SELECTIVE INSURANCE GROUP INC
Form 10-K
February 27, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K

(Mark one)

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

For the fiscal year ended December 31, 2008

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 1-33067

SELECTIVE INSURANCE GROUP, INC.

(Exact name of registrant as specified in its charter)

New Jersey (State or Other Jurisdiction of Incorporation or Organization)	22-2168890 (I.R.S. Employer Identification No.)
40 Wantage Avenue, Branchville, New Jersey (Address of Principal Executive Office)	07890 (Zip Code)

Registrant s telephone number, including area code: (973) 948-3000

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $2 per share	NASDAQ Global Select Market
7.5% Junior Subordinated Notes due September 27, 2066	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

þ Yes o No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

o Yes þ No

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, and (2) has been subject to such filing requirements for the past 90 days.

þ Yes o No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

o

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o Smaller reporting company o

(Do not check if a smaller reporting company)

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

o Yes þ No

The aggregate market value of the voting common stock held by non-affiliates of the registrant, based on the closing price on the NASDAQ Global Select Market, was $960,558,610 on June 30, 2008. As of February 13, 2009, the registrant had outstanding 52,699,262 shares of common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive Proxy Statement for the 2009 Annual Meeting of Stockholders to be held on April 29, 2009 are incorporated by reference into Part III of this report.

SELECTIVE INSURANCE GROUP, INC.

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PART I

Item 1. Business.

Overview

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

We classify our business into three operating segments:

- Insurance Operations, which sells property and casualty insurance products and services primarily in 22 states in the Eastern and Midwestern U.S.;
- Investments; and
- Diversified Insurance Services, which provides human resource administration outsourcing (HR Outsourcing) products and services, and federal flood insurance administrative services (Flood).

Financial information about our three operating segments is contained in this report in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, and Item 8. Financial Statements and Supplementary Data, Note 12 to the consolidated financial statements, Segment Information.

Description of Operating Segment Products and Markets

Insurance Operations Segment

Our Insurance Operations sell property and casualty insurance policies, which are contracts to cover losses for specified risks in exchange for premiums. Property insurance generally covers the financial consequences of accidental loss to the insured s property. Property claims are generally reported and settled in a relatively short period of time. Casualty insurance generally covers the financial consequences of bodily injury and/or property damage to a third party as a result of the insured s negligent acts, omissions, or legal liabilities. Casualty claims often take years to be reported and settled.

Our Insurance Operations segment writes property and casualty insurance products through seven insurance subsidiaries (Insurance Subsidiaries), which are listed on the following table together with their respective pooled financial strength ratings by A.M. Best Company, Inc. (A.M. Best), and state of domicile by which each is primarily regulated:

Insurance Subsidiaries	A.M. Best Rating[1]	Domiciliary State
Selective Insurance Company of America (SICA)	A+ (Superior)	New Jersey
Selective Way Insurance Company (SWIC)	A+ (Superior)	New Jersey
Selective Insurance Company of South Carolina (SICSC[2])	A+ (Superior)	Indiana
Selective Insurance Company of the Southeast (SICSE[2])	A+ (Superior)	Indiana
Selective Insurance Company of New York (SICNY)	A+ (Superior)	New York
Selective Insurance Company of New England (SICNE)	A+ (Superior)	Maine
Selective Auto Insurance Company of New Jersey (SAICNJ)	A+ (Superior)	New Jersey

1 With regard to an A+ rating, A.M. Best uses its highest Financial Strength Rating of Secure, and a descriptor of

Superior, which it defines as, Assigned to companies that have, in our opinion, a superior ability to meet their ongoing obligations to policyholders. Approximately 10% of commercial and personal insurance companies carry an A+ or better rating from A.M. Best.

2 Effective June 30, 2008, two of the Insurance Subsidiaries, SICSE and SICSC, changed their regulatory state of domicile from North Carolina and South Carolina, respectively, to Indiana.

In 2008, A.M. Best, in its list of Top 200 U.S. Property/Casualty Groups, ranked us the 41st largest property and casualty group in the U.S. based on combined net premiums written (NPW) for 2007.

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Insurance Operations

The Insurance Operations segment derives substantially all of its revenues from insurance policy premiums. The Insurance Subsidiaries predominantly write annual policies, of which the associated premiums are defined as direct premium written. Direct premium written plus premium assumed from other carriers, less premium ceded to reinsurers is NPW. NPW is recognized as revenue as net premiums earned (NPE) ratably over the term of the insurance policy.

Expenses related to the Insurance Operations fall into three categories: (i) losses associated with claims and various loss expenses incurred for adjusting claims; (ii) expenses related to the issuance of insurance policies, such as agent commissions, premium taxes, and other underwriting expenses, including employee compensation and benefits; and (iii) policyholder dividends.

The Insurance Subsidiaries are regulated by each of the states in which they do business. Each Insurance Subsidiary is required to file financial statements with such states, prepared in accordance with accounting principles prescribed by, or permitted by, such Insurance Subsidiary s state of domicile (Statutory Accounting Principles or SAP). SAP have been promulgated by the National Association of Insurance Commissioners (NAIC) and adopted by the various states. We evaluate and manage the performance of the Insurance Subsidiaries in accordance with SAP. Incentive-based compensation to independent agents and employees is based on SAP results and our rating agencies use SAP information to evaluate our performance and for industry comparative purposes.

The underwriting performance of insurance companies is measured under SAP by four different ratios:

1) Loss and loss expense ratio, which is calculated by dividing incurred loss and loss expenses by NPE;

2) Underwriting expense ratio, which is calculated by dividing all expenses related to the issuance of insurance policies by NPW;

3) Dividend ratio, which is calculated by dividing policyholder dividends by NPE; and

4) Combined ratio, which is the sum of the loss and loss expense ratio, the underwriting expense ratio, and the dividend ratio.

A statutory combined ratio under 100% generally indicates an underwriting profit and a statutory combined ratio over 100% generally indicates an underwriting loss. The statutory combined ratio does not reflect investment income, federal income taxes, or other non-operating income or expense.

SAP differs in several ways from U.S. generally accepted accounting principles (GAAP), under which we are required to report our financial results to the United States Securities and Exchange Commission (SEC). The most notable differences between SAP and GAAP income are as follows:

- Under SAP, Insurance Operations underwriting expenses are recognized when incurred; whereas under GAAP, underwriting expenses are deferred and amortized to expense over the life of the policy;

- Under SAP, deferred taxes are recorded directly to surplus; whereas under GAAP, deferred taxes are recognized in our Consolidated Statements of Income as either a deferred tax expense or a deferred tax benefit;

- Under SAP, changes in the fair value of our alternative investments, which are part of our other investment portfolio on our Consolidated Balance Sheets, are recorded directly to surplus; whereas under GAAP, these fluctuations are recognized in income; and

- Under SAP, the results of our flood line of business are included in the income of the Insurance Operations segment, whereas under GAAP, these results are included within the income of Diversified Insurance Services segment on our Consolidated Statements of Income.

The most notable differences between SAP statutory surplus and GAAP equity are as follows:

- The Insurance Operations underwriting expense item above results in a difference in statutory surplus and GAAP equity as a difference in expense recognition timing exists between SAP and GAAP;

Under SAP, fixed maturity securities are carried at cost with no recognition of unrealized gains or losses in statutory surplus; whereas under GAAP, these securities are carried at market value with unrealized gains or losses recognized in equity;

Under SAP, the recognition of deferred tax assets are limited to those that are expected to be realized within one year, or to the extent that we have a deferred tax liability or available carryback capabilities; whereas under GAAP, deferred tax assets are recognized based on a qualitative analysis of the temporary differences, past financial history, and future earning projections. A GAAP valuation allowance is required when it is determined that a gross deferred tax asset cannot be realized based on the more likely than not criteria.

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Under SAP, a liability is recognized in an amount equal to the excess of the vested accumulated benefit obligation over the fair value of the pension plan assets with any changes in this balance not recognized in income being recognized in statutory surplus; whereas under GAAP, a liability is recognized in an amount equal to the excess of the projected benefit obligation over the fair value of the pension assets with any changes in this balance not recognized through income being recognized in equity as a component of other comprehensive income.

In addition to the above differences between SAP and GAAP, the underwriting expense ratio is calculated using NPW as the denominator for SAP; whereas NPE is used as the denominator under GAAP.

We believe that providing SAP financial information for our Insurance Operations segment helps our investors, agents, and customers better evaluate the underwriting success of our insurance business.

The following table shows the statutory results of our Insurance Operations segment for the last three completed fiscal years:

	Year Ended December 31,		
($ in thousands)	**2008**	2007	2006
Insurance Operations Results			
NPW	**$ 1,492,938**	1,562,728	1,540,901
NPE	**$ 1,504,387**	1,525,163	1,504,632
Losses and loss expenses incurred	**1,011,700**	997,230	958,741
Net underwriting expenses incurred	**471,629**	494,944	482,657
Policyholders dividends	**5,211**	7,202	5,927
Underwriting profit	**$ 15,847**	25,787	57,307
Ratios:			
Losses and loss expense ratio	**67.2%**	65.4	63.7
Underwriting expense ratio	**31.7%**	31.6	31.3
Policyholders dividends ratio	**0.3%**	0.5	0.4
Combined ratio	**99.2%**	97.5	95.4
GAAP combined ratio[1]	**101.0%**	98.9	96.1

1 The GAAP combined ratio excludes the flood line of business, which is included in the Diversified Insurance Services segment on a GAAP basis. The total

statutory combined ratio excluding flood was 99.9% in 2008, 98.2% in 2007, and 96.1% in 2006.

Our statutory combined ratio has been lower than the statutory combined ratio of the property and casualty insurance industry for seven of the past 10 years and has also outperformed the industry average during that period by 2.6 points. The table below sets forth a comparison of certain statutory ratios based on our operations in comparison to our industry:

	Simple Average of All Periods Presented	**2008**	2007	2006	2005	2004	2003	2002	2001	2000	1999
Our Ratios:[1]											
Loss and loss expense	69.2	**67.2**	65.4	63.7	63.5	65.3	70.3	72.3	74.3	75.7	74.4
Underwriting expense	31.0	**31.7**	31.6	31.3	30.7	30.3	30.7	30.3	31.5	31.7	30.5
Policyholders dividends	0.6	**0.3**	0.5	0.4	0.4	0.3	0.5	0.6	0.9	0.9	0.8
Statutory combined ratio	100.8	**99.2**	97.5	95.4	94.6	95.9	101.5	103.2	106.7	108.2	105.7
Growth in net premiums written	7.3	**(4.5)**	1.4	5.3	6.9	12.0	15.7	13.8	10.5	3.6	8.1
Industry Ratios:[1, 2]											
Loss and loss expense	76.4	**77.0**	67.7	65.4	75.3	73.5	75.0	81.5	88.4	81.5	78.8
Underwriting expense	26.2	**27.1**	27.1	26.1	25.4	24.9	24.6	25.1	26.5	27.4	27.9
Policyholders dividends	0.8	**0.7**	0.7	0.9	0.5	0.5	0.5	0.6	0.8	1.4	1.3
Statutory combined ratio	103.4	**104.7**	95.6	92.4	101.2	98.9	100.1	107.3	115.7	110.4	108.1
Growth in net premiums written	4.7	**(0.8)**	(0.8)	4.0	0.0	4.4	9.7	15.1	8.5	4.7	1.9
Favorable (Unfavorable) to Industry:											
Statutory combined ratio	2.6	**5.5**	(1.9)	(3.0)	6.6	3.0	(1.4)	4.1	9.0	2.2	2.4
Growth in net premiums written	2.6	**(3.7)**	2.2	1.3	6.9	7.6	6.0	(1.3)	2.0	(1.1)	6.2

1 The ratios and percentages are based on SAP prescribed or permitted by state insurance departments in the states in which each company is domiciled. Effective January 1, 2001, we adopted a codified set of statutory accounting principles, as required by the NAIC. These principles were not retroactively applied, but would not have had a material effect on the ratios presented above.

2 Source: A.M. Best. The industry ratios for 2008 have been estimated by A.M. Best.

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Lines of Business and Products

Our Insurance Operations segment includes: (i) commercial lines (Commercial Lines), which markets primarily to businesses and represents approximately 86% of our NPW; and (ii) personal lines (Personal Lines), which markets primarily to individuals and represents approximately 14% of our NPW.

Commercial Lines

Commercial Lines underwrites and issues general liability (including excess coverage), commercial automobile, workers compensation, commercial property, business owners policies, and bond risks through traditional insurance and alternative risk management products.

Personal Lines

Personal Lines underwrites and issues insurance policies for personal automobile, homeowners, and other various risks, including excess and dwelling fire coverages.

Regional Geographic Market Focus

Our Insurance Operations segment primarily focuses its marketing efforts and sells its products and services in the Eastern and Midwestern regions of the U.S. Although still concentrated in coastal eastern states, this geographic diversification lessens our exposure to regulatory, competitive, and catastrophic risk. The Insurance Operations segment does not conduct any business outside of the U.S. The following table shows the principal states in which we write insurance business and the percentage of our total NPW that such state represents for the last three fiscal years.

	Year Ended December 31,		
Net Premiums Written	**2008**	2007	2006
New Jersey	**28.6**%	30.0	32.6
Pennsylvania	**14.5**	14.1	14.3
New York	**10.2**	10.8	11.1
Maryland	**7.4**	7.6	7.5
Virginia	**5.7**	6.0	5.9
Illinois	**4.8**	4.4	3.9
North Carolina	**4.0**	4.0	3.8
Georgia	**3.7**	3.5	3.2
Indiana	**3.7**	3.5	3.1
South Carolina	**2.7**	2.8	2.5
Michigan	**2.3**	2.0	1.9
Ohio	**2.0**	1.8	1.6
Connecticut	**1.7**	1.7	1.4
Rhode Island	**1.4**	1.3	1.3
Delaware	**1.1**	1.2	1.3
Wisconsin	**1.1**	1.2	1.1
Massachusetts	**1.0**	0.2	0.0
Iowa	**1.0**	0.8	0.7
Other states [1]	**3.1**	3.1	2.8
Total	**100.0**%	100.0	100.0

[1] Other states and districts include, among others, Florida, Kentucky, Minnesota,

Missouri,
Tennessee and
Washington
D.C.

