
+1 Percent Change in Severity			
Estimated increase in reserves		2,350	4,700
Estimated decrease in net income		(1,528)	(3,055)
Commercial automobile retained loss and LAE reserves			
-1 Percent Change in Severity			
Estimated decrease in reserves	(820)	(410)	
Estimated increase in net income	533	267	
No Change in Severity			
Estimated (decrease) increase in reserves	(410)		410
Estimated increase (decrease) in net income	267		(267)
+1 Percent Change in Severity			
Estimated increase in reserves		410	820
Estimated decrease in net income		(267)	(533)
Homeowners retained loss and LAE reserves			
-1 Percent Change in Severity			
Estimated decrease in reserves	(506)	(253)	
Estimated increase in net income	329	164	
No Change in Severity			
Estimated (decrease) increase in reserves	(253)		253
Estimated increase (decrease) in net income	164		(164)
+1 Percent Change in Severity			
Estimated increase in reserves		253	506
Estimated decrease in net income		(164)	(329)
All other retained loss and LAE reserves			
-1 Percent Change in Severity			
Estimated decrease in reserves	(399)	(200)	
Estimated increase in net income	259	130	
No Change in Severity			
Estimated (decrease) increase in reserves	(200)		200
Estimated increase (decrease) in net income	130		(130)
+1 Percent Change in Severity			
Estimated increase in reserves		200	399
Estimated decrease in net income		(130)	(259)

Our estimated share of CAR loss and LAE reserves is based on assumptions about our Participation Ratio, the size of CAR, and the resulting deficit (similar assumptions apply with respect to the FAIR Plan). Our assumptions consider that past experience, adjusted for the effects of current developments and anticipated trends, are an appropriate basis for establishing our CAR reserves. Each of our assumptions could have a reasonably possible range of plus or minus 5 percentage-points for each estimation.

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

The following sensitivity table presents information of the effect each 1 percentage-point change in our assumptions on our share of reserves for CAR and other residual markets could have on our assumed loss and LAE reserves and net income for

Table of Contents

the nine months ended September 30, 2009. In evaluating the information in the table, it should be noted that a 1 percentage-point change in our assumptions would change estimated reserves by 1 percentage-point.

	-1 Percent Change in Estimation	+1 Percent Change in Estimation
CAR assumed private passenger automobile		
Estimated (decrease) increase in reserves	\$ (260)	\$ 260
Estimated increase (decrease) in net income	169	(169)
CAR assumed commercial automobile		
Estimated (decrease) increase in reserves	(160)	160
Estimated increase (decrease) in net income	104	(104)
FAIR Plan assumed homeowners		
Estimated (decrease) increase in reserves	(162)	162
Estimated increase (decrease) in net income	105	(105)

Reserve Development Summary

The changes we have recorded in our reserves in the past illustrate the uncertainty of estimating reserves. Our prior year reserves decreased by \$30,057, and \$22,904 for the nine months ended September 30, 2009 and 2008, respectively.

The following table presents a comparison of prior year development of our net reserves for losses and LAE for the nine months ended September 30, 2009 and 2008. Each accident year represents all claims for an annual accounting period in which loss events occurred, regardless of when the losses are actually reported, booked or paid. Our financial statements reflect the aggregate results of the current and all prior accident years.

Accident Year	Nine Months Ended September 30,	
	2009	2008
1999 & prior	\$ (261)	\$ (320)
2000	(206)	(327)
2001	(828)	(870)
2002	(1,207)	(1,606)
2003	(1,071)	(1,910)
2004	(2,755)	(4,676)
2005	(5,017)	(4,819)
2006	(6,765)	(3,138)
2007	(4,717)	(5,238)
2008	(7,230)	
All prior years	\$ (30,057)	\$ (22,904)

The decreases in prior years reserves during the nine months ended September 30, 2009 and 2008 resulted from re-estimations of prior year ultimate loss and LAE liabilities. The 2009 decrease is primarily composed of reductions of \$15,706 in our retained automobile reserves, \$8,780 in CAR assumed reserves and \$4,139 in our retained homeowners reserves. The 2008 decrease is primarily composed of reductions of \$14,681 in our retained automobile reserves and \$6,334 in CAR assumed reserves.

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

Table of Contents

The following table presents information by line of business for prior year development of our net reserves for losses and LAE for the nine months ended September 30, 2009.

Accident Year	Private Passenger Automobile	Commercial Automobile	Homeowners	Total
1999 & prior	\$ (258)	\$ (3)	\$	\$ (261)
2000	(197)	(9)		(206)
2001	(373)	(159)	(296)	(828)
2002	(807)	(245)	(155)	(1,207)
2003	(653)	(220)	(198)	(1,071)
2004	(1,812)	(490)	(453)	(2,755)
2005	(3,427)	(746)	(844)	(5,017)
2006	(4,409)	(999)	(1,357)	(6,765)
2007	(2,849)	(541)	(1,327)	(4,717)
2008	(5,914)	(375)	(941)	(7,230)
All prior years	\$ (20,699)	\$ (3,787)	\$ (5,571)	\$ (30,057)

To further clarify the effects of changes in our reserve estimates for CAR and other residual markets, the next two tables break out the information in the table above by source of the business (i.e., non-residual market vs. residual market).

The following table presents information by line of business for prior year development of retained reserves for losses and LAE for the nine months ended September 30, 2009; that is, all our reserves except for business ceded or assumed from CAR and other residual markets.

Accident Year	Retained Private Passenger Automobile	Retained Commercial Automobile	Retained Homeowners	Total
1999 & prior	\$ (258)	\$	\$	\$ (258)
2000	(197)			(197)
2001	(321)	(145)	(296)	(762)
2002	(620)	(238)	(155)	(1,013)
2003	(450)	(242)	(198)	(890)
2004	(1,544)	(666)	(445)	(2,655)
2005	(2,702)	(794)	(826)	(4,322)
2006	(3,481)	(804)	(1,276)	(5,561)
2007	(1,538)	1	(943)	(2,480)
2008	(1,710)	3		(1,707)
All prior years	\$ (12,821)	\$ (2,885)	\$ (4,139)	\$ (19,845)

Table of Contents

The following table presents information by line of business for prior year development of reserves assumed from CAR and other residual markets for losses and LAE for the nine months ended September 30, 2009.