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Independent Insurance Agent Distribution Model

According to a study published in 2008 by the Independent Insurance Agents and Brokers of America, based on 2006 information, independent insurance agents and brokers wrote approximately 80% of commercial property and casualty insurance and approximately 35% of the personal lines insurance business in the U.S. Independent agents are a significant force in overall insurance industry premium production, in large part because they represent more than one insurance company and, therefore, can provide insureds with a wider choice of commercial and personal property and casualty insurance products. As a result, we are committed to the independent agency distribution channel and focus our primary strategy on building relationships with well-established, independent insurance agents, including efforts to assist in the hiring and training of producers. In addition, we carefully monitor each agent s profitability, growth, financial stability, staff, and mix of business against plans that are developed annually with the agent. In developing annual plans with our independent insurance agents, our field personnel and management spend considerable time meeting with agencies to: (i) advise them on our developments; (ii) receive feedback on products and services; (iii) help agents increase market share through our market planning and leads program; (iv) consolidate more of their business utilizing our technology advantages; and (v) offer them 24 hours a day, seven days a week service capabilities through our customer self-service initiative and our claims service center capabilities.

As of December 31, 2008, the Insurance Subsidiaries had entered into agency agreements with approximately 940 independent insurance agents having approximately 1,850 storefronts. The agents are authorized to sell policies written by the Insurance Subsidiaries and are paid commissions pursuant to calculations and specific percentages stated in the agency agreement. Under the agency agreement, other than as provided by law, agents are not permitted to receive compensation for the business they place with us from any insured or applicant for insurance. The agency agreement provides for commissions to be paid based on a percentage of the premium written. We and our agents also negotiate other compensation arrangements, including supplemental commissions, based on the volume and underwriting results of the business the agent writes with us. In addition, each year selected agents are appointed to our President s Club for their high standards in customer satisfaction, customer retention, sales, and profitability. Our President s Club agencies receive benefits throughout the year, including access to top business consulting services and participation in company/agency strategic planning sessions, including an annual President s Club trip.

Technology and Field Model Business Strategy

We use the service mark High-Tech x High-Touch = HT²SM to describe our business strategy for the Insurance Operations. High-Tech signifies the advanced technology that we use to make it easy for: (i) independent insurance agents to transact and process business with us; and (ii) customers to access real-time information, manage their accounts and pay their bills through an online customer portal that was established in September 2006. High-Touch signifies the close relationships that we have with our independent insurance agents and customers as a result of our business model that places underwriters, claims representatives, technical staff, and safety management representatives in the field near its agents and customers.

Technology

We seek to transact as much of our business as possible through the use of technology and, in recent years, we have made significant investments in state-of-the-art information technology platforms, integrated systems, Internet-based applications, and predictive modeling initiatives to: (i) provide our independent agents and customers with access to accurate business information; (ii) provide an expanded platform through which our agent s small business can be integrated seamlessly into our systems; (iii) provide our independent agents the ability to process business transactions from their offices and systems; and (iv) provide underwriters with targeted pricing tools to enhance profitability while growing the business. In 2008, Applied Systems Client Network presented us with the 2008 Commercial Lines Interface Carrier of the Year Award for promoting efficient communication between insurance carriers and independent agents. Applied Systems Client Network is a provider of automated solutions for property and casualty insurance agents. The award was given in recognition of our superior download and real-time interface technology with independent agents through our xSELerate® agency integration technology.

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We manage our information technology projects through a project management office (PMO). The PMO is staffed by certified individuals who apply methodologies to: (i) communicate project management standards; (ii) provide project management training and tools; (iii) review project status and cost; and (iv) provide non-technology project management consulting services to the rest of the organization. Our senior management meets monthly with the PMO to review all major projects and receive reports on the status of other projects. We believe that the PMO is a factor in the success of our technology implementation and is a competitive advantage. Our technology operations are located in Branchville, New Jersey; Glastonbury, Connecticut; and Sarasota, Florida. We also have an agreement with Satyam Computer Services Ltd. (Satyam) to provide supplemental staffing services to our information technology operation. Satyam is a consulting and information technology services company that is based in India. They provide approximately 25% of our total capacity for skilled technology resources, and we retain all management oversight of project and ongoing information technology production operations. We believe we would be able to manage an efficient transition to a new vendor and not experience a significant negative impact to our operations in the event that we no longer retain Satyam in their current capacity due to the financial issues they are currently experiencing.

Field Strategy

To support our independent agents, we employ a field underwriting model and a field claims model that are supported by the Corporate office in Branchville, New Jersey, and five regional branch offices (Regions), which as of December 31, 2008 were as follows:

Region	**Office Location**
Heartland	Carmel, Indiana
New Jersey	Hamilton, New Jersey
Northeast	Branchville, New Jersey
Mid-Atlantic	Allentown, Pennsylvania and Hunt Valley, Maryland
Southern	Charlotte, North Carolina

During 2008, our Region structure was realigned from seven Regions to the above five Regions. As a result, we have ceased use of our Columbus, Ohio office.

As of December 31, 2008, our field force included:

97 Commercial Lines field underwriters, known as agency management specialists (AMSs). AMSs live and work in the geographic vicinity of our appointed agents and generally work from offices in their homes. As a result of this close proximity and direct and regular interaction, AMSs are able to build strong relationships with agents.

14 Personal Lines territory managers (TMs) that work with AMSs and independent agents to advance production. TMs build strong relationships with agents through direct and regular interaction, which better positions them to evaluate new business opportunities.

12 SRM account managers who, like AMSs, live and work in the geographic vicinity of their coverage territories.

15 field technology employees. These employees work directly with agents, training and marketing our technology systems such as xSELerate® and SelectPLUS®. They also gather feedback from the agents to help improve our technology to meet the agents needs.

75 safety management specialists (SMSs). SMSs are located in the Regions and are responsible for surveying and assessing insured and prospective risks from a risk/safety standpoint, and for providing ongoing safety management services to certain insureds.

140 field claims adjusters, known as claim management specialists (CMSs). Like AMSs, CMSs live in the geographic vicinity of our appointed agents and generally work from offices in their homes. CMSs, because

of their geographic location, are able to conduct on-site inspections of losses and resolve claims faster, more accurately, and with higher levels of customer satisfaction. As a result, CMSs also obtain knowledge about potential exposures that they can share with AMSs.

Underwriting

We seek to underwrite a variety of insurance risks and we divide our markets into three components:

- Small business accounts with premiums less than $25,000 represent 56% of total direct premium written. During 2008, 33% of new small business was written through our Internet-based One & Done® system s automated underwriting templates;
- Middle market business accounts with premiums greater than $25,000 but less than $250,000 represent 39% of total direct premium written. This business is the primary focus of the AMSs; and
- Large business accounts with annual premiums of approximately $250,000 or greater represent 5% of our total direct premium written and are supported by both our regional offices, who underwrite and issue these policies, and a specialized management group, Selective Risk Managers (SRM), that is charged with handling account-specific issues, as well as developing strategic plans for enhancing our alternative risk transfer capabilities. Approximately 22% of the SRM premium includes alternative risk transfer mechanisms such as retrospective rating plans, self-insured group retention programs, or individual self-insured accounts.

Our underwriting process requires communication and interaction among:

- The independent agents and the AMSs, who identify product and market needs;
- Our strategic business units (SBUs), located in the home office, which are organized by customer and product type, and develop our pricing and underwriting guidelines in conjunction with regions;
- The Regions, which work with the SBUs to establish annual premium and pricing goals; and
- The Actuarial Department, located in the home office, which assists in the determination of rate and pricing levels while also monitoring pricing and profitability.

We also have an underwriting service center (USC) located in Richmond, Virginia. The USC assists our agents by servicing small to mid-sized business customers. During 2006, the USC became available to Personal Lines customers of our New Jersey agents, with a rollout to our remaining Personal Lines states during 2008. At the USC, our employees, who are licensed agents, respond to customer inquiries about insurance coverage, billing transactions, and other matters. The agent, as consideration for these services, receives a commission that is lower than the standard commission by approximately two points. We have found that the USC also provides additional opportunities to increase direct premiums written, as larger agencies seek insurance companies that have service center capabilities. As of December 31, 2008, the USC is servicing Commercial Lines net premiums written of $63 million and Personal Lines net premiums written of $33 million. The total $96 million serviced represents 6% of total NPW.

We believe that a distinct advantage of our field underwriting model is its ability to provide a wide range of front-line safety management services focused on improving the policyholder s safety and risk management programs, as expressed by its service mark Safety Management: Solutions for a safer workplace® . Safety management services include: (i) risk evaluation and improvement surveys intended to evaluate potential exposures and provide solutions for mitigation; (ii) web-based safety management educational resources, including a large library of coverage-specific safety materials, videos and on-line courses, such as defensive driving and employee educational safety courses; (iii) thermographic infrared surveys aimed at identifying electrical hazards; and (iv) OSHA construction and general industry certification training. Risk improvement efforts for existing customers are designed to improve loss experience and policyholder retention through valuable ongoing consultative service. Our safety management goal is to partner with our policyholders to identify and eliminate potential loss exposures.

We analyze our Insurance Operations segment s underwriting profitability by line of business, account, product, agency, and other bases. Our goal is to continue to underwrite the risks that we understand well and that, in aggregate, are profitable.

Claims Management

Effective, fair, and timely claims management is one of the most important customer services that we provide and one of the critical factors in achieving underwriting profitability. Our claims practices emphasize the maintenance of timely and adequate claims reserves, and the cost-effective delivery of claims services by controlling losses and loss expenses. We have a claims service center (CSC), co-located with the USC, in Richmond, Virginia, that receives all first notices of loss from our insureds. The CSC is designed to reduce the loss settlement time on first- and third-party personal automobile claims and on first-party commercial lines automobile claims as well as to increase the usage of our discounts at body shops, glass repair shops, and car rental agencies. The CSC has expanded claim handling capabilities and, if necessary, is responsible for assigning claims to the appropriate Region for involvement by our CMSs, or for referring these claims to the corporate office for specialized handling. All workers compensation claims are directed from the CSC to the workers compensation claims unit of the applicable Region.

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CMSs are primarily responsible for investigating and settling a significant portion of our claims directly with policyholders and claimants. By promptly and personally investigating claims, CMSs are able to provide personal service and quickly resolve claims that are within their jurisdiction to handle. In territories where there is insufficient claim volume to justify the placement of a CMS, or when a particular claim expertise is required, we use independent adjusters to investigate and resolve claims. In addition, property liability claims that exceed established dollar thresholds are referred by the CMS to our general property adjusters for consultation and all environmental claims are referred by the CMS to our corporate environmental unit that specializes in the handling of these claims.

We have a centralized special investigations unit (SIU) that investigates potential insurance fraud and abuse, and supports efforts by regulatory bodies and trade associations to curtail the cost of fraud. The SIU adheres to uniform internal procedures to improve detection and takes action on potentially fraudulent claims. It is our practice to notify the proper authorities of its findings. This practice sends a clear message that we will not tolerate fraudulent activity committed against us or our customers. The SIU also supervises anti-fraud training for CMSs and other employees, including AMSs.

Net Loss and Loss Expense Reserves

We establish loss and loss expense reserves that are estimates of amounts needed to pay claims and related expenses in the future for insured loss events that have already occurred. The process of estimating reserves involves a considerable degree of judgment by management and, as of any given date, is inherently uncertain. See Critical Accounting Policies and Estimates in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-K for a full discussion regarding our loss reserving process.

Our loss and loss expense reserve development over the proceeding 10 years is shown on the following table.

Section I of the 10-year table shows the estimated liability that was recorded at the end of each of the indicated years for all current and prior accident year s unpaid loss and loss expenses. The liability represents the estimated amount of loss and loss expenses for claims that were unpaid at the balance sheet date, including incurred but not reported (IBNR) reserves. In accordance with GAAP, the liability for unpaid loss and loss expenses is recorded in the balance sheet gross of the effects of reinsurance, with an estimate of reinsurance recoverables arising from reinsurance contracts reported separately as an asset. The net balance represents the estimated amount of unpaid loss and loss expenses outstanding as of the balance sheet date, reduced by estimates of amounts recoverable under reinsurance contracts.

Section II of the table shows the re-estimated amount of the previously recorded net liability as of the end of each succeeding year. Estimates of the liability for unpaid loss and loss expenses are increased or decreased as payments are made and more information regarding individual claims and trends, such as overall frequency and severity patterns, becomes known. Section III of the table shows the cumulative amount of net loss and loss expenses paid relating to recorded liabilities as of the end of each succeeding year. Section IV of the table shows the re-estimated gross liability and re-estimated reinsurance recoverables through December 31, 2008. Section V of the table shows the cumulative net (deficiency)/redundancy representing the aggregate change in the liability from the original balance sheet dates and the re-estimated liability through December 31, 2008.

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This table does not present accident or policy year development data. Conditions and trends that have affected development of the reserves in the past may not necessarily occur in the future. Accordingly, it may not be appropriate to extrapolate redundancies or deficiencies based on this table.

($ in millions)	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	**2008**
I.Gross reserves for unpaid losses and loss expenses at December 31	$ 1,193.3	1,273.8	1,272.7	1,298.3	1,403.4	1,587.8	1,835.2	2,084.0	2,288.8	2,542.5	**2,641.0**
Reinsurance recoverables on unpaid losses and loss expenses at December 31	$ (140.5)	(192.0)	(160.9)	(166.5)	(160.4)	(184.6)	(218.8)	(218.2)	(199.7)	(227.8)	**(224.2)**
Net reserves for unpaid losses and loss expenses at December 31	$ 1,052.8	1,081.8	1,111.8	1,131.8	1,243.1	1,403.2	1,616.4	1,865.8	2,089.0	2,314.7	**2,416.8**
II. Net Reserves estimated as of:											
One year later	$ 1,044.2	1,080.7	1,125.5	1,151.7	1,258.1	1,408.1	1,621.5	1,858.5	2,070.2	**2,295.4**	
Two years later	1,035.9	1,088.2	1,152.7	1,175.8	1,276.3	1,452.3	1,637.3	1,845.1	**2,024.0**		
Three years later	1,033.3	1,115.6	1,181.9	1,210.7	1,344.6	1,491.1	1,643.7	**1,825.2**			
Four years later	1,040.3	1,134.4	1,220.2	1,290.2	1,371.5	1,522.9	**1,649.8**				
Five years later	1,049.9	1,156.0	1,278.3	1,306.8	1,413.8	**1,529.2**					
Six years later	1,058.6	1,194.6	1,287.5	1,349.6	**1,420.8**						
Seven years later	1,090.0	1,203.2	1,325.5	**1,357.6**							
Eight years later	1,101.1	1,238.2	**1,332.8**								
Nine years later	1,135.4	**1,243.5**									
Ten years later	**1,137.8**										
Cumulative net redundancy (deficiency)	$ **(85.0)**	**(161.7)**	**(221.0)**	**(225.8)**	**(177.7)**	**(126.0)**	**(33.4)**	**40.6**	**65.0**	**19.3**	

III. Cumulative amount of net reserves paid through:										
One year later	$ 328.1	348.2	399.2	377.1	384.0	414.5	422.4	468.6	469.4	**579.4**
Two years later	537.5	600.3	649.1	627.3	653.3	691.4	729.5	775.0	**841.3**	
Three years later	703.8	767.5	815.3	807.2	836.3	903.7	942.4	**1,026.9**		
Four years later	797.1	870.8	930.9	926.9	966.2	1,033.5	**1,101.0**			
Five years later	856.1	933.6	1,002.4	1,003.3	1,044.6	**1,128.4**				
Six years later	892.2	974.6	1,046.3	1,053.8	**1,110.0**					
Seven years later	919.2	1,001.1	1,081.7	**1,100.3**						
Eight years later	937.1	1,029.0	**1,115.9**							
Nine years later	956.7	**1,055.2**								
Ten years later	**979.2**									
IV. Re-estimated gross liability	$ 1,405.2	1,526.1	1,583.0	1,620.5	1,658.1	1,783.6	1,913.1	2,099.3	2,256.5	2,528.8
Re-estimated reinsurance recoverables	$ (267.4)	(282.6)	(250.2)	(262.9)	(237.3)	(254.4)	(263.3)	(274.1)	(232.5)	(233.3)
Re-estimated net liability	$ 1,137.8	1,243.5	1,332.8	1,357.6	1,420.8	1,529.2	1,649.8	1,825.2	2,024.0	2,295.4
V. Cumulative gross redundancy (deficiency)	$ (211.9)	(252.3)	(310.4)	(322.2)	(254.7)	(195.8)	(77.9)	(15.3)	32.3	13.8
Cumulative net redundancy (deficiency)	$ (85.0)	(161.7)	(221.0)	(225.8)	(177.7)	(126.0)	(33.4)	40.6	65.0	19.3

Note: Some amounts may not foot due to rounding.

We experienced favorable prior year development in 2008, 2007, and 2006 of $19.3 million, $18.8 million and $7.3 million, respectively. The following paragraphs provide information regarding the overall favorable development in each of these calendar years.

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We experienced overall favorable development in our loss and loss expense reserves totaling $19.3 million in 2008, which was primarily driven as follows:

The workers compensation line of business experienced favorable prior year loss and loss expense reserve development of approximately $24 million, which was primarily driven by favorable development in accident years 2004 to 2006 as a result of the implementation of our multi-faceted underwriting strategy, higher budgeted medical trends, and the redesign and re-contracting of our managed care process, partially offset by adverse prior year development in accident year 2007 from higher severity.

The general liability line of business experienced adverse prior year loss and loss expense reserve development of approximately $3 million reflecting normal volatility in this line of business.

The remaining lines of business, which collectively contributed approximately $2 million of adverse development, do not individually reflect any significant trends related to prior year development.

We experienced overall favorable development in our loss and loss expense reserves totaling $18.8 million in 2007, which was primarily driven as follows:

The commercial automobile line of business experienced favorable prior year loss and loss expense reserve development of approximately $19 million, which was primarily driven by lower than expected severity in accident years 2004 through 2006.

The personal automobile line of business experienced favorable prior year development of approximately $10 million, due to lower than expected loss emergence for accident years 2005 and prior based on a revaluation of the impact of an adverse judicial ruling by the New Jersey Supreme Court to eliminate the application of the serious life impact standard to personal automobile cases under the verbal tort threshold of New Jersey s Automobile Insurance Cost Reduction Act in 2005. This was partially offset by higher severity in accident year 2006.

The workers compensation line of business experienced favorable prior year development of approximately $4 million reflecting the implementation of a series of improvement strategies for this line in recent accident years partially offset by an increase in the tail factor related to medical inflation and general development trends.

The homeowners line of business experienced adverse prior year loss and loss expense reserve development of approximately $6 million driven by unfavorable trends in claims for groundwater contamination caused by the leakage of certain underground oil storage tanks.

The personal excess line of business experienced adverse prior year loss and loss expense reserve development of approximately $4 million in 2007, which was due to the impact of several significant losses on this small line.

The remaining lines of business, which collectively contributed approximately $4 million of adverse development, do not individually reflect any significant trends related to prior year development.

We experienced overall favorable development in our loss and loss expense reserves totaling $7.3 million in 2006, which was driven by the following:

The commercial automobile line of business experienced favorable prior year loss and loss expense reserve development of approximately $15 million, which was primarily driven by lower than expected severity in accident years 2004 and 2005.

The workers compensation line of business experienced favorable prior year development of approximately $4 million, which was driven, in part, by savings realized from changing medical and pharmacy networks outside New Jersey and re-contracting our medical bill review services.

The personal automobile line of business experienced favorable prior year development of approximately $9 million, due to lower than expected frequency.

The general liability line of business experienced adverse prior year loss and loss expense reserve development of approximately $15 million in 2006, which was largely driven by our contractor completed operations business and an increase in reserves for legal expenses.

The remaining lines of business, which collectively contributed approximately $6 million of adverse development, do not individually reflect significant prior year development.

The significant cumulative loss and loss expense reserve net deficiencies seen between 1998 and 2003 are generally reflective of the soft market pricing in the industry during that time frame, which hit the lowest levels in 1999. The property and casualty insurance industry, as a whole, underestimated reserves and loss trends leading to intense pricing competition. Additionally, during 1999, we significantly increased gross and ceded reserves by $37.5 million for prior accident years related to unlimited medical claims under personal injury protection provisions of personal automobile policies ceded to the Unsatisfied Claim and Judgment Fund in the State of New Jersey.

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The following table reconciles losses and loss expense reserves under SAP and GAAP at December 31, as follows:

($ in thousands)	**2008**	2007
Statutory losses and loss expense reserves[1]	**$ 2,414,743**	2,312,086
Provision for uncollectible reinsurance	**2,470**	2,750
Other	**(432)**	(90)
GAAP losses and loss expense reserves net	**2,416,781**	2,314,746
Reinsurance recoverables on unpaid losses and loss expenses	**224,192**	227,801
GAAP losses and loss expense reserves gross	**$ 2,640,973**	2,542,547

1 Statutory losses and loss expense reserves are presented net of reinsurance recoverables on unpaid losses and loss expenses.

Environmental Reserves

Reserves established for liability insurance include exposure to environmental claims, both asbestos and non-asbestos. Our asbestos and non-asbestos environmental claims have arisen primarily from insured exposures in municipal government, small non-manufacturing commercial risks, and homeowners policies. The emergence of these claims is slow and highly unpredictable.

Asbestos claims are claims presented to us in which bodily injury is alleged to have occurred as a result of exposure to asbestos and/or asbestos-containing products. In the past, we had been the insurer of various distributors of asbestos and/or asbestos-containing products but not manufacturers of such products. During the past two decades, the insurance industry has experienced the emergence and development of an increasing number of asbestos claims. At December 31, 2008, asbestos claims constituted 86% of our 2,362 environmental claims compared with 89% of our 2,448 outstanding environmental claims at December 31, 2007.

Non-asbestos claims are pollution and environmental claims alleging bodily injury or property damage presented, or expected to be presented to us, other than asbestos claims. These claims primarily include landfills and leaking underground storage tanks. In past years, landfill claims have accounted for a significant portion of our environmental claim unit s litigation costs. Over the past few years, we have been experiencing adverse development in our homeowners line of business as a result of unfavorable trends in claims for groundwater contamination caused by leakage of certain underground heating oil storage tanks in New Jersey.

We refer all environmental claims to our centralized and specialized environmental claim unit. Environmental reserves are evaluated on a case-by-case basis. As cases progress, the ability to assess potential liability often improves. Reserves are then adjusted accordingly. In addition, each case is reviewed in light of other factors affecting liability, including judicial interpretation of coverage issues.

IBNR reserve estimation for environmental claims is difficult because, in addition to other factors, there are significant uncertainties associated with critical assumptions in the estimation process, such as average clean-up costs, third-party costs, potentially responsible party shares, allocation of damages, insurer litigation costs, insurer coverage defenses and potential changes to state and federal statutes. Moreover, normal historically based actuarial approaches are difficult to apply because past environmental claims are not indicative of future potential environmental claims. In addition, while models can be applied, such models can produce significantly different results with small changes in assumptions. As a result, we do not calculate a specific environmental loss range. Historically, our environmental claims have been significantly less volatile and uncertain than other competitors in the commercial lines industry. In part, this is due to the fact that we are the primary insurance carrier on the majority of our environmental exposures, thus providing more certainty in our reserve position compared to the insurance marketplace.

Reinsurance

In the ordinary course of their business, the Insurance Subsidiaries reinsure a portion of the risks that they underwrite in order to control exposure to losses and protect capital resources. Reinsurance also permits the Insurance Subsidiaries additional underwriting capacity by permitting them to accept larger risks and underwrite a greater number of risks without a corresponding increase in capital or surplus. For a premium paid by the Insurance Subsidiaries, reinsurers assume a portion of the losses ceded by the Insurance Subsidiaries. We use traditional forms of reinsurance and do not use finite risk reinsurance. Amounts not reinsured are known as retention. The Insurance Subsidiaries use the following to control exposure to losses:

- Treaty reinsurance, in which certain types of policies are automatically reinsured without the need for approval by the reinsurer of the individual risks covered;

- Facultative reinsurance, in which an individual insurance policy or a specific risk is reinsured with the prior approval of the reinsurer. Facultative reinsurance is primarily used for policies with limits greater than the limits available under the reinsurance treaties; and

- Protection provided under the Terrorism Risk Insurance Act of 2002, which was modified and extended through December 31, 2014 via the Terrorism Risk Insurance Program Reauthorization Act of 2007 (collectively referred to as TRIA). For further information regarding TRIA, see Item 1A. Risk Factors of this Form 10-K.

In addition, we are a servicing carrier in the Write-Your-Own (WYO) Program of the U.S. government s National Flood Insurance Program (NFIP). This program allows participating property and casualty insurance companies to write and service the Standard Flood Insurance Policy in their own names for agreed upon fees, while ceding all of the premiums collected and losses incurred on these policies to the federal government.

Reinsurance does not legally discharge an insurer from its liability for the full-face amount of its policies, but it does make the reinsurer liable to the insurer to the extent of the reinsurance ceded. Reinsurance carries counterparty credit risk, which may be mitigated in certain cases by collateral such as letters of credit, trust funds, or funds withheld by the Insurance Subsidiaries. We attempt to mitigate the credit risk related to reinsurance by pursuing relationships with companies rated A- or higher in most circumstances and/or requiring collateral to secure reinsurance obligations. In addition, we employ procedures to continuously review the quality of reinsurance recoverables and reserve for uncollectible reinsurance. We also may take actions, such as commutations, in cases of potential reinsurer default. Some of the Insurance Subsidiaries reinsurance contracts include provisions that give us a contractual right to terminate and/or commute the reinsurers portion of the liabilities based on deterioration of the reinsurer s rating or financial condition.

Reinsurance recoverable balances tend to fluctuate based on the underlying losses incurred by the Insurance Subsidiaries. If a severe catastrophic event occurs, reinsurance recoverable balances may increase significantly. The following table presents information regarding our reinsurance recoverables, including specific data on the three largest individual uncollateralized balances, excluding the two uncollateralized federal and state pools also shown below:

	As of: 12/31/08		As of: 12/31/07	
($ in thousands)	**Recoverables on Paid and Unpaid**	**% of Stockholders Equity**	Recoverables on Paid and Unpaid	% of Stockholders Equity
Total Reinsurance Recoverables	**$ 230,705**	**26%**	$ 235,230	22%
Collateral[1]	**51,790**	**6%**	44,233	4%
Net Unsecured Reinsurance Recoverables	**178,915**	**20%**	190,997	18%

Federal and State Pools[2]:						
NJ Unsatisfied Claim Judgment Fund		**60,716**	**7%**		64,498	6%
National Flood Insurance Program		**23,291**	**3%**		12,583	1%
Other		**5,994**	**1%**		6,154	1%
Total Federal and State Pools		**90,001**	**10%**		83,235	8%
Remaining Unsecured Reinsurance Recoverables	**$**	**88,914**	**10%**	$	107,762	10%
Munich Re Group (A.M. Best Rated A+)	**$**	**21,354**	**2%**	$	34,620	3%
Hannover Ruckversicherungs AG (A.M. Best Rated A)		**17,347**	**2%**		18,014	2%
Swiss Re Group. (A.M. Best Rated A+)		**17,572**	**2%**		14,434	1%
All Other Reinsurers		**32,641**	**4%**		40,694	4%
Total	**$**	**88,914**	**10%**	$	107,762	10%

[1] Includes letters of credit, trust funds, and funds withheld.

[2] Considered to have minimal risk of default.

Note: Some amounts may not foot due to rounding.

We continually monitor the financial condition of our reinsurers and any potential impact on the recoverability of paid and unpaid claims from such reinsurers. For information surrounding our relationships with specific reinsurers, see the Reinsurance section of Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations. of this Form 10-K.

The table below summarizes the significant reinsurance treaties covering the Insurance Subsidiaries.