Accident Year	CAR Assumed Private Passenger Automobile	CAR Assumed Commercial Automobile	FAIR Plan Homeowners	Total
1999 & prior	\$	\$	(3)	\$ (3)
2000		(9)		(9)
2001	(52)	(14)		(66)
2002	(187)	(7)		(194)
2003	(203)	22		(181)
2004	(268)	176	(8)	(100)
2005	(725)	48	(18)	(695)
2006	(928)	(195)	(81)	(1,204)
2007	(1,311)	(542)	(384)	(2,237)
2008	(4,204)	(378)	(941)	(5,523)
All prior years	\$ (7,878)	\$ (902)	\$ (1,432)	\$ (10,212)

Our private passenger automobile line of business prior year reserves decreased by \$20,699 for the nine months ended September 30, 2009. The decrease was primarily due to improved retained private passenger results of \$10,975 for the accident years 2004 through 2008, and improved assumed CAR results for the private passenger automobile pool of \$7,168 for accident years 2005 through 2008. The improved retained private passenger results were primarily due to fewer IBNR claims than previously estimated and better than previously estimated severity on our established bodily injury and property damage case reserves. The improved CAR results were due primarily to improved CAR private passenger loss ratios as published and reported by the CAR Loss Reserving Committee.

Our commercial automobile line of business prior year reserves decreased by \$3,787 for the nine months ended September 30, 2009 due primarily to fewer IBNR claims than previously estimated.

Our retained homeowners line of business prior year reserves decreased by \$4,139 for the nine months ended September 30, 2009. Our FAIR Plan homeowners reserve decreased by \$1,432 for the nine months ended September 30, 2009.

In estimating all our loss reserves, including CAR, we follow the guidance prescribed by ASC 944 Financial Services-Insurance (prior authoritative literature Financial Accounting Statement of Financial Accounting Standards No. 60, *Accounting and Reporting by Insurance Enterprise* and FAS No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*).

For further information, see Results of Operations: *Losses and Loss Adjustment Expenses*.

Table of Contents**Results of Operations****Three and Nine Months Ended September 30, 2009 Compared to Three and Nine Months Ended September 30, 2008**

The following table shows certain of our selected financial results.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Direct written premiums	\$ 143,210	\$ 139,425	\$ 438,269	\$ 459,543
Net written premiums	\$ 137,260	\$ 132,640	\$ 419,176	\$ 445,159
Net earned premiums	\$ 133,059	\$ 141,251	\$ 399,715	\$ 439,001
Investment income	11,093	11,710	32,221	34,445
Net realized (losses) gains on investments	(20)	(1,047)	(337)	1,056
Finance and other service income	4,197	4,584	12,578	13,597
Total revenue	148,329	156,498	444,177	488,099
Loss and loss adjustment expenses	82,280	87,702	261,555	274,650
Underwriting, operating and related expenses	42,061	43,130	122,681	132,069
Interest expenses	23	22	66	59
Total expenses	124,364	130,854	384,302	406,778
Income before income taxes	23,965	25,644	59,875	81,321
Income tax expense	6,941	7,286	15,992	22,987
Net income	\$ 17,024	\$ 18,358	\$ 43,883	\$ 58,334
Earnings per weighted average common share:				
Basic	\$ 1.11	\$ 1.13	\$ 2.80	\$ 3.59
Diluted	\$ 1.11	\$ 1.12	\$ 2.79	\$ 3.58
Cash dividends paid per common share	\$ 0.40	\$ 0.40	\$ 1.20	\$ 1.20

Direct Written Premiums. Direct written premiums for the quarter ended September 30, 2009 increased by \$3,785, or 2.7%, to \$143,210 from \$139,425 for the comparable 2008 period primarily due to an increase in our homeowners line of business. Direct written premiums for the nine months ended September 30, 2009 decreased by \$21,274, or 4.6%, to \$438,269 from \$459,543 for the comparable 2008 period. The 2009 decrease occurred primarily in our personal and commercial automobile lines, which experienced decreases of 5.7% and 7.1%, respectively, in average written premium per exposure and decreases of 2.1% and 6.8%, respectively, in written exposures. The decrease in our personal automobile line was primarily a result of rate decreases totaling 6.7% which we filed under the competitive pricing system introduced to the private passenger automobile market in Massachusetts beginning April 1, 2008. Our homeowners line average written premium per exposure decreased by 0.2% with a 21.7% increase in written exposures. The 2.1% decrease in personal automobile exposures and 21.7% increase in homeowners exposures is the result of our rounded account pricing strategy under managed competition that began April 1, 2008, which has preferred pricing for policyholders who insure an automobile and home with us, and standard pricing for policyholders with stand-alone automobile policies.

Net Written Premiums. Net written premiums for the quarter ended September 30, 2009 increased by \$4,620, or 3.5%, to \$137,260 from \$132,640 for the comparable 2008 period. Net written premiums for the nine months ended September 30, 2009 decreased by \$25,983, or 5.8%, to \$419,176 from \$445,159 for the comparable 2008 period. This decrease was due to the factors that decreased direct written premiums combined with decreases in premiums assumed from CAR, and partially offset by decreases in premiums ceded to CAR. Written premiums assumed and ceded to CAR decreased as a result of the phase-out of the CAR personal automobile reinsurance pool, which was replaced by an assigned risk plan, the MAIP. Beginning with policy effective dates after March 31, 2009, all personal automobile business was eligible for

MAIP and could no longer be ceded to CAR.

Net Earned Premiums. Net earned premiums for the quarter ended September 30, 2009 decreased by \$8,192, or 5.8%, to \$133,059 from \$141,251 for the comparable 2008 period. Although direct and net written premiums increased for the quarter, net earned premium decreased due to prior quarter decreases and the lag between the time the premium is written and earned. Net earned premiums for the nine months ended September 30, 2008 decreased by \$39,286, or 8.9%, to \$399,715 from \$439,001 for the comparable 2008 period. This decrease was due to the factors that decreased direct and net written premiums.

The effect of reinsurance on net written and net earned premiums is presented in the following table.

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

Table of Contents

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Written Premiums				
Direct	\$ 143,210	\$ 139,425	\$ 438,269	\$ 459,543
Assumed	3,059	5,693	12,447	30,685
Ceded	(9,009)	(12,478)	(31,540)	(45,069)
Net written premiums	\$ 137,260	\$ 132,640	\$ 419,176	\$ 445,159
Earned Premiums				
Direct	\$ 139,101	\$ 148,650	\$ 415,810	\$ 451,367
Assumed	5,778	8,522	22,377	37,517
Ceded	(11,820)	(15,921)	(38,472)	(49,883)
Net earned premiums	\$ 133,059	\$ 141,251	\$ 399,715	\$ 439,001

Net Investment Income. Net investment income for the quarter ended September 30, 2009 was \$11,093 compared to \$11,710 for the comparable 2008 period, a decrease of 5.3%. Net investment income for the nine months ended September 30, 2009 was \$32,221 compared to \$34,445 for the comparable 2008 period, a decrease of 6.5%. Average cash and investment securities (at cost) increased by \$3,700, or 0.4%, to \$1,058,983 for the nine months ended September 30, 2009, from \$1,055,283 for the comparable 2008 period. Net effective annualized yield on the investment portfolio decreased to 4.1% during the nine months ended September 30, 2009, from 4.4% during the comparable 2008 period. Our portfolio duration was 3.2 years at September 30, 2009 and December 31, 2008.

Net Realized Gains(Losses) on Investments. Net realized losses on investments were \$20 for the quarter ended September 30, 2009, compared to net realized losses of \$1,047 for the comparable 2008 period. Net realized losses on investments were \$337 for the nine months ended September 30, 2009 compared to net realized gains on investments of \$1,056 for the comparable 2008 period.

The gross unrealized gains and losses on investments in fixed maturity securities and equity securities, including interests in mutual funds, were as follows:

	As of September 30, 2009				
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (3) Non-OTTI Unrealized Losses	OTTI Unrealized Losses	Estimated Fair Value
U.S. Treasury securities and obligations of U.S. Government agencies(1)	\$ 319,268	\$ 13,873	\$ (152)	\$	\$ 332,989
Obligations of states and political subdivisions	477,327	21,533	(258)		498,602
Asset-backed securities (1)	93,958	931	(3,403)		91,486
Corporate and other securities	99,200	4,791	(250)		103,741
Subtotal, fixed maturity securities	989,753	41,128	(4,063)		1,026,818
Equity securities (2)	9,645	161			9,806
Totals	\$ 999,398	\$ 41,289	\$ (4,063)	\$	\$ 1,036,624

(1) Obligations of U.S. Government agencies include collateralized mortgage obligations issued, guaranteed and/or insured by the following issuers: Government National Mortgage Association (GNMA), Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA) and Small Business Administration (SBA). The total of these fixed maturity securities was \$307,808 at

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

amortized cost and \$321,378 at fair value as of September 30, 2009. As such, the asset-backed securities presented exclude such issuers already presented under U.S. Treasury securities and obligations of U.S. Government Agencies.

(2) Equity securities consist solely of interests in mutual funds held to fund the Company's executive deferred compensation plan.

(3) The Company's investment portfolio included 64 securities in an unrealized loss position at September 30, 2009.

As of September 30, 2009, with the exception of one security which represented 0.1% of our total investment in fixed income securities, our portfolio of fixed maturity investments was comprised entirely of investment grade corporate fixed maturity

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

Table of Contents

securities, U.S. government and agency securities and asset-backed securities. All of our securities received a rating assigned by Moody's of Baa or higher, except the few securities not rated by Moody's. The Company holds no subprime mortgage debt securities. All of the Company's holdings in mortgage-backed securities are either U.S. Government or Agency guaranteed or are rated Aaa.

The composition of our fixed income security portfolio by Moody's rating was as follows:

	As of September 30, 2009	
	Estimated Fair Value	Percent
U.S. Treasury securities and obligations of U.S. Government agencies	\$ 332,989	32.4%
Aaa/Aa	462,632	45.1
A	152,332	14.8
Baa	46,883	4.6
Not rated (Standard & Poor's rating of A- or higher)	31,276	3.0
Not rated	706	0.1
Total	\$ 1,026,818	100.0%

Ratings are assigned by Moody's, or the equivalent, as discussed above. Such ratings are generally assigned upon the issuance of the securities and are subject to revision on the basis of ongoing evaluations. Ratings in the table are as of the date indicated.

The following table illustrates the gross unrealized losses included in our investment portfolio and the fair value of those securities, aggregated by investment category. The table also illustrates the length of time that they have been in a continuous unrealized loss position as of September 30, 2009.

	Less than 12 Months		As of September 30, 2009 12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
U.S. Treasury securities and obligations of U.S. Government agencies	\$ 23,057	\$ 116	\$ 667	\$ 36	\$ 23,724	\$ 152
Obligations of states and political subdivisions	255		18,448	258	18,703	258
Asset-backed securities			49,523	3,403	49,523	3,403
Corporate and other securities	1,987	9	6,422	241	8,409	250
Subtotal, fixed maturity securities	25,299	125	75,060	3,938	100,359	4,063
Equity securities						
Total temporarily impaired securities	\$ 25,299	\$ 125	\$ 75,060	\$ 3,938	\$ 100,359	\$ 4,063

As of September 30, 2009, we held insured investment securities of approximately \$315,945, which represented approximately 30.5% of our total investment portfolio. Approximately \$37,039 of these securities are pre-refunded, meaning that funds have been set aside in escrow to satisfy the future interest and principal obligations of the bond.