Treaty	Reinsurance Coverage	Terrorism Coverage
TRIA, Federal Statutory Program	See Item 1A. Risk Factors of this Form 10-K for the description of TRIA. 85% of all TRIA certified losses above the retention. Our retention for 2009 is approximately $201 million. Current program covers both domestic and foreign terrorism. Terrorism acts related to the use of nuclear, biological, chemical or radioactive (NBCR) weapons are covered by TRIA provided that the Secretary of the Treasury certifies the event.	Current program is set to expire on December 31, 2014. For further information regarding TRIA and our risks concerning terrorism exposure, see Item 1A. Risk Factors of this Form 10-K.
Property Excess of Loss	$28 million above $2 million retention in two layers. Losses other than TRIA certified losses are subject to the following reinstatements and annual aggregate limits: $8 million in excess of $2 million layer provides unlimited reinstatements, no annual aggregate limit; and $20 million in excess of $10 million layer provides three reinstatements.	All NBCR losses are excluded regardless of whether or not they are certified under TRIA. For non-NBCR losses, the treaty distinguishes between acts certified under TRIA and those that are not. The treaty provides annual aggregate limits for TRIA certified (other than NBCR) acts of $24 million for the first layer and $40 million for the second layer. Non-certified terrorism losses (other than NBCR) are subject to the normal limits under the treaty.
Property Catastrophe Excess of Loss	95% of $310 million above $40 million retention in three layers: 95% of losses in excess of $40 million up to $100 million; 95% of losses in excess of $100 million up to $200 million; and 95% of losses in excess of $200 million up to $350 million.	All nuclear, biological and chemical (NBC) losses are excluded regardless of whether or not they are certified under TRIA. TRIA losses related to foreign acts of terrorism are excluded from the treaty. Domestic terrorism is included regardless of whether it is certified under TRIA or not. Please see Item 1A. Risk Factors of this Form 10-K for further discussion regarding changes in TRIA.

	The treaty provides one reinstatement per layer, $589.0 million in annual aggregate limit, net of the Insurance Subsidiaries co-participation.	
Casualty Excess of Loss	The 1st layer of $3 million in excess of $2 million is covered at 65%. The 2nd through 5th layers are covered at 100% and the 6th layer of $40 million in excess of $50 million is covered at 75%. Losses other than terrorism losses are subject to the following reinstatements and annual aggregate limits: 65% of $3 million in excess of $2 million layer provides up to $2.0 million of per occurrence coverage net of co-participation with 22 reinstatements, $45 million net annual aggregate limit; $7 million in excess of $5 million layer provides three reinstatements, $28 million annual aggregate limit; $9 million in excess of $12 million layer provides two reinstatements, $27 million annual aggregate limit; $9 million in excess of $21 million layer provides one reinstatement, $18 million annual aggregate limit; $20 million in excess of $30 million layer provides one reinstatement, $40 million annual aggregate limit; and 75% of $40 million in excess of $50 million layer provides up to $30 million of per occurrence coverage net of co-participation with one reinstatement, $60 million in net annual aggregate limit.	All NBCR losses are excluded. All other losses stemming from the acts of terrorism are subject to the following reinstatements and annual aggregate limits: 65% of $3 million in excess of $2 million layer provides up to $2.0 million of per occurrence coverage net of co-participation with four reinstatements for terrorism losses, $10 million net annual aggregate limit; $7 million in excess of $5 million layer provides two reinstatements for terrorism losses, $21 million annual aggregate limit; $9 million in excess of $12 million layer provides two reinstatements for terrorism losses, $27 million annual aggregate limit; $9 million in excess of $21 million layer provides one reinstatement for terrorism losses, $18 million annual aggregate limit; $20 million in excess of $30 million layer provides one reinstatement for terrorism losses, $40 million annual aggregate limit; and 75% of $40 million in excess of $50 million layer provides up to $30 million of per occurrence coverage net of co-participation with one reinstatement for terrorism losses, $60 million in net annual aggregate limit.

National Workers Compensation Reinsurance Pool (NWCRP)	100% quota share up to a maximum ceded combined ratio cap of 152%. Provides up to 5 points in pool participant insolvency assessment protection.	Provides full terrorism coverage including NBCR.
Flood	100% reinsurance by the federal government s WYO Program.	None

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Reinsurance Pooling Agreement

The Insurance Subsidiaries are parties to an inter-company reinsurance pooling agreement (Pooling Agreement). The purpose of the Pooling Agreement is to:

- Pool or share proportionately the underwriting profit and loss results of property and casualty underwriting operations through reinsurance;
- Prevent any Insurance Subsidiary from suffering undue loss;
- Reduce administration expenses; and
- Permit all of the Insurance Subsidiaries to obtain a uniform rating from A.M. Best.

Under the Pooling Agreement, all of the Insurance Subsidiaries mutually reinsure all insurance risks written by them pursuant to the respective percentage set forth opposite each Insurance Subsidiary s name on the table below:

Insurance Subsidiary	**Respective Percentage**
SICA	49.5%
SWIC	21.0%
SICSC	9.0%
SICSE	7.0%
SICNY	7.0%
SAICNJ	6.0%
SICNE	0.5%

Insurance Regulation

General

Insurance companies are subject to supervision and regulation in the states in which they are domiciled and transact business. Such supervision and regulation relates to a variety of aspects of an insurance company s business and financial condition. The primary public purpose of such supervision and regulation is to protect the insurer s policyholders, not the insurer s shareholders. The extent of regulation varies and generally is derived from state statutes that delegate regulatory, supervisory, and administrative authority to state insurance departments. Although the insurance industry is primarily regulated by individual states, federal initiatives can have an impact on the industry, such as the federal government s enactment and extension of TRIA, the enforcement of economic and trade sanctions by the Office of Foreign Assets Control, and the proposal for an optional federal charter that would allow companies to choose between state regulation and national regulatory structure that would eliminate the need to comply with 51 sets of different regulations.

The Financial Services Modernization Act of 1999, also known as the Gramm-Leach-Bliley Act (GLB), and related regulations govern, among other things, the privacy of consumer financial information. GLB limits disclosure by financial institutions of nonpublic personal information about individuals who obtain financial products or services for personal, family, or household purposes. GLB generally applies to disclosures to non-affiliated third parties, but not to disclosures to affiliates. Many states in which we operate have adopted laws that are at least as restrictive as GLB. Privacy of consumer financial information is an evolving area of regulation requiring continued monitoring to ensure continued compliance with GLB.

We cannot quantify the financial impact we would incur to satisfy revised or additional regulatory requirements that may be imposed in the future.

State Regulation

The regulatory authority of state insurance departments extends to such matters as insurer solvency standards, insurer and agent licensing, investment restrictions, payment of dividends and distributions, provisions for current losses and future liabilities, deposit of securities for the benefit of policyholders, restrictions on policy terminations, unfair trade practices, and approval of premium rates and policy forms. State insurance departments also conduct periodic examinations of the financial and business affairs of insurers and require insurers to file annual and other periodic reports relating to their financial condition. Regulatory agencies require that premium rates not be excessive, inadequate, or unfairly discriminatory. The Insurance Subsidiaries, consequently, must file all rates for commercial and personal insurance with the insurance department of each state in which they operate.

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All states have enacted legislation that regulates insurance holding company systems. Each insurance company in a holding company system is required to register with certain insurance supervisory agencies and furnish information concerning the operations of companies within the holding company system that may materially affect the operations, management, or financial condition of the insurers. Pursuant to these laws, the respective departments may: (i) examine us and the Insurance Subsidiaries at any time; (ii) require disclosure or prior approval of material transactions of the Insurance Subsidiaries with any affiliate; and (iii) require prior approval or notice of certain transactions, such as dividends or distributions to the Parent from the Insurance Subsidiary domiciled in that state.

National Association of Insurance Commissioners (NAIC) Guidelines

The Insurance Subsidiaries are subject to statutory accounting principles and reporting formats established by the NAIC. The NAIC also promulgates model insurance laws and regulations relating to the financial and operational regulations of insurance companies, which includes the Insurance Regulatory Information System (IRIS). IRIS identifies 11 industry ratios and specifies usual values for each ratio. Departure from the usual values on four or more of the ratios can lead to inquiries from individual state insurance departments about certain aspects of the insurer s business. The Insurance Subsidiaries have consistently met the majority of the IRIS ratio tests.

NAIC model laws and regulations are not usually applicable unless enacted into law or promulgated into regulation by the individual states. The adoption of certain NAIC model laws and regulations is a key aspect of the NAIC Financial Regulations Standards and Accreditation Program, which also sets forth minimum staffing and resource levels for all state insurance departments. All of the Insurance Subsidiaries states of domicile, except New York, are accredited by the NAIC. Examinations conducted by, or along with, accredited states can be accepted by other states. The NAIC intends to create a nationwide regulatory network of accredited states.

The NAIC model laws and regulations are also intended to enhance the regulation of insurer solvency. These model laws and regulations contain certain risk-based capital requirements for property and casualty insurance companies designed to assess capital adequacy and to raise the level of protection that statutory surplus provides for policyholders. Risk-based capital is measured by the four major areas of risk to which property and casualty insurers are exposed: (i) asset risk; (ii) credit risk; (iii) underwriting risk; and (iv) off-balance sheet risk. Insurers with total adjusted capital that is less than two times their Authorized Control Level, as calculated pursuant to the NAIC model laws and regulations, are subject to different levels of regulatory intervention and action. Based upon the unaudited 2008 statutory financial statements for the Insurance Subsidiaries, each Insurance Subsidiary s total adjusted capital substantially exceeded two times their Authorized Control Level.

Investments Segment

Our Investments segment operations are based primarily in Parsippany, New Jersey, while certain segments of the portfolio are managed by external investment portfolio managers. Like many other property and casualty insurance companies, we depend on income from our investment portfolio for a significant portion of our revenues and earnings. We are exposed to significant financial and capital markets risks, primarily relating to interest rates, credit spreads, equity price risks and the change in market value of our alternative investment portfolio. A decline in both income and our investment portfolio asset values could occur as a result of, among other things, a decrease in market liquidity, falling interest rates, decreased dividend payment rates, negative market perception of credit risk with respect to types of securities in our portfolio, a decline in the performance of the underlying collateral of our structured securities, reduced returns on our other investments, including our portfolio of alternative investments, or general market conditions.

Our investment philosophy includes setting certain return and risk objectives for our equity and fixed maturity portfolios. The return objective of our equity portfolio is to meet or exceed a weighted-average benchmark of public equity indices. The primary return objective of our fixed maturity portfolio is to maximize after-tax investment yield and income while balancing certain risk objectives with a secondary objective of meeting or exceeding a weighted-average benchmark of public fixed income indices. The risk objectives for our portfolios are focused on: (i) asset diversification; (ii) investment quality; (iii) liquidity, particularly to meet the cash obligations of the Insurance Operations; (iv) consideration of taxes; and (v) preservation of capital. Although yield and income generation remain the key drivers to our investment strategy, our overall philosophy is to invest with a long-term horizon along with a buy-and-hold principle. Tactically, we also plan to further increase our portfolio allocation to Government and Agency holdings in the near-term in an effort to increase liquidity and capital preservation. At December 31, 2008, our investment portfolio consisted of $3,035.4 million (86%) of fixed maturity securities, $134.7 million (4%) of equity securities, $198.1 million (5%) of short-term investments, and $172.1 million (5%) of other investments.

While we have remained focused on our stated objectives, recently the fixed-income markets have been experiencing a period of extreme volatility, which has negatively impacted market liquidity conditions and increased the risk that issuers, or guarantors, of fixed maturity securities could default on principal and interest payments. Initially, the effects were focused on the subprime segment of the mortgage-backed securities market. However, this volatility has since spread, negatively impacting: (i) a broad range of mortgage-and asset-backed and other fixed income securities, including those rated investment grade; (ii) the U.S. and international credit and interbank money markets generally; and (iii) a wide range of financial institutions and markets, asset classes, and sectors. As a result, the market for fixed income securities has experienced decreased liquidity, increased price volatility, credit downgrade events, and increased probability of default. Securities that are less liquid are more difficult to value and may be hard to sell. As a result, investment quality has become increasingly more important given the extreme volatility in the fixed-income markets. Our fixed maturity portfolio is comprised primarily of highly rated securities, with almost 100% rated investment grade. The average rating of our fixed maturity securities is AA+ by Standard & Poor s Insurance Rating Services (S&P) , their second highest credit quality rating. We expect to continue to invest primarily in high quality, fixed maturity investments in order to reduce volatility of the portfolio and to maximize after-tax investment yield. However, the continuing market disruption has, in the short-term, kept us more focused on liquidity and capital preservation, at the expense of additional yield. The average duration of our fixed maturity portfolio, including short-term investments, was 3.5 years at December 31, 2008 and 3.9 years at December 31, 2007.

Domestic and international equity markets have also experienced heightened volatility and turmoil, with issuers (such as our company) exposed to the mortgage securities and credit markets particularly affected. As a result, we also took steps to limit our overall portfolio volatility by reducing our equity position by approximately $50 million. As noted above, our equity portfolio now represents only 4% of our total portfolio, which is down from 7% a year ago.

Additionally, our other investments include alternative investments in private limited partnerships that invest in various strategies such as private equity, mezzanine debt, distressed debt, and real estate. Our other investment strategy has historically provided additional yield with equity-like returns that were not significantly correlated to the S&P 500 index. The general volatility in the capital markets, the dislocation of the credit markets, and reduced values of financial assets globally has resulted in a negative return for this asset class during 2008; however, its total return outperformed the S&P 500 index by 2,700 basis points. As of December 31, 2008, these types of investments represented 5% of our total invested assets, which was consistent with prior year. Although our other investment asset class adds some earnings volatility, their continued outperformance of the S&P 500 index is expected to build more value for our shareholders over the long-term.

For further information regarding our risks associated with the overall investment portfolio, see Item 7A. Quantitative and Qualitative Disclosures about Market Risk and Item 1A. Risk Factors of this Form 10-K. For additional information about investments, see the section entitled, Investments, in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, and Item 8. Financial Statements and Supplementary Data, Note 4 of this Form 10-K.

Diversified Insurance Services Segment

Our Diversified Insurance Services segment provides fee-based revenues that are expected to contribute to earnings, increase operating cash flow, and help mitigate potential volatility in insurance operating results. The Diversified Insurance Services segment is complementary to our business model by sharing a common marketing or distribution system and creating new opportunities for independent agents to bring value-added services and products to their customers. The Diversified Insurance Services operation has two major components: (i) HR Outsourcing; and (ii) Flood.