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

Table of Contents

The following table shows our insured investment securities that are backed by financial guarantors including pre-refunded securities as of September 30, 2009. We do not have any direct investment holdings in a financial guarantee insurance company.

Financial Guarantor	As of September 30, 2009		
	Total	Pre-refunded Securities	Exposure Net of Pre-refunded Securities
Municipal bonds			
Ambac Assurance Corporation	\$ 48,077	\$ 8,472	\$ 39,605
Financial Guaranty Insurance Company	279	279	
Financial Security Assurance, Inc.	112,784	19,493	93,291
National Public Finance Guaranty Corporation	147,499	8,795	138,704
	308,639	37,039	271,600
Other asset-backed securities			
Ambac Assurance Corporation	3,592		3,592
Financial Guaranty Insurance Company	2,394		2,394
Syncora Corporation (XL Capital Assurance)	1,320		1,320
	7,306		7,306
Total	\$ 315,945	\$ 37,039	\$ 278,906

The following table shows our insured investments by Moody's rating where it is available both with and without the impact of the insurance guarantee as of September 30, 2009.

Rating	As of September 30, 2009	
	Rating With Insurance	Rating Without Insurance
Aaa	\$ 4,007	\$ 4,007
Aa1	10,656	10,656
Aa2	33,338	33,338
Aa3	141,977	83,335
A1	51,063	85,868
A2	23,267	36,286
A3	23,184	27,712
Baa1	279	279
Baa2	3,592	3,592
Ba2		6,290
	\$ 291,363	\$ 291,363

ASC 320, *Investments - Debt and Equity Securities* (prior authoritative literature FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*) requires entities to separate an other-than-temporary impairment (OTTI) of a debt security into two components when there are credit related losses associated with the impaired debt security for which the Company asserts that it does not have the intent to sell the security, and it is more likely than not that it will not be required to sell the security before recovery of its cost basis. Prior to April 1, 2009, we had to determine whether we had the intent and ability to hold the investment for a sufficient period of time for the value to recover. When the analysis of the above factors resulted in our conclusion that declines in market values were other-than-temporary, the cost of the securities was written down to market value and the reduction in value was reflected as a realized loss. We adopted ASC 320 effective for our interim reporting period ending June 30, 2009. The adoption of ASC 320 did not have an impact on our consolidated results of operations or financial position.

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

Effective under ASC 320, the amount of the OTTI related to a credit loss is recognized in earnings, and the amount of the OTTI related to other factors is recorded as a component of other comprehensive income (loss). In instances where no credit loss exists but it is more likely than not that we will have to sell the debt security prior to the anticipated recovery, the decline in market value below amortized cost is recognized as an OTTI in earnings. In periods after the recognition of an OTTI on debt

Table of Contents

securities, we account for such securities as if they had been purchased on the measurement date of the OTTI at an amortized cost basis equal to the previous amortized cost basis less the OTTI recognized in earnings. For debt securities for which OTTI was recognized in earnings, the difference between the new amortized cost basis and the cash flows expected to be collected will be accreted or amortized into net investment income.

We reviewed the unrealized losses in our fixed income portfolio as of September 30, 2009 for potential other-than-temporary asset impairments. We obtained specific qualitative analysis regarding certain debt securities held at September 30, 2009 with a material (20% or greater) unrealized loss for four or more consecutive quarters. Specific qualitative analysis was also performed for any additional securities appearing on our Watch List. Qualitative analysis considered such factors as the financial condition and the near term prospects of the issuer, whether the debtor is current on its contractually obligated interest and principal payments, changes to the rating of the security by a rating agency and the historical volatility of the fair value of the security.

Of the \$4,063 gross unrealized losses as of September 30, 2009, \$410 relates to fixed maturity obligations of U.S. Government agencies and obligations of states and political subdivisions. The remaining \$3,653 of gross unrealized losses relates primarily to holdings of investment grade asset-backed, corporate, and other fixed maturity securities.

The unrealized losses recorded on the fixed maturity investment portfolio at September 30, 2009 resulted from fluctuations in market interest rates and other temporary market conditions as opposed to fundamental changes in the credit quality of the issuers of such securities. Given our current level of liquidity, the fact that we do not intend to sell these securities, and that it is more likely than not that we will not be required to sell these securities prior to recovery of the cost basis of these securities, these decreases in values are viewed as being temporary.

During the three and nine months ended September 30, 2009, there was no significant deterioration in the credit quality of any of our holdings. During the three and nine months ended September 30, 2008, there was a significant deterioration in the issuer's financial condition of one of our holdings, American International Group, Inc. Accordingly in the third quarter of 2008, we recorded an other-than-temporary impairment charge of \$1,032 for this security. We sold this security during the quarter ended September 30, 2009 and recognized an additional loss of \$14.

ASC 820, *Fair Value Measurements and Disclosure* (prior authoritative literature - FAS157, *Fair Value Measurements*) provides a revised definition of fair value establishes a framework for measuring fair value and expands financial statement disclosure requirements for fair value information. We adopted ASC 820 on January 1, 2008. The adoption of ASC 820 did not have an impact on our consolidated results of operations or financial position.

Under ASC 820, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants (an exit price). ASC 820 establishes a fair value hierarchy that distinguishes between inputs based on market data from independent sources (observable inputs) and a reporting entity's internal assumptions based upon the best information available when external market data is limited or unavailable (unobservable inputs). The fair value hierarchy in ASC 820 prioritizes fair value measurements into three levels based on the nature of the inputs as follows:

Level 1 Valuations based on quoted prices in active markets for identical assets and liabilities;

Level 2 Valuations based on observable inputs that do not meet the criteria for Level 1, including quoted prices in inactive markets and quoted prices in active markets for similar, but not identical instruments; and

Level 3 Valuations based on unobservable inputs.

Fair values for our fixed maturity securities are based on prices provided by our custodian bank and our investment manager. Both the custodian bank and the investment manager use a variety of independent, nationally recognized pricing services to determine market valuations. If the pricing service cannot provide fair value determinations, we obtain non-binding price quotes from broker-dealers. A minimum of two quoted prices is obtained for the majority of fixed maturity securities in our investment portfolio. Our custodian bank is our primary provider of quoted prices from third-party pricing services and broker-dealers. To provide reasonable assurance of the validity of each price or quote, a secondary third-party pricing service or broker-dealer quote is obtained from our investment manager. An examination of the pricing data is then performed for each security. If the variance between the primary and secondary price quotes for a security is within an accepted tolerance level, the quoted price obtained from our custodian bank is used in our financial statements for the security. If the variance between the primary and secondary price quotes exceeds an accepted tolerance level, we obtain a quote from an alternative source, if possible, and document and resolve any differences between the pricing sources. In addition, we may request that our investment manager and

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

Table of Contents

their traders provide input as to which vendor is providing prices that their traders believe are reflective of fair value for the security. Following this process, we may decide to value the security in our financial statements using the secondary or alternative source if we believe that pricing is more reflective of the security's value than the primary pricing provided by our custodian bank. We analyze market valuations received to verify reasonableness, to understand the key assumptions used and their sources, and to determine an appropriate ASC 820 fair value hierarchy level based upon trading activity and the observability of market inputs. Based on this evaluation and investment class analysis, each price is classified into Level 1, 2 or 3.

Our Level 1 securities consist of equity securities whose values are based on quoted prices in active markets for identical assets. Our Level 2 securities are comprised of securities whose fair value was determined using observable market inputs. Fair values for securities for which quoted market prices were unavailable were estimated based upon reference to observable inputs such as benchmark interest rates, market comparables, and other relevant inputs. On January 1 and September 30, 2009, our Level 3 securities consisted of one asset-backed security whose price was based solely on a single broker quote which was deemed to be obtained through unobservable inputs.

In order to ensure the fair value determination is representative of an exit price (consistent with ASC 820), our procedures for validating quotes or prices obtained from third-parties include, but are not limited to, obtaining a minimum of two price quotes for each fixed maturity security if possible, as discussed above, the periodic testing of sales activity to determine if there are any significant differences between the market price used to value the security as of the balance sheet date and the sales price of the security for sales that occurred around the balance sheet date, and the periodic review of reports provided by our investment manager regarding those securities with ratings changes and securities placed on the our Watch List. In addition, valuation techniques utilized by pricing services and prices obtained from external sources are reviewed by our external investment manager, whose investment professionals are familiar with the securities being priced and the markets in which they trade to ensure the fair value determination is representative of an exit price (consistent with ASC 820).

Approximately 99.8% of our portfolio was priced based upon quoted market prices or other observable inputs as of September 30, 2009. There were no significant changes to the valuation process during the third quarter of 2009.

As of September 30, 2009 and December 31, 2008, no quotes or prices obtained were adjusted by management. All broker quotes obtained were non-binding.

The following table summarizes our total fair value measurements and the fair value measurements based on Level 3 inputs for investments at September 30, 2009.

	Total	As of September 30, 2009		
		Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
U.S. Treasury securities and obligations of U.S. Government agencies	\$ 332,989	\$	\$ 332,989	\$
Obligations of states and political subdivisions	498,602		498,602	
Asset-backed securities	91,486		89,092	2,394
Corporate and other securities	103,741		103,741	
Equity securities	9,806	9,806		
Total investment securities	\$ 1,036,624	\$ 9,806	\$ 1,024,424	\$ 2,394

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

Table of Contents

The following table summarizes the changes in our Level 3 fair value measurements for the three months ended September 30, 2009.

	Asset-Backed Securities
Balance at July 1, 2009	\$ 1,842
Net gains and losses included in earnings	
Net gains included in other comprehensive income	552
Purchases and sales	
Transfers in (out) of Level 3	
Balance at September 30, 2009	\$ 2,394
Amount of total losses included in earnings attributable to the change in unrealized losses related to assets still held at September 30, 2009	\$

The following table summarizes the changes in our Level 3 fair value measurements for the nine months ended September 30, 2009.

	Asset-Backed Securities
Balance at January 1, 2009	\$ 1,842
Net gains and losses included in earnings	
Net gains included in other comprehensive income	552
Purchases and sales	
Transfers in (out) of Level 3	
Balance at September 30, 2009	\$ 2,394
Amount of total losses included in earnings attributable to the change in unrealized losses related to assets still held at September 30, 2009	\$

On January 1 and September 30, 2009, one fixed maturity security was manually priced solely using broker quotes. This was deemed to render the fair value measurements as based upon unobservable inputs and accordingly, it was classified within Level 3. Transfers in and out of Level 3 would be attributable to changes in the ability to observe significant inputs in determining fair value exit pricing. As noted in the table above, no transfers were made in or out of Level 3 inputs during the three and nine months ended September 30, 2009.

Finance and Other Service Income. Finance and other service income includes revenues from premium installment charges, which we recognize when earned, and other miscellaneous income and fees. Finance and other service income decreased by \$387, or 8.4%, to \$4,197 for the quarter ended September 30, 2009 from \$4,584 for the comparable 2008 period. Finance and other service income decreased by \$1,019, or 7.5%, to \$12,578 for the nine months ended September 30, 2009 from \$13,597 for the comparable 2008 period.