HR Outsourcing and Related Regulation

HR Outsourcing products and services are sold by Selective HR Solutions, Inc. and its subsidiaries (Selective HR), which are headquartered in Sarasota, Florida. Selective HR s customers are small businesses who generally have existing relationships with our independent insurance agents. Selective HR leverages these relationships by using independent insurance agents as its distribution channel for its products and services in the states where it operates. As a Professional Employer Organization (PEO), Selective HR enters into agreements with clients that establish a three-party relationship under which Selective HR and the client are co-employers of the employees who work at the client s location (worksite employees). Selective HR s 2008 operations have been adversely impacted by the economic downturn and the recent increase in unemployment in the U.S. These challenges are manifesting themselves through lower worksite lives and pressure on our State Unemployment Tax Authority (SUTA) margins as further discussed in the section entitled, Diversified Insurance Services Segment, in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-K. As of December 31, 2008, Selective HR had approximately 22,500 worksite employees, 34% of which were located in the state of Florida.

As a co-employer for some of its clients, Selective HR is subject to federal, state, and local laws and regulations relating to labor, tax, employment, employee benefits, and immigration matters. By contracting with its clients and creating a co-employer relationship with the worksite employees, Selective HR may be assuming certain contractual and legal obligations and responsibilities of an employer and could incur liability for violations of such laws and regulations, even if it was not actually responsible for the conduct giving rise to such liability. Some states in which Selective HR operates have already passed licensing or registration requirements for PEOs. These laws and regulations vary from state to state but generally provide for the monitoring of the fiscal responsibility of PEOs. Currently, many of these laws and regulations do not specifically address the obligations and responsibilities of co-employers. There can be no assurance that Selective HR will be able to satisfy new or revised laws and regulations.

Flood Insurance and Related Regulation

We are a servicing carrier in the WYO Program of the U.S. government s NFIP. The NFIP is administered by the Federal Emergency Management Agency (FEMA), which is, in turn, part of the Department of Homeland Security. The WYO Program is a cooperative undertaking of the insurance industry and FEMA. The WYO Program allows participating property and casualty insurance companies to write and service the Standard Flood Insurance Policy in their own names, while ceding all of the premiums collected and losses incurred on these policies to the federal government. We receive the following amounts from the NFIP: (i) fees associated with servicing policy premium; and (ii) fees associated with the handling of claims. On June 1, 2008, the NFIP revised their fee structure associated with the handling of claims to provide for fees of 1% of direct premiums written, which are paid even in non-catastrophe years, coupled with fees equal to 1.5% of all incurred losses. Prior to June 1, 2008, we received claims handling fees equal to 3.3% of all incurred losses. Although these expenses could potentially change with future legislation, our servicing fee is currently 29.8% of direct premiums written. As of December 31, 2008, we served approximately 317,000 Flood policies under the NFIP through over 5,400 independent agents in 50 states and the District of Columbia.

The viability of the NFIP s reinsurance program under the WYO Program is an essential component of our Diversified Insurance Services operations. On September 30, 2008, a law was passed to extend the NFIP authority to issue new policies, increase coverage on existing policies, and issue renewal policies until March 6, 2009. The NFIP currently has borrowing authority in the amount of $20.8 billion and has borrowed $17.3 billion through 2008. This amount is expected to rise as claims from Hurricane Ike continue to mature. The NFIP calculates that they will reach the borrowing limit in the first quarter of fiscal year 2010 and FEMA is currently seeking additional borrowings from Congress. We continue to monitor developments with the NFIP.

Competition

We face significant competition in both our Insurance Operations and Diversified Insurance Services segments. Property and casualty insurance is highly competitive on the basis of both price and service, and is extensively regulated by state insurance departments. In 2008, we were ranked as the 47th largest property and casualty group in the U.S. based on the 2007 NPW, by A.M. Best in its list, Top 200 U.S. Property/Casualty Groups. The Insurance Operations compete with regional insurers, such as Cincinnati Financial Corporation and Harleysville Group, Inc., and national insurance companies, such as Liberty Mutual Group, Travelers Companies, Inc., The Hartford Financial Services Group, Inc., and Zurich Financial Services Group. We also compete against direct writers of insurance coverage, including insurance offered through competitors Internet websites. These writers, such as GEICO and The Progressive Corporation, offer coverage primarily in personal lines. Many of our competitors have more customers and more financial and operating resources than we do. As a result, they have greater scalability and more information regarding their risks which, with the use of statistical and computer models, may give them greater ability to make pricing and underwriting decisions. Purchasers of property and casualty insurance products do not always differentiate between insurance carriers and differences in coverage. The more significant competitive factors for most of our insurance products are financial ratings, safety management, price, coverage terms, claims service, and technology. In addition, we also face competition within each insurance agency that sells its insurance products as the agencies represent more than one insurance company.

With regard to our Diversified Insurance Services segment, according to the most recent published information, Selective HR was ranked as the 14th largest PEO in a Staffing Industry Report published by Staffing Industry

Analysts, Inc., based on 2007 gross revenue. Based on 2007 information, our flood line of business is the 7th largest WYO carrier for the NFIP based on information obtained from statutory annual statements.

Please refer to Item 1A. Risk Factors, of this Form 10-K for a discussion of the factors that could impact our ability to compete.

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Seasonality

Our insurance business experiences modest seasonality with regard to premiums written. Due to the general timing of commercial policy renewals, premiums written are usually highest in January and July and lowest during the fourth quarter of the year. Although the writing of insurance policies experiences modest seasonality, the premiums related to these policies are earned consistently over the period of coverage. Losses and loss expenses incurred tend to remain consistent throughout the year, unless a catastrophe occurs from man-made or weather-related events such as hail, tornadoes, windstorms, hurricanes, and nor easters.

Customers

No one customer or independent agency accounts for 10% or more of our total revenue or the revenue of any one of our business segments.

Employees

At December 31, 2008, we had approximately 2,000 employees, of which 1,800 worked in the Insurance Operations and Investments segments and 200 worked in the Diversified Insurance Services segment.

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Executive Officers of the Registrant

The following table sets forth biographical information about our Chief Executive Officer and executive officers as of February 27, 2009:

Name, Age, Title	Occupation and Background
Gregory E. Murphy, 53 Chairman, President, and Chief Executive Officer	Present position since May 2000 President, Chief Executive Officer, and Director, Selective, 1999 2000 President, Chief Operating Officer, and Director, Selective, 1997 1999 Other senior executive, management, and operational positions, Selective, since 1980 Certified Public Accountant (New Jersey) (Inactive) Director, Newton Memorial Hospital Foundation, Inc., since 1999 Director, Property Casualty Insurers Association of America, since 2008 Director, Insurance Information Institute, since 2000 Trustee, the American Institute for CPCU (AICPCU) and the Insurance Institute of America (IIA), since June 2001 Graduate of Boston College (B.S. Accounting) Harvard University (Advanced Management Program) M.I.T. Sloan School of Management
Richard F. Connell, 63 Senior Executive Vice President and Chief Administrative Officer	Present position since October 2007 Senior Executive Vice President and Chief Information Officer, Selective, 2006 2007 Executive Vice President and Chief Information Officer, Selective, 2000 2006 Chief Technology Officer, Liberty Mutual, 1998 2000 Central Connecticut State University (B.S. Marketing)
Kerry A. Guthrie, 51 Executive Vice President and Chief Investment Officer	Present position since February 2005 Senior Vice President and Chief Investment Officer, Selective, 2002 2005 Various investment positions, Selective, 1987 2002

	Chartered Financial Analyst
	Certified Public Accountant (New Jersey) (Inactive)
	Member, New York Society of Security Analysts
	Siena College (B.S. Accounting)
	Fairleigh Dickinson University (M.B.A. Finance)
Dale A. Thatcher, 47 Executive Vice President, Chief Financial Officer and Treasurer	Present position since February 2003 Senior Vice President, Chief Financial Officer and Treasurer, Selective, 2000 2003 Certified Public Accountant (Ohio) (Inactive) Chartered Property and Casualty Underwriter Chartered Life Underwriter Member, American Institute of Certified Public Accountants Member, Ohio Society of Certified Public Accountants Member, Financial Executives Initiative Member, Insurance Accounting and Systems Association University of Cincinnati (B.B.A. Accounting; M.B.A. Finance) Harvard University (Advanced Management Program)

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Name, Age, Title	Occupation and Background
Ronald J. Zaleski, 54 Executive Vice President and Chief Actuary	Present position since February 2003 Senior Vice President and Chief Actuary, Selective, 2000 - 2003 Vice President and Chief Actuary, Selective, 1999 2000 Fellow of Casualty Actuarial Society Member, American Academy of Actuaries Loyola College (B.A. Mathematics)
Steven B. Woods, 49 Executive Vice President, Human Resources	Present position since January 2009 Vice President, Human Resources, Corporate Affairs, Administration and Vice President, International for Crayola, LLC, 2000 2009 Southeastern Massachusetts University (B.S.) Old Dominion University (Ph.D., M.S.)
Michael H. Lanza, 47 Executive Vice President, General Counsel, and Chief Compliance Officer	Present position since October 2007 Senior Vice President and General Counsel, Selective, 2004 - 2007 Corporate advisor and legal consultant, 2003 2004 Executive Vice President and Corporate Secretary, QuadraMed Corporation, 2000 2003 Member, Society of Corporate Secretaries and Corporate Governance Professionals Member, National Investor Relations Institute University of Connecticut (B.A.) University of Connecticut School of Law (J.D.)
Mary T. Porter, 53 Executive Vice President, Chief Claims Officer	Present position since October 2007 Senior Vice President, Director of Corporate Claims, Selective, 2007 Vice President, Group General Counsel, St. Paul Travelers, 1999 2006 Assistant Vice President, Group Counsel USF&G, St. Paul Companies, 1993 1999

	Member, Federation of Defense and Corporate Counsel
	Long Island University, C.W. Post College (B.A. Political Science)
	George Washington University (J.D.)
John J. Marchioni, 39 Executive Vice President, Chief Underwriting and Field Operations Officer	Present position since October 2008 Executive Vice President, Chief Field Operations Officer, Selective, 2007 2008 Senior Vice President, Director of Personal Lines, Selective, 2005 2007 Various insurance operations and government affairs positions, Selective, 1998 2005 Chartered Property Casualty Underwriter (CPCU) Princeton University (B.A. History) Harvard University (Advanced Management Program)

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Information regarding our Board of Directors (the Board) is included in the definitive Proxy Statement for the 2009 Annual Meeting of Stockholders to be held on April 29, 2009 in Information About Proposal 1, Election of Directors, and is also incorporated by reference into Part III of this Form 10-K.

Available Information

We file our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements, and other required information with the SEC. The public may read and copy any materials on file with the SEC at the SEC s Public Reference Room at 100 F Street N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site, www.sec.gov, that contains reports, proxy and information statements, and other information regarding issuers, including ourselves, that file electronically with the SEC.

We have a website, www.selective.com, through which our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (Exchange Act) are available free of charge as soon as reasonably practicable after they are electronically filed with, or furnished to the SEC.

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Item 1A. Risk Factors

Certain risk factors exist that can have a significant impact on our business, liquidity, capital resources, results of operations, and financial condition. The impact of these risk factors could also impact certain actions that we take as part of our long-term capital strategy including, but not limited to, contributing capital to subsidiaries in our Insurance Operations and Diversified Insurance Services segments, issuing additional debt and/or equity securities, repurchasing shares of the Parent s common stock, or changing stockholders dividends. The following list of risk factors is not exhaustive and others may exist. We operate in a continually changing business environment and new risk factors emerge from time to time. Consequently, we can neither predict such new risk factors nor assess the impact, if any, they might have on our business in the future.

Difficult conditions in global capital markets and the economy may adversely affect our revenue and profitability and harm our business, and these conditions may not improve in the near future.

Our results of operations are materially affected by conditions in the global capital markets and the economy generally, in both the U.S. and abroad. As widely reported, financial markets in the U.S., Europe, and Asia have been experiencing extreme disruption from the second half of 2007 through 2008. Concerns over the availability and cost of credit, the U.S. mortgage market, a declining real estate market in the U.S., increased unemployment, volatile energy and commodity prices and geopolitical issues, among other factors, have contributed to increased volatility and diminished expectations for the economy and the financial and insurance markets going forward. These concerns have also led to declines in business and consumer confidence, which have precipitated an economic slowdown and fears of a sustained recession.

In addition, the fixed-income markets are experiencing a period of extreme volatility, which has negatively impacted market liquidity conditions and increased the risk that issuers, or guarantors, of fixed maturity securities will default on principal and interest payments. Initially, the effects were focused on the subprime segment of the mortgage-backed securities market. However, this volatility has since spread, negatively impacting: (i) a broad range of mortgage and asset-backed and other fixed income securities, including those rated investment grade; (ii) the U.S. and international credit and interbank money markets generally; and (iii) a wide range of financial institutions and markets, asset classes, and sectors. As a result, the market for fixed income securities has experienced decreased liquidity, increased price volatility, credit downgrade events, and increased probability of default. Securities that are less liquid are more difficult to value and may be hard to sell. Domestic and international equity markets have also been experiencing heightened volatility and turmoil, with issuers (such as our company) exposed to the mortgage securities and credit markets particularly affected. These factors and the continuing market disruption may have an adverse effect on our investment portfolio, revenues, and profit margins.

Factors such as consumer spending, business investment, government spending, the volatility and strength of the capital markets, and inflation, all affect the business and economic environment and, indirectly, the amount and profitability of our business. In an economic downturn characterized by higher unemployment, lower family income, lower corporate earnings, lower business investment, and lower consumer spending, the demand for insurance products could be adversely affected. In addition, we are impacted by the recent decrease in commercial and new home construction and home ownership in 2008 because 43% of NPW in our Commercial Lines business was generated through contractors business. Further unfavorable economic developments could adversely affect our earnings if our customers have less need for insurance coverage, cancel existing insurance policies, modify coverage or choose not to renew with us. These circumstances could have a material adverse effect on our business, results of operations and financial condition. Challenging economic conditions also may impair the ability of our customers to pay premiums as they come due. We are unable to predict the likely duration and severity of the current disruptions in financial markets and adverse economic conditions in the U.S. and other countries, which may have an adverse effect on us.