Losses and Loss Adjustment Expenses. Losses and loss adjustment expenses incurred for the quarter ended September 30, 2009, decreased by \$5,422, or 6.2%, to \$82,280 from \$87,702 for the comparable 2008 period. Losses and loss adjustment expenses incurred during the nine months ended September 30, 2009 decreased by \$13,095, or 4.8%, to \$261,555 from \$274,650 for the comparable 2008 period. Our GAAP loss ratio for the quarter ended September 30, 2009 decreased to 61.8% from 62.1% for the comparable 2008 period. Our GAAP loss ratio for the nine months ended September 30, 2009 increased to 65.4% from 62.6% for the comparable 2008 period. Our GAAP loss ratio excluding loss adjustment expenses for the quarter ended September 30, 2009 decreased to 52.0% from 53.3% for the comparable 2008 period. The loss ratio decreased for the quarter ending September 30, 2009 primarily as a result of an increase in prior year favorable development. Total prior year favorable development included in the pre-tax results for the quarter ended September 30, 2009 was \$11,911 compared to \$8,211 for the comparable 2008 period. Our GAAP loss ratio excluding loss adjustment expenses for the nine months ended September 30, 2009 increased to

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

55.9% from 53.9% for the comparable 2008 period. The loss ratio increased primarily as a result of a decrease in our personal automobile earned premiums per exposure. Total prior year favorable development included in the pre-tax results for the nine months ended September 30, 2009 was \$30,057 compared to \$22,904 for the comparable 2008 period.

Underwriting, Operating and Related Expenses. Underwriting, operating and related expense for the quarter ended September 30, 2009 decreased by \$1,069, or 2.5%, to \$42,061 from \$43,130 for the comparable 2008 period. Underwriting, operating and related expense for the nine months ended September 30, 2009 decreased by \$9,388, or 7.1%, to \$122,681 from \$132,069 for the comparable 2008 period. Our GAAP expense ratios for the quarter ended September 30, 2009 increased to 31.6 % from 30.5% for

Table of Contents

the comparable 2008 period. Our GAAP expense ratios for the nine months ended September 30, 2009 increased to 30.7% from 30.1% for the comparable 2008 period.

Interest Expenses. Interest expense for the quarter ended September 30, 2009 was \$23, compared to \$22 for the comparable 2008 period. Interest expense for the nine months ended September 30, 2009 was \$66 compared to \$59 for the comparable 2008 period. The credit facility commitment fee included in interest expense for both the three months and nine months ended September 30, 2009 and 2008 was \$19 and \$56, respectively.

Income Tax Expense. Our effective tax rate was 29.0% and 28.4% for the quarters ended September 30, 2009 and 2008, respectively. Our effective tax rate was 26.7% and 28.3% for the nine months ended September 30, 2009 and 2008, respectively. These effective rates were lower than the statutory rate of 35.0% primarily due to adjustments for tax-exempt investment income.

Liquidity and Capital Resources

As a holding company, Safety's assets consist primarily of the stock of our direct and indirect subsidiaries. Our principal source of funds to meet our obligations and pay dividends to shareholders, therefore, is dividends and other permitted payments from our subsidiaries, principally Safety Insurance. Safety is the borrower under our credit facility.

Safety Insurance's sources of funds primarily include premiums received, investment income and proceeds from sales and redemptions of investments. Safety Insurance's principal uses of cash are the payment of claims, operating expenses and taxes, the purchase of investments and payment of dividends to Safety.

Net cash provided by operating activities was \$40,873 and \$52,339 during the nine months ended September 30, 2009 and 2008, respectively. The decline in 2009 was primarily due to the decrease in direct written premiums and net earned premiums, as discussed above. Our operations typically generate positive cash flows from operations as most premiums are received in advance of the time when claim and benefit payments are required. These positive operating cash flows are expected to continue to meet our liquidity requirements.

Net cash provided by investing activities was \$33,115 during the nine months ended September 30, 2009 due primarily from sales, paydowns, calls and maturities of fixed maturity and short-term securities exceeding purchases of fixed maturity securities. Net cash provided by investing activity during the nine months ended September 30, 2008 was \$29,028 and was primarily the result of sales, paydowns, calls and maturities of fixed maturity securities exceeding purchases.

Net cash used for financing activities increased to \$60,741 during the nine months ended September 30, 2009 from \$19,896 during the comparable 2008 period. The increase in 2009 is due to the purchase of 1,332,535 of our common shares under our share buyback program at a cost of \$42,196 during the nine months ended September 30, 2009 compared to a purchase of 74,200 common shares at a cost of \$2,444 during the comparable 2008 period. Net cash used for financing activities is primarily comprised of the acquisition of treasury stock and dividend payments to shareholders.

Credit Facility

On August 14, 2008, we entered into an Amended and Restated Revolving Credit Agreement (the "New Credit Agreement") with RBS Citizens, NA ("RBS Citizens"). The New Credit Agreement amended and restated the terms of our existing Revolving Credit Agreement with RBS Citizens prior to its expiration date of August 17, 2008. The New Credit Agreement extends the maturity date to August 14, 2013 and provides a \$30,000 revolving credit facility with an accordion feature allowing for future expansion of the committed amount up to \$50,000. Loans under the credit facility bear interest at the Company's option at either (i) the LIBOR rate plus 1.25% per annum or (ii) the higher of RBS Citizens prime rate or 0.5% above the federal funds rate plus 1.25% per annum. Interest only is payable prior to maturity.

Our obligations under the credit facility are secured by pledges of our assets and the capital stock of our operating subsidiaries. The credit facility is guaranteed by our non-insurance company subsidiaries. The credit facility contains covenants including requirements to maintain minimum risk based capital ratios and statutory surplus of Safety Insurance Company as well as limitations or restrictions on indebtedness, liens, and other matters. Among other covenants, the credit facility restricts our payment of dividends (i) if a default under the credit facility is continuing or would result therefrom or (ii) in an amount in excess of 50% of our prior year's net income, as determined in accordance with GAAP. As of September 30, 2009, we were in compliance with all such covenants. In addition, the credit facility includes customary events of default, including a cross-default provision permitting the lenders to accelerate the facility if we (i) default in any payment obligation under debt having a principal amount in excess of \$10,000 or (ii) fail to perform any other covenant permitting acceleration of all such debt.

Table of Contents

We had no amounts outstanding on our credit facility at September 30, 2009 and December 31, 2008. The credit facility commitment fee included in interest expenses was computed at a rate of 0.25% on the \$30,000 commitment for the nine months ended September 30, 2009 and 2008.