We are also subject to the risk that the issuers, or guarantors, of fixed maturity securities we own may default on principal and interest payments due under the terms of the securities. At December 31, 2008, our fixed maturity securities portfolio represented approximately 86% of our total invested assets. Approximately 66% of our fixed maturity securities are state, municipality, or U.S. Government obligations. The occurrence of a major economic downturn (such as the current economy), acts of corporate malfeasance, widening credit spreads, budgetary deficits, or other events that adversely affect the issuers or guarantors of these securities could cause the value of our fixed maturity securities portfolio and our net income to decline and the default rate of our fixed maturity securities portfolio to increase. With economic uncertainty, credit quality of issuers or guarantors could be adversely affected and a ratings downgrade of the issuers or guarantors of the securities in our portfolio could also cause the value of our fixed maturity securities portfolio and our net income to decrease. For example, rating agency downgrades of monoline insurance companies during 2008 contributed to a decline in the carrying value and the market liquidity of our municipal bond investment portfolio. A reduction in the value of our investment portfolio could have a material adverse effect on our business, results of operations and financial condition. Levels of write down are impacted by our assessment of the impairment, including a review of the underlying collateral of structured securities, and our intent and ability to hold securities which have declined in value until recovery. If we determine to reposition or realign portions of the portfolio where we determine not to hold certain securities in an unrealized loss position to recovery, then we will incur an other-than-temporary impairment (OTTI) charge.

The current economic crisis has also raised the possibility of future legislative and regulatory actions, in addition to the recent enactment of the Emergency Economic Stabilization Act of 2008 (the EESA), which could further impact our business. We discuss government actions further in this section. We cannot predict whether or when such actions may occur, or what impact, if any, such actions could have on our business, results of operations and financial condition.

Our loss reserves may not be adequate to cover actual losses and expenses.

We are required to maintain loss reserves for our estimated liability for losses and loss expenses associated with reported and unreported insurance claims for each accounting period. From time to time, we adjust reserves and, if the reserves are inadequate, must increase our reserves. An increase in reserves: (i) reduces net income and stockholders equity for the period in which the deficiency in reserves is identified; and (ii) could have a material adverse effect on our results of operations, liquidity, financial condition, and financial strength and debt ratings. Our estimates of reserve amounts are based on facts and circumstances of which we are aware, including our expectations of the ultimate settlement and claim administration expenses, predictions of future events, trends in claims severity and frequency, and other subjective factors relating to our insurance policies in force. There is no method for precisely estimating the ultimate liability for settlement of claims.

We regularly review our reserving techniques and our overall amount of reserves. We also review:

- Information regarding each claim for losses, including potential extra-contractual liabilities, or amounts paid in excess of the policy limits, which may not be covered by our contracts with reinsurers;
- Our loss history and the industry s loss history;
- Legislative enactments, judicial decisions and legal developments regarding damages;
- Changes in political attitudes; and
- Trends in general economic conditions, including inflation.

In addition to the above, we continue to manage our claims process in an effort to reduce claim cycle times and improve workflows. The initiatives undertaken in 2008 included: (i) claims automation; (ii) enhancement of claims quality and control; (iii) litigation management; (iv) enhancement of compliance and bill review; (v) enhancement of workers compensation review; and (vi) enhancement of salvage and subrogation review. As these initiatives are anticipated to accelerate the timing of reserve establishment, we ultimately expect lower loss costs to be realized through reduced legal and loss adjustment expenses. This acceleration will inflate our severity statistics in the near

term, but we expect the longer-term benefit to be a more efficient management of the claims process.
We cannot be certain that the reserves we establish are adequate or will be adequate in the future. For more information regarding reserves, see the section entitled Reserve for Losses and Loss Expenses in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-K.

As a property and casualty insurer we are particularly vulnerable to catastrophic events.

Results of property and casualty insurers, such as our company, are subject to weather and other conditions. While one year may be relatively free of major weather occurrences or other disasters, another year may have numerous such events, causing results to be materially worse than other years. The Insurance Subsidiaries have experienced catastrophe losses and we expect them to experience such losses in the future.

Various natural and man-made events can cause catastrophes, including, but not limited to; hurricanes, tornadoes, windstorms, earthquakes, hail, terrorism, explosions, severe winter weather, floods and fires, some of which may be related to climate changes. The frequency and severity of these catastrophes are inherently unpredictable. The extent of losses from a catastrophe is determined by the severity of the event and the total amount of insured exposures in the area affected by the event. Although catastrophes can cause losses in a variety of property and casualty lines, most of the catastrophe-related claims of the Insurance Subsidiaries historically have been related to commercial property and homeowners coverages. Our property and casualty insurance business is concentrated geographically in the Eastern and Midwestern regions of the U.S. New Jersey accounted for 29% of our total NPW during the year ended December 31, 2008.

The Insurance Subsidiaries seek to reduce their exposure to catastrophe losses through the purchase of catastrophe reinsurance. Reinsurance, however, may prove inadequate if:

- The modeling software we use to analyze the Insurance Subsidiaries risk results in an inadequate purchase of reinsurance by us;
- A major catastrophic loss exceeds the reinsurance limit or the reinsurers financial capacity; or
- The frequency of catastrophe losses result in the Insurance Subsidiaries exceeding their one reinstatement.

Continued deterioration in the public debt and equity markets, as well as in the private investment marketplace, could lead to investment losses, which may adversely affect our results of operations, financial condition and liquidity.

Like many other property and casualty insurance companies, we depend on income from our investment portfolio for a significant portion of our revenues and earnings. We are exposed to significant financial and capital markets risks, primarily relating to interest rates, credit spreads, equity price risks, and the changes in market value of our alternative investment portfolio. A decline could occur as a result of, among other things, a decrease in market liquidity, falling interest rates, decreased dividend payment rates, negative market perception of credit risk with respect to types of securities in our portfolio, a decline in the performance of the underlying collateral of our structured securities, reduced returns on our other investments, including our portfolio of alternative investments, or general market conditions.

Our notes payable and line of credit are subject to certain debt-to-capitalization restrictions and net worth covenants, which could also be impacted by a significant decline in investment values, and further OTTI charges could be necessary if there is a future significant decline in investment values. Depending on market conditions going forward, and in the event of extreme prolonged market events, such as the global credit crisis, we could incur additional realized and unrealized losses in future periods, which could have an adverse impact on our results of operations, financial condition, debt and financial strength ratings, and our ability to access capital markets as a result of realized losses, impairments and changes in unrealized positions.

Interest rate risk

Our exposure to interest rate risk relates primarily to the market price (and cash flow variability) associated with changes in interest rates. A rise in interest rates may decrease the fair value of our existing fixed maturity investments and declines in interest rates may result in an increase in the fair value of our existing fixed maturity investments. Our fixed income investment portfolio contains interest rate sensitive instruments, that may be adversely affected by changes in interest rates resulting from governmental monetary policies, domestic and international economic and political conditions, and other factors beyond our control. A rise in interest rates would increase the net unrealized loss position of the investment portfolio, offset by our ability to earn higher rates of return on funds reinvested and new investments. Conversely, a decline in interest rates would decrease the net unrealized loss position of the investment portfolio, offset by lower rates of return on funds reinvested and new investments. We seek to mitigate our interest rate risk associated with holding fixed maturity investments by monitoring and maintaining the average duration of our portfolio with a view toward achieving an adequate after-tax return without subjecting the portfolio to an unreasonable level of interest rate risk. Although we take measures to manage the economic risks of investing in a changing interest rate environment, we may not be able to mitigate the interest rate risk of our assets relative to our liabilities.

Equity price risk

Our primary exposure to equity risk relates to the potential adverse impact on our equity investments associated with volatility in equity market prices, decreased dividend payment rates, and reduced returns in certain of our other investments, which reduces our investment portfolio. 4%, or $134.7 million, of our total investment portfolio was equity securities and 5%, or $165.0 million, of our total investment portfolio was alternative investments as December 31, 2008. 49%, or $81.0 million, of our alternative investments were private equity investments (including secondary market), which represented 2% of our total investment portfolio as of December 31, 2008.

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We are also exposed to interest rate and equity risk based on the discount rate and expected long-term rate of return assumptions associated with our pension and other post-retirement benefit obligations. Sustained declines in long-term interest rates or equity returns likely would have a negative effect on the funded status of our pension plan. Even in the absence of a market downturn, we are exposed to substantial risk of loss due to market volatility.

The factors discussed above have resulted in significant realized and unrealized losses, including write downs for OTTI charges, in our equity and other investment portfolio. Any further decline in the market value of our equity and other investments would continue to reduce our revenue, stockholders equity, and policyholders surplus, which could impact our ability to issue additional insurance policies.

For more information regarding market, interest rate, credit, and equity price risk, see Item 7A. Quantitative and Qualitative Disclosures About Market Risk in this Form 10-K.

The property and casualty insurance industry is cyclical.

Historically, the results of the property and casualty insurance industry have experienced significant fluctuations due to competition, occurrence or severity of catastrophic events, levels of capacity, general economic conditions, interest rates, and other factors. Demand for insurance is influenced significantly by prevailing general economic conditions. The supply of insurance is related to prevailing prices, the levels of insured losses and the levels of industry surplus which, in turn, may fluctuate in response to changes in rates of return on investments being earned in the insurance industry. As a result, the insurance industry historically has been a cyclical industry characterized by periods of intense price competition due to excessive underwriting capacity as well as periods when shortages of capacity permitted favorable premium levels. For example, competitors pricing business below technical levels could force us to reduce our profit margin in order to protect our best business. We have experienced the following fluctuations in Commercial Lines premium pricing, excluding exposure (pure price), over the past several years:

Year	Percentage Increase (Decrease) from Year to Year
2008	(3.1)%
2007	(3.9)%
2006	(1.7)%
2005	0%
2001-2004	Increases ranging from 4.3% to 12.6%

As an example of pricing and loss trends on the statutory combined ratio, taking a pure price decline of 1.4% and removing the expense that directly varies with premium volume yields an adverse combined ratio impact of approximately 1 point, in addition to a claims inflation increase of 3%, will cause the loss and loss adjustment expense ratio to increase approximately 2 points, all else remaining equal. The combination of claims inflation and price decreases could raise the combined ratio approximately 3 points in this example, absent any initiatives targeted to address these trends.

The industry s profitability also is affected by unpredictable developments, including:

- Natural and man-made disasters;
- Fluctuations in interest rates and other changes in the investment environment that affect investment returns;
- Inflationary pressures (medical and economic) that affect the size of losses;
- Judicial, regulatory, legislative, and legal decisions that affect insurers liabilities;
- Changes in the frequency and severity of losses;
- Pricing and availability of reinsurance in the marketplace; and

Weather-related impacts due to the effects of climate changes.

Any of the above developments could cause the supply or demand for insurance to change, which could adversely affect our results of operations and financial condition.

There can be no assurance that the actions of the U.S. Government, Federal Reserve and other governmental and regulatory bodies to try to stabilize the financial markets will achieve their intended effect.

In response to the financial crises affecting the banking system and financial markets, on October 3, 2008, President George Bush signed the EESA into law. Under the EESA, the U.S. Treasury has the authority to, among other things, purchase up to $700 billion of mortgage-backed and other securities from financial institutions to try to stabilize the financial markets. The EESA or similar legislation, as well as monetary or fiscal actions by the U.S. Federal Reserve Board or comparable authorities in other countries, may fail to stabilize the financial markets. These new forms of legislation and actions may have other consequences on financial factors, including interest rates, foreign exchange rates, and the markets for the financial instruments purchased and sold by the U.S. Department of Treasury pursuant to the EESA. These other consequences could materially affect our investments, results of operations and liquidity in ways that we cannot predict. The failure to effectively implement this legislation and related actions, or ineffectiveness of the legislation and actions, could result in a crisis of investor confidence in the U.S. economy and financial markets, which could increase constraints on the liquidity available in the banking system and financial markets and increase pressure on the price of our fixed income and equity portfolios. These results could materially and adversely affect our results of operations, financial condition, liquidity and the trading price of the Parent s common stock.

In the event of future material deterioration in business conditions, we may need to raise additional capital or consider other transactions to manage our capital position and liquidity. However, since we are unable to predict the likely duration and severity of the current disruptions in the marketplace, we may find it difficult to raise capital, and if we do, we may be forced to incur a relatively high cost to obtain such capital.

Although we do not plan to participate in any of the EESA programs, it is possible that our competitors may, and those competitors may gain a competitive advantage by accessing funds through the EESA programs. Furthermore, it is possible that some companies, including competitors, may attempt to use the existing market volatility and enhanced market oversight as a platform for isolating poorly performing assets into separate stand-alone entities. There can be no assurance as to the effect that any such actions will have on our competitive position.

In addition, we are subject to extensive laws and regulations that are administered and enforced by a number of different governmental authorities and non-governmental self-regulatory agencies. In light of the current financial crisis, some of these authorities have implemented, or may in the future implement, new or enhanced regulatory requirements intended to restore confidence in financial institutions and reduce the likelihood of similar economic events in the future. These authorities may also seek to exercise their supervisory or enforcement authority in new or more robust ways. Such events could affect the way we conduct our business and manage our capital, and may require us to satisfy increased capital requirements. These developments, if they occurred, could materially affect our results of operations, financial condition and liquidity.

The Federal Deposit Insurance Corporation (FDIC) approved the Temporary Liquidity Guarantee Program (TLGP) on November 21, 2008. The program was designed to strengthen confidence and encourage liquidity in the banking system by guaranteeing newly issued senior unsecured debt of banks, thrifts, and certain holding companies, and by providing full coverage of non-interest bearing deposit transaction accounts, regardless of dollar amount. If we purchase securities guaranteed under the TLGP, and the program does not strengthen confidence or encourage liquidity in the marketplace, the carrying value of such securities in our investment portfolio could be adversely affected.

We are subject to the types of risks inherent in making alternative investments in private limited partnerships.