Regulatory Matters

The Insurance Subsidiaries are subject to various regulatory restrictions that limit the maximum amount of dividends available to be paid to their parent without prior approval of the Commissioner. The Massachusetts statute limits the dividends an insurer may pay in any twelve-month period, without the prior permission of the Commissioner, to the greater of (i) 10% of the insurer's surplus as of the preceding December 31 or (ii) the insurer's net income for the twelve-month period ending the preceding December 31, in each case determined in accordance with statutory accounting practices. Our insurance company subsidiaries may not declare an extraordinary dividend (defined as any dividend or distribution that, together with other distributions made within the preceding twelve months, exceeds the limits established by Massachusetts statute) until thirty days after the Commissioner has received notice of the intended dividend and has not objected. As historically administered by the Commissioner, this provision requires the Commissioner's prior approval of an extraordinary dividend. Under Massachusetts law, an insurer may pay cash dividends only from its unassigned funds, also known as earned surplus, and the insurer's remaining surplus must be both reasonable in relation to its outstanding liabilities and adequate to its financial needs. At year-end 2008, the statutory surplus of Safety Insurance was \$560,462, and its net income for 2008 was \$68,509. As a result, a maximum of \$68,509 is available in 2009 for such dividends without prior approval of the Commissioner. During the nine months ended September 30, 2009, Safety Insurance paid dividends to Safety of \$54,909.

The maximum dividend permitted by law is not indicative of an insurer's actual ability to pay dividends, which may be constrained by business and regulatory considerations, such as the impact of dividends on surplus, which could affect an insurer's ratings or competitive position, the amount of premiums that can be written and the ability to pay future dividends.

On February 17, 2009, our Board approved and declared a quarterly cash dividend on our common stock of \$0.40 per share, or \$6,474, which was paid on March 13, 2009 to shareholders of record on March 2, 2009. On May 5, 2009, our Board approved and declared a quarterly cash dividend of \$0.40 per share or \$6,205 which was paid on June 15, 2009 to shareholders of record on June 1, 2009. On August 4, 2009 our Board approved and declared a quarterly cash dividend on our common stock of \$0.40 per share or \$6,137 which was paid on September 15, 2009 to shareholders of record on September 1, 2009. On November 2, 2009 our Board approved a \$0.40 per share quarterly cash dividend on our common stock, payable on December 15, 2009 to shareholders of record on December 1, 2009. We plan to continue to declare and pay quarterly cash dividends in 2010, depending on our financial position and the regularity of our cash flows.

On August 3, 2007, our Board approved a share repurchase program of up to \$30,000 of Safety's outstanding common shares. On March 24, 2009, the Board of Directors increased this existing share repurchase program by authorizing repurchase of up to \$60,000 of Safety's outstanding common shares. Under the program, Safety may repurchase shares of its common stock for cash in public or private transactions, in the open market or otherwise, at management's discretion. The timing of such repurchases and actual number of shares repurchased will depend on a variety of factors including price, market conditions and applicable regulatory and corporate requirements. The program does not require Safety to repurchase any specific number of shares and may be modified, suspended or terminated at any time without prior notice. During the nine months ended September 30, 2009, we purchased 1,332,535 of our common shares on the open market under the program at a cost of \$42,196. At December 31, 2008, we had purchased 232,013 of our common shares on the open market under the program at a cost of \$7,516.

Management believes that the current level of cash flow from operations provides us with sufficient liquidity to meet our operating needs over the next 12 months. We expect to be able to continue to meet our operating needs after the next 12 months from internally generated funds.

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

Since our ability to meet our obligations in the long term (beyond such twelve-month period) is dependent upon such factors as market changes, insurance regulatory changes and economic conditions, no assurance can be given that the available net cash flow will be sufficient to meet our operating needs. We expect that we would need to borrow or issue capital stock if we needed additional funds, for example, to pay for an acquisition or a significant expansion of our operations. There can be no assurance that sufficient funds for any of the foregoing purposes would be available to us at such time.

Off-Balance Sheet Arrangements

We have no material obligations under a guarantee contract meeting the characteristics identified in ASC 460, *Guarantees* (prior authoritative literature - Financial Accounting Standards Board Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements, Including Indirect Guarantees of Indebtedness of Others*). We have no material retained or contingent interests in assets transferred to an unconsolidated entity. We have no material obligations, including contingent obligations, under contracts that would be accounted for as derivative instruments. We have no obligations, including contingent obligations, arising out of a variable

Table of Contents

interest in an unconsolidated entity held by, and material to, us, where such entity provides financing, liquidity, market risk or credit risk support to, or engages in leasing, hedging or research and development services with us. We have no direct investments in real estate and no holdings of mortgages secured by commercial real estate. Accordingly, we have no material off-balance sheet arrangements.

Forward-Looking Statements

Forward-looking statements might include one or more of the following, among others:

- Projections of revenues, income, earnings per share, capital expenditures, dividends, capital structure or other financial items;
- Descriptions of plans or objectives of management for future operations, products or services;
- Forecasts of future economic performance, liquidity, need for funding and income;
- Descriptions of assumptions underlying or relating to any of the foregoing; and
- Future performance of credit markets.

Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. They often include words such as believe, expect, anticipate, intend, plan, estimate, aim, projects, or words of similar meaning and expressions that indicate future conditions, events, results or trends, or future or conditional verbs such as will, would, should, could, or may. All statements that address expectations or projections about the future, including statements about the Company's strategy for growth, product development, market position, expenditures and financial results, are forward-looking statements.

Forward-looking statements are not guarantees of future performance. By their nature, forward-looking statements are subject to risks and uncertainties. There are a number of factors, many of which are beyond our control, that could cause actual future conditions, events, results or trends to differ significantly and/or materially from historical results or those projected in the forward-looking statements. These factors include but are not limited to the competitive nature of our industry and the possible adverse effects of such competition. Although a number of national insurers that are much larger than we are do not currently compete in a material way in the Massachusetts private passenger automobile market, if one or more of these companies decided to aggressively enter the market it could have a material adverse effect on us. Other significant factors include conditions for business operations and restrictive regulations in Massachusetts, the possibility of losses due to claims resulting from severe weather, the possibility that the Commissioner may approve future Rule changes that change the operation of the residual market, our possible need for and availability of additional financing, and our dependence on strategic relationships, among others, and other risks and factors identified from time to time in our reports filed with the SEC. Refer to Part I, Item 1A Risk Factors.

Some other factors, such as market, operational, liquidity, interest rate, equity and other risks, are described elsewhere in this Quarterly Report on Form 10-Q. Factors relating to the regulation and supervision of our Company are also described or incorporated in this report. There are other factors besides those described or incorporated in this report that could cause actual conditions, events or results to differ from those in the forward-looking statements.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date on which they are made. We do not undertake any obligation to update publicly or revise any forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made.

Item 3. Quantitative and Qualitative Information about Market Risk (Dollars in thousands)

Market Risk. Market risk is the risk that we will incur losses due to adverse changes in market rates and prices. We have exposure to market risk through our investment activities and our financing activities. Our primary market risk exposure is to changes in interest rates. We use both fixed and variable rate debt as sources of financing. We have not entered, and do not plan to enter, into any derivative financial instruments for trading or speculative purposes.

Interest Rate Risk. Interest rate risk is the risk that we will incur economic losses due to adverse changes in interest rates. Our exposure to interest rate changes primarily results from our significant holdings of fixed rate investments and from our financing activities. Our fixed maturity investments include U.S. and foreign government bonds, securities issued by government agencies, obligations of state and local governments and governmental authorities, corporate bonds and asset-backed securities, most of which are exposed to changes in prevailing interest rates.

We manage our exposure to risks associated with interest rate fluctuations through active review of our investment portfolio by our management and Board and consultation with third-party financial advisors. As a general matter, we do not attempt to match

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

Table of Contents

the durations of our assets with the durations of our liabilities, and the majority of our liabilities are short tail. Our goal is to maximize the total after-tax return on all of our investments. An important strategy that we employ to achieve this goal is to try to hold enough in cash and short-term investments in order to avoid liquidating longer-term investments to pay claims.

Based upon the results of interest rate sensitivity analysis, the following table shows the interest rate risk of our investments in fixed maturities, measured in terms of fair value (which is equal to the carrying value for all our fixed maturity securities).

	-100 Basis Point Change	No Change	+100 Basis Point Change
As of September 30, 2009			
Estimated fair value	\$ 1,059,645	\$ 1,026,818	\$ 988,359
Estimated increase (decrease) in fair value	\$ 32,827	\$	\$ (38,459)

With respect to floating rate debt, we are exposed to the effects of changes in prevailing interest rates. At September 30, 2009, we had no debt outstanding under our credit facility. Assuming the full utilization of our current available credit facility, a 2.0% increase in the prevailing interest rate on our variable rate debt would result in interest expense increasing approximately \$600 for 2009, assuming that all of such debt is outstanding for the entire year.

In addition, in the current market environment, our investments can also contain liquidity risks.

Equity Risk. Equity risk is the risk that we will incur economic losses due to adverse changes in equity prices. In the past, our exposure to changes in equity prices primarily resulted from our holdings of common stocks, mutual funds and other equities. While we have in the past held common equity securities in our investment portfolio, presently we hold none, except for interests in mutual funds to fund the executive deferred compensation plan. We continuously evaluate market conditions and we expect in the future to purchase equity securities. We principally managed equity price risk through industry and issuer diversification and asset allocation techniques.

Item 4. Controls and Procedures

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures [as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act)] as of the end of the period covered by this report. Based on that evaluation, our CEO and CFO have concluded that our disclosure controls and procedures are adequate and effective and ensure that all information required to be disclosed is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and that information required to be disclosed in such reports is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings - Please see Item 1 Financial Statements - Note 7, Commitments and Contingencies.

Item 1A. Risk Factors

There have been no subsequent material changes from the risk factors previously disclosed in the Company's 2008 Annual Report on Form 10-K and the Company's Quarterly Reports on Form 10-Q for the quarters ended March 31, 2009 and June 30, 2009.

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

On August 3, 2007, our Board approved a share repurchase program of up to \$30 million of Safety's outstanding common shares. On March 24, 2009, the Board of Directors increased this existing share repurchase program by authorizing repurchase of up to \$60 million of Safety's outstanding common shares. Under the program, Safety may repurchase shares of its common stock for cash in public or private transactions, in the open market or otherwise, at management's discretion. The timing of such repurchases and actual number of shares repurchased will depend on a variety of factors including price, market conditions and applicable regulatory and corporate requirements. The program does not require Safety to repurchase any specific number of shares and may be modified, suspended or terminated at any time without prior notice.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plan (\$000)
July 1-31	10,005	\$ 30.02	1,284,854	\$ 19,751
August 1-31		\$	1,284,854	\$ 19,751
September 1-30	293,994	\$ 32.19	1,564,548	\$ 10,288

Item 3. Defaults upon Senior Securities - None.

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

Item 5. Other Information - None.

Item 6. Exhibits - The exhibits are contained herein as listed in the Exhibit Index.

Table of Contents

SIGNATURE

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

SAFETY INSURANCE GROUP, INC. (Registrant)

Date: November 5, 2009

By: */s/ WILLIAM J. BEGLEY, JR.*
William J. Begley, Jr.
Vice President, Chief Financial Officer and Secretary

Table of Contents

SAFETY INSURANCE GROUP, INC.

EXHIBIT INDEX

Exhibit Number	Description
11	Statement re:Computation of Per Share Earnings.(1)
31.1	CEO Certification Pursuant to Rule 13a-14(a)/15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.(2)
31.2	CFO Certification Pursuant to Rule 13a-14(a)/15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.(2)
32.1	CEO Certification Pursuant to U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.(2)
32.2	CFO Certification Pursuant to U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.(2)

(1) Not included herein as the information is included as part of this Form 10-Q, Item 1 - Financial Statements, Note 3, Earnings per Weighted Average Common Share.

(2) Included herein.