Our other investments include alternative investments in private limited partnerships that invest in various strategies such as private equity, mezzanine debt, distressed debt, and real estate. As of December 31, 2008, these types of investments represented 5% of our total invested assets. The amount and timing of income from these partnerships tends to be variable as a result of the performance and investment stage of the underlying investments. The timing of distributions from the partnerships, which depends on particular events relating to the underlying investments, as well as the partnerships schedules for making distributions and their need for cash, can be difficult to predict. As a result, the amount of income that we record from these investments can vary substantially from quarter to quarter. In addition, the general volatility in the capital markets, the dislocation of the credit markets, and reduced values of financial assets globally in the last half of 2008 has reduced investment income from these types of investments. Pursuant to the various limited partnership agreements of these partnerships, we are committed to potential future capital calls in the aggregate amount of approximately $120 million as of December 31, 2008.

We are also subject to the risks arising from the fact that the determination of the fair value of these types of investments is inherently subjective. The general partner of each of these partnerships generally reports the change in the fair value of the interests in the partnership on a one quarter lag because of the nature of the underlying assets or liabilities. Since these partnerships underlying investments consist primarily of assets or liabilities for which there are no quoted prices in active markets for the same or similar assets, the valuation of interests in these partnerships are subject to a higher level of subjectivity and unobservable inputs than substantially all of our other investments. Pursuant to FASB Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157), each of these general partners is required to determine fair value by the price obtainable for the sale of the interest at the time of determination. Valuations based on unobservable inputs are subject to greater scrutiny and reconsideration from one reporting period to the next and therefore, the changes in the fair value of these investments may be subject to significant fluctuations which could lead to significant decreases in their fair value from one reporting period to the next. Since we record our investments in these various partnerships under the equity method of accounting, any decreases in the valuation of these investments would negatively impact our results of operations.

The valuation of our investments include methodologies, estimations and assumptions which are subject to differing interpretations and could result in changes to investment valuations that may adversely affect our results of operations or financial condition.

Fixed maturity, equity and trading securities and short-term investments, which are reported at fair value on the consolidated balance sheet, represented the majority of our total cash and invested assets as of December 31, 2008. As required under accounting rules, we have categorized these securities into a three-level hierarchy, based on the priority of the inputs to the respective valuation technique. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1), the next priority to quoted prices in markets that are not active or inputs that are observable either directly or indirectly, including quoted prices for similar assets or liabilities or in markets that are not active and other inputs that can be derived principally from, or corroborated by, observable market data for substantially the full term of the assets or liabilities (Level 2) and the lowest priority to unobservable inputs supported by little or no market activity and that reflect the reporting entity s own assumptions about the exit price, including assumptions that market participants would use in pricing the asset or liability (Level 3). An asset or liability s classification within the fair value hierarchy is based on the lowest level of significant input to its valuation. We generally use a combination of independent pricing services and broker quotes to price our investment securities. At December 31, 2008, approximately 13% and 87% of these securities represented Level 1 and Level 2, respectively. However, prices provided by independent pricing services and independent broker quotes can vary widely even for the same security. Rapidly changing and unprecedented credit and equity market conditions could materially impact the valuation of securities as reported within our consolidated financial statements and the period-to-period changes in value could vary significantly. Decreases in value may have a material adverse effect on our financial condition and may result in an increase in non-cash OTTI charges.

The determination of the amount of impairments taken on our investments is highly subjective and could materially impact our results of operations or financial position.

The determination of the amount of impairments taken on our investments is based on our periodic evaluation and assessment of our investments and known and inherent risks associated with the various asset classes. Such evaluations and assessments are revised as conditions change and new information becomes available. Management updates its evaluations regularly and reflects changes in impairments as such evaluations are revised. There can be no assurance that our management has accurately assessed the level of impairments taken reflected in our financial statements. Furthermore, additional impairments may need to be taken in the future. Historical trends may not be indicative of future impairments.

An investment in a fixed maturity or equity security, is impaired if its fair value falls below its carrying value and the decline is considered to be other than temporary. We regularly review our entire investment portfolio for declines in value. If we believe that a decline in the value of a particular investment is temporary, we record the decline as an unrealized loss in accumulated other comprehensive income for those securities that are held as available for sale. If we believe the decline is other-than-temporary we write down the carrying value of the investment and record a realized loss in our consolidated statements of income. Management s assessment of a decline in value includes current judgment as to the financial position and future prospects of the security issuer as well as our ability and intent to hold such security until a recovery could occur.

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Additionally, our management considers a wide range of factors about the security issuer and uses their best judgment in evaluating the cause of the decline in the estimated fair value of the security and in assessing the prospects for near-term recovery. Inherent in management s evaluation of the security are assumptions and estimates about the operations of the issuer and its future earnings potential. Considerations in the impairment evaluation process include, but are not limited to: (i) whether the decline appears to be issuer or industry specific; (ii) the relationship of market prices per share to book value per share at the date of acquisition and date of evaluation; (iii) the price-earnings ratio at the time of acquisition and date of evaluation; (iv) the financial condition and near-term prospects of the issuer, including any specific events that may influence the issuer s operations; (v) the recent income or loss of the issuer; (vi) the independent auditors report on the issuer s recent financial statements; (vii) the dividend policy of the issuer at the date of acquisition and the date of evaluation; (viii) any buy/hold/sell recommendations or price projections published by outside investment advisors; (ix) any rating agency announcements; (x) the length of time and the extent to which the fair value has been less than carrying value; and (xi) the stress testing of projected cash flows under various economic and default scenarios.

As of December 31, 2008, there were 401 securities in our portfolio in an unrealized loss position, including certain securities that were priced at a significant discount compared to our original cost due to uncertainties in the marketplace. Our gross unrealized losses on available-for-sale fixed maturity securities at December 31, 2008 were $160.2 million, pre-tax, in the aggregate and the component of gross unrealized losses for securities with a fair value of less than 85% of their amortized costs was approximately $122.7 million, pre-tax, at such date. Realized losses or impairments may have a material adverse impact on our results of operation and financial position.

A downgrade or a potential downgrade in our financial strength or credit ratings could result in a loss of business and could have a material adverse effect our financial condition and results of operations.

Insurance companies are subject to financial strength ratings issued by various Nationally Recognized Statistical Rating Organizations (NRSROs), based on factors relevant to policyholders. Ratings are not recommendations to buy, hold, or sell any of our securities. Higher ratings generally indicate financial stability and a strong ability to pay claims. We and the Insurance Subsidiaries currently maintain: (i) an A.M. Best financial strength rating of A+ with a stable financial strength outlook; (ii) a S&P s financial strength rating of A+ with a negative outlook; (iii) a Fitch financial strength rating of A+ with a stable outlook; and (iv) a Moody s financial strength rating of A2 with a stable outlook. A significant downgrade in ratings, from A.M. Best in particular, could: (i) affect our ability to write new business with customers, some of whom are required (under various third party agreements) to maintain insurance with a carrier that maintains a specified minimum rating; or (ii) be an event of default under our line of credit.

Pursuant to our line of credit agreement with Wachovia Bank, National Association (Line of Credit), the Insurance Subsidiaries must maintain a financial strength rating by A.M. Best of at least A- (two levels below our current rating) at all times. A default under our Line of Credit could lead to acceleration of principal, which could trigger default provisions under certain of our other debt instruments and could negatively impact our ability to borrow in the future. As a result, any significant downgrade in ratings could have a material adverse effect our financial condition and results of operations.

In addition to financial strength ratings, various NRSROs also publish credit ratings for us. Credit ratings are indicators of a debt issuer s ability to meet the terms of debt obligations in a timely manner and are important factors in our overall funding profile and ability to access certain types of liquidity. Currently, we maintain: (i) an A.M. Best long term issuer credit rating of a- with a stable long term credit outlook; (ii) a S&P s long term local issuer credit rating of BBB+ with a negative outlook; (iii) a Fitch long term issuer default rating of A- with a stable outlook; and (iv) a Moody s Investor Service (Moody s) senior unsecured debt rating of Baa2 with a stable outlook. Downgrades in our credit ratings could have a material adverse effect on our financial condition and results of operations in many ways, including making it more expensive for us to access capital markets. The Insurance Subsidiaries are also parties to the Pooling Agreement that allows them to obtain a uniform rating from A.M. Best. If one or more of the Insurance Subsidiaries suffered a ratings downgrade, the ability of the entire pool to maintain its uniform rating would be uncertain.

In view of the difficulties experienced recently by many financial institutions, including our competitors in the insurance industry, we believe it is possible that the external rating agencies: (i) will heighten the level of scrutiny that they apply to such institutions; (ii) will increase the frequency and scope of their reviews; and (iii) may adjust upward the capital and other requirements employed in their models for maintenance of certain rating levels. We cannot predict what actions rating agencies may take, or what actions we may take in response to the actions of rating agencies, which could adversely affect our business.

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We operate in a highly competitive environment which could adversely impact our results of operations and financial condition.

We compete with regional and national property and casualty insurance companies, including public and mutual companies, some of which do not use independent agents and write directly with insureds. Many of these competitors are larger than us and have greater financial and operating resources, as well as greater information scale. The Internet has also emerged as a significant place of new competition, both from existing competitors and new competitors. A new form of competition may enter the marketplace as some reinsurers attempt to diversify their insurance risk by writing business in the primary marketplace. Because we sell our coverages through independent insurance agents who also are agents of our competitors, we face competition within each of our appointed independent insurance agencies.

We also face competition, primarily in the commercial insurance market, from entities that self-insure their own risks. Some of our customers and potential customers from time to time examine the benefits and risks of self-insuring as an alternative to traditional insurance. The ability to self-insure is generally only available to large risks. However, some small and mid-sized public entities do have the opportunity to partially self-insure through the use of risk pools or joint insurance funds.

New competition could cause the supply or demand for insurance to change, which could adversely affect our results of operations and financial condition.

The occurrence of any acts of terrorism not covered by, or exceeding, reinsurance limits could have a material adverse affect on our results of operations and financial condition.

The U.S. Terrorism Risk Insurance Act of 2002 (TRIA), as amended, established the Terrorism Risk Insurance Program (TRIP) which became effective on November 26, 2002 and was a three-year federal program effective through 2005. On December 22, 2005, President George Bush signed a bill extending TRIA for two more years, continuing TRIP through 2007. On December 26, 2007, President George Bush signed the Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA) which further extended TRIP for seven years until December 31, 2014, and also eliminated the distinction between foreign and domestic acts of terrorism. This seven-year period was designed to provide the market with much needed stability.

TRIA requires sharing the risk of future losses from terrorism between private insurers and the federal government, and is applicable to almost all commercial lines of insurance. Insurance companies with direct commercial insurance exposure in the U.S., including our company, are required to participate in this program. TRIA rescinded all previously approved exclusions for terrorism. Policyholders of non-workers compensation policies have the option to accept or decline the terrorism coverage we offer in our policies, or negotiate other terms. In 2008, approximately 90% of our commercial non-workers compensation policyholders purchased terrorism coverage. The terrorism coverage is mandatory for all workers compensation primary policies. In addition, 46%, or 10 of the 22 primary states in which we write commercial property coverage, mandated during 2008 the coverage of fire following an act of terrorism. These provisions apply to new policies written after enactment of TRIA. A terrorism act must be certified by the U.S. Secretary of Treasury in order to be covered by TRIA. Each participating insurance company will be responsible for paying out a certain amount in claims (a deductible) before federal assistance becomes available. This deductible, which was equal to approximately $201 million in 2009, is based on a percentage of commercial lines direct earned premiums for lines subject to TRIA from the prior calendar year. For losses above an insurer s deductible, the federal government will cover 85%, while the insurer contributes 15%. Although the provisions of TRIPRA will serve to mitigate our exposure in the event of a large-scale terrorist attack, our deductible is substantial.

The Parent is a holding company, and its subsidiaries may have a limited ability to declare dividends, and thus it may not have access to the cash that is needed to meet its cash needs.

Substantially all of the Parent s operations are conducted through its subsidiaries. Restrictions on the ability of its subsidiaries, particularly the Insurance Subsidiaries, to pay dividends or make other cash payments to the Parent may materially affect its ability to pay principal and interest on our indebtedness and dividends on its common stock. Under the terms of our debt and line of credit agreements and financial solvency laws affecting insurers, the Parent s subsidiaries are permitted to incur indebtedness up to certain levels which may restrict or prohibit the making of distributions, the payment of dividends, or the making of loans by its subsidiaries to the Parent. We cannot assure that the laws and agreements governing the current and future indebtedness of the Parent s subsidiaries will permit such subsidiaries to provide the Parent with sufficient dividends or distributions to fund the Parent s cash needs. Sources of funds for the Insurance Subsidiaries primarily consist of premiums, investment income, and proceeds from sales and redemption of investments. Such funds are applied primarily to payment of claims, insurance operating expenses, income taxes and the purchase of investments, as well as dividends and other payments.

The Insurance Subsidiaries may declare and pay dividends to the Parent only if they are permitted to do so under the insurance regulations of their respective state of domicile. All of the states in which the Insurance Subsidiaries are domiciled regulate the payment of dividends. Some states, including New Jersey, require that notice is given to the relevant state insurance commissioner prior to our Insurance Subsidiary domiciled in that respective state declaring any dividends and distributions payable to the Parent. During the notice period, the state insurance commissioner may disallow all or part of the proposed dividend upon determination that: (i) the insurer s surplus is not reasonable in relation to its liabilities and adequate to its financial needs and those of the policyholders, or (ii) the insurer is otherwise in a hazardous financial condition. In addition, insurance regulators may block dividends or other payments to affiliates that would otherwise be permitted without prior approval upon determination that, because of the financial condition of the insurance subsidiary or otherwise, payment of a dividend or any other payment to an affiliate would be detrimental to an insurance subsidiary s policyholders or creditors. Selective HR may also declare and pay dividends, which are restricted by the operating needs of this entity as well as professional employer organization s licensing requirements to maintain a current ratio of at least 1:1.

We are subject to a variety of modeling risks which could have a material adverse impact on our business results.

We rely on complex financial models, such as predictive modeling, Risk Management Solutions, the ALGO risk tool and value-at-risk (VaR), which have been developed internally or by third parties to analyze historical loss costs and pricing, trends in claims severity and frequency, the occurrence of catastrophe losses, investment performance and portfolio risk. Flaws in these financial models and/or faulty assumptions used by these financial models, could lead to increased losses. For example, VaR is a method used by us to evaluate portfolio risk. VaR is a probabilistic method of measuring the potential loss in portfolio value over a given time period and for a given distribution of historical returns. Portfolio risk, as measured by VaR, is affected by four primary risk factors: asset concentration, asset volatility, asset correlation and systematic risk. While VaR models are relatively sophisticated, the quantitative market risk information generated is limited by the assumptions and parameters established in creating the related models. We believe that statistical models alone do not provide a reliable method of monitoring and controlling market risk. Therefore, such models are tools and do not substitute for the experience or judgment of senior management.

Our ability to reduce our exposure to risks depends on the availability and cost of reinsurance.

We transfer our risk exposure to other insurance and reinsurance companies through reinsurance arrangements. Through these arrangements, another insurer assumes a specified portion of our losses and loss adjustment expenses in exchange for a specified portion of the insurance policy premiums. While reinsurance agreements generally bind the reinsurance companies for the life of the business reinsured at generally fixed pricing, market conditions beyond our control determine the availability and cost of the reinsurance protection for new business. In certain circumstances, the price of reinsurance for business already reinsured may also increase. The availability, amount and cost of reinsurance depend on market conditions, which may vary significantly. Any decrease in the amount of our reinsurance will increase our risk of loss and any increase in the cost of reinsurance will, absent a decrease in the amount of reinsurance, reduce our earnings. Accordingly, we may be forced to incur additional expenses for reinsurance or may not be able to obtain sufficient reinsurance on acceptable terms, which could adversely affect our ability to write future business or result in the assumption of more risk with respect to those policies we issue.

In general, reinsurance does not relieve us of our direct liability to our policyholders, even when the reinsurer is liable to us. Accordingly, we bear credit risk with respect to our reinsurers. Reinsurers which we have contracted with may default in their obligations as a result of insolvency, lack of liquidity, operational failure or other reasons. We cannot provide assurance that our reinsurers will pay the reinsurance recoverables owed to us now or in the future or that they will pay these recoverables on a timely basis. For example, we maintain reinsurance relationships with certain subsidiaries of American International Group, Inc., which is currently party to a securities lending agreement with the Federal Reserve and was also given a line of credit by the Federal Reserve in order to meet its liquidity needs. Due to the uncertainty associated with casualty business, current reinsurance recoverables are subject to the credit risk of the reinsurers. The inability of any of our reinsurers to meet their financial obligations could materially and adversely affect our operations, as we remain primarily liable to our customers under the policies that we have insured.

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We depend on independent insurance agents and other third party service providers.

We market and sell our insurance products through independent, non-exclusive insurance agencies and brokers. Agents and brokers are not obligated to promote our insurance products, and they may also sell the insurance products of our competitors. As a result, our business depends in part on the marketing and sales efforts of these agencies and brokers. As we diversify and expand our business geographically, we may need to expand our network of agencies and brokers to successfully market our products. If these agencies and brokers fail to market our products successfully, our business may be adversely impacted. Also, independent agents may decide to sell their businesses to banks, other insurance agencies, or other businesses. Agents with our appointment may decide to buy other agents. Changes in ownership of agencies or expansion of agencies through acquisition could adversely affect an agency s ability to control growth and profitability, thereby adversely affecting our business.

In addition to independent insurance agents, we also rely on third party service providers to conduct a portion of our premium audits, safety management services, and claims adjusting services. HR Outsourcing relies on third party service providers for products such as health coverage, flexible spending accounts, and 401(k) savings plans. If these third party service providers fail to perform their respective services and/or fail to provide their products successfully and/or accurately, our business may be adversely impacted.

We are heavily regulated in the states in which we operate and changes in regulation may reduce our profitability and limit our growth.

We are subject to extensive supervision and regulation in the states in which the Insurance Subsidiaries transact insurance business. The primary purpose of insurance regulation is to protect individual policyholders and not stockholders or other investors. Our business can be adversely affected by regulations affecting property and casualty insurance companies. For example, laws and regulations can lead to mandated reductions in rates to levels that we do not believe are adequate for the risks we insure. Other laws and regulations limit our ability to cancel or refuse to renew certain policies and require us to offer coverage to all consumers. Changes in laws and regulations, or their interpretations, pertaining to insurance may also have an impact on our business. Our concentration of business may expose us to increased risks of regulatory matters in the states in which the Insurance Subsidiaries write insurance that could be greater than the risks we could be exposed to by transacting business in a greater number of geographic markets.

Although the insurance industry is primarily regulated by individual states and the U.S. federal government does not directly regulate the business of insurance, federal initiatives, such as the NFIP, the proposed National Insurance Act of 2007 (which would permit an optional federal charter for insurers), the proposed Free Choice Act (which would make it easier for workers to unionize), the Office of Foreign Assets Control, financial services regulation, privacy regulation and tort reform regulation can also impact the insurance industry and our company. Proposals intended to control the cost and availability of healthcare services have been debated in the U.S. Congress and state legislatures. Although we neither write health insurance nor assume any healthcare risk, rules affecting healthcare services can affect workers compensation, commercial and personal automobile, liability, and other insurance that we do write. We cannot determine whether, or in what form, healthcare reform legislation may be adopted by the U.S. Congress or any state legislature or what effect, if any, such adoption would have on us as an insurer or as an employer. In addition, in view of recent events involving certain financial institutions, it is possible that the U.S. federal government will heighten its oversight of insurers such as us, including possibly through a federal system of insurance regulation. Proposals to create such a federal regulatory system for property and casualty insurers continue to be considered. We cannot predict whether these or other proposals will be adopted, or what impact, if any, such proposals or, if enacted, such laws, could have on our business, financial condition or results of operations.

State laws in the U.S. grant insurance regulatory authorities broad administrative powers with respect to, among other things:

- Insurer solvency standards;
- Insurer and agent licensing;
- Investment restrictions;

Payment of dividends and distributions;

Provisions for current losses and future liabilities;

Deposit of securities for the benefit of policyholders;

Restrictions on policy terminations;

Unfair trade practices; and

Approval of premium rates and policy forms.

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Further specific examples of insurance regulatory risks include:

Automobile Insurance Regulation

In 1998, New Jersey instituted an Urban Enterprise Zone (UEZ) Program, which requires New Jersey auto insurers to have a market share in certain urban territories that is in proportion to their statewide market share. Due to mandated urban rate caps, the premiums on these UEZ policies are typically insufficient to cover losses. Although the law that imposed these urban rate caps was repealed in 1998, the caps continue to be enforced by the New Jersey Department of Banking and Insurance (NJDOBI). In an effort to mitigate this rate inadequacy, the NJDOBI implemented a new territorial rating structure in 2008.

From time to time, legislative proposals are passed and judicial decisions are rendered related to automobile insurance regulation that could adversely affect our results of operations. For example, in 2005 a New Jersey Supreme Court decision eliminated the application of the serious life impact standard to personal automobile bodily injury liability cases under the verbal tort threshold of New Jersey s AICRA. This decision allows claimants to file lawsuits for non-economic damages without proving that the injuries sustained had a serious impact on their lives.

Workers Compensation Insurance Regulation

Because we voluntarily write workers compensation insurance, we are required by state law to support the involuntary market. Insurance companies that underwrite voluntary workers compensation insurance can either directly write involuntary coverage, which is assigned by state regulatory authorities, or participate in a sharing arrangement, where the business is written by a servicing carrier and the profits or losses of that serviced business are shared among the participating insurers. We currently participate through a sharing arrangement in all states. State laws regulate not only the amounts and types of workers compensation benefits that must be paid to injured workers, but in some instances the premium rates that may be charged by us to insure businesses for those liabilities. For example, in approximately 16 states, workers compensation insurance rates are set by the state insurance regulators and are adjusted periodically. Historically, monoline workers compensation business has been unprofitable whether written directly or handled through a sharing arrangement. Additionally, we are required to provide workers compensation benefits for losses arising from acts of terrorism under our workers compensation policies. The impact of any terrorist act is unpredictable, and the ultimate impact on us will depend upon the nature, extent, location, and timing of such an act. Any such impact on us could be material.

Homeowners Insurance Regulation

We are subject to regulatory provisions that are designed to address potential availability and/or affordability problems in the homeowners property insurance marketplace. Involuntary market mechanisms, such as the New Jersey Insurance Underwriting Association (New Jersey FAIR Plan), generally result in assessments against the Insurance Subsidiaries. The New Jersey FAIR Plan writes fire and extended coverage on homeowners for those individuals unable to secure insurance elsewhere. Insurance companies who voluntarily write homeowners insurance in New Jersey are assessed a portion of any deficit from the New Jersey FAIR Plan based on their share of the voluntary market. Similar involuntary plans exist in most other states where we operate.

Certain coastal states have instituted, or are considering adopting, legislation or regulation to maintain or increase the availability of property insurance, particularly homeowners insurance, in those states. As an example, certain states, including certain states in which the Insurance Subsidiaries transact homeowners insurance business, are considering legislation requiring that insurers that write homeowners insurance in any geographic area of a state must write homeowners insurance in all geographic areas of that state. We cannot predict whether any such legislation or regulation will be enacted, and the ultimate impact on us will depend upon the specifics of the legislation or regulation and the state or states that adopt any such legislation or regulation.

Credit Scoring Regulation

We use certain aspects of credit scores when evaluating individual risks. In June 2007, the U.S. Supreme Court interpreted the Fair Credit Reporting Act (FCRA) concerning the meaning of the term adverse action as it relates to an insurance carrier s use of credit scoring when it quotes premium for a personal lines applicant or raises premium for an existing personal lines insured. This interpretation requires insurance carriers to notify policyholders and applicants when their credit reports are the basis for adverse action, such as a rate increase. An adverse action notification, according to the interpretation, would be required if a quoted rate is higher than it would have been in a credit neutral comparison, which compares the credit score based-rate against a credit score neutral-rate. The interpretation does not require an insurance carrier to inform all policyholders that their credit reports have been reviewed in the underwriting process or that the rate they have received is higher than the best possible rate of the carrier.

In 2008, the Federal Trade Commission (FTC) asked nine of the largest homeowners insurance companies to provide information it says will allow it to determine how consumer credit data is used by the companies in underwriting and rate setting. In addition, legislation was introduced that would amend the FCRA to prohibit personal lines property casualty insurers from utilizing credit information to underwrite a personal lines policy if the FTC study concludes that insurers use of credit information in underwriting results in racial or ethnic discrimination or represents a proxy or proxy effect for race or ethnicity.

Changes to regulation regarding the use of credit scores at either the federal or state level may impact the way in which we price business and/or notify policyholders or applicants of adverse actions resulting from the use of these scores. However, the impact of such a change would apply similarly to all market participants that currently utilize credit scores.

Regulation and Legislation of Agent Compensation

The Insurance Subsidiaries sell insurance products and services primarily through appointed independent insurance agents. Accordingly, we seek to compensate our agents consistent with market practices and pay commissions and other consideration for business agents place with the Insurance Subsidiaries. We disclose our compensation practices in notices to all policyholders and on our public website, while referring all specific questions about agent compensation to the agent that placed the business with us.

At present, we believe our agent compensation practices and disclosures meet current legal and regulatory requirements. In recent years, however, certain state attorney generals have investigated various alleged anticompetitive practices engaged in by several insurance brokers and national insurance companies that compete with us. Some of these investigations, mainly related to insureds that are much larger than our target customers, have resulted in consent orders under which brokers and several of our competitors have left uncontested the attorney general s allegations that some of their compensation arrangements may have caused certain brokers to clandestinely steer clients to specific insurers without sufficient disclosure to the client. The consent orders also have, to one degree or another, banned the use of such compensation arrangements by the offending brokers and insurers in several, but not all, lines of business.

Given the regulatory scrutiny of compensation arrangements with brokers to date, it is possible that compensation arrangements between insurers and independent agents will come under further review and will be the subject of public policy debate and possible legislative reform. We monitor these developments but cannot determine the nature or effect, if any, that such a public policy debate or possible legislative reform will have on our agent compensation practices or business.

Reinsurance Regulation

Florida, a state in which we do not write homeowners insurance or private passenger automobile insurance, passed legislation in 2008: (i) changing the funding and operation of the Florida state-sponsored insurer of last resort, Citizens Property Insurance Corporation, and the Florida Hurricane Catastrophe Fund (FHCF), which is the Florida state-sponsored reinsurance facility; and (ii) prohibiting residential property insurers from including in rate calculations the additional costs of private reinsurance or loss exposure that duplicates FHCF coverage. In the short-term, such legislative action may increase overall private property reinsurance availability and reduce our costs outside of Florida. Should other states in which we write business enact similar legislation, it is possible that we may not be able to include the costs of reinsurance that we deem appropriate in our rates. In such an event, we may be forced, if permitted under applicable law, to exit certain markets. If not permitted to exit such markets, we may face unfair competitive situations, where state-sponsored insurers implement rate freezes or decreases.

We face risks as a servicing carrier in the WYO Program of the U.S. government s NFIP.

We are a servicing carrier in the WYO program of the NFIP. Flood insurance is offered through the NFIP, which is managed by the Mitigation Division of FEMA under the U.S. Department of Homeland Security. On September 30, 2008, a law was passed to extend the NFIP authority to issue new policies, increase coverage on existing policies, and issue renewal policies until March 6, 2009. The NFIP currently has borrowing authority established by Congress in the amount of $20.8 billion and, prior to Hurricane Ike in the third quarter of 2008, had borrowed $17.3 billion from the U.S. Treasury. FEMA is currently seeking additional borrowings from the U.S. Treasury as the current limitation is expected to only last into the first quarter of 2010. We continue to monitor developments with the NFIP.

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As a servicing carrier in the WYO program we receive an expense allowance, or servicing fee, for policies written and claims serviced under the WYO program. Effective June 1, 2008, the NFIP revised their claim servicing fee structure to provide for fees of 1% of direct premiums written, which are paid even in non-catastrophe years, coupled with fees equal to 1.5% of all incurred losses. Prior to June 1, 2008, we received claims handling fees equal to 3.3% of all incurred losses. Effective October 1, 2008, the expense allowance for servicing policies written was increased 0.1% to 29.8%. Any future changes to the fee structure or the expenses incurred by us to adhere to additional regulatory requirements of the WYO program could have an adverse effect on our operations.

While currently there are no active bills in Congress reforming the NFIP, we do expect to see legislative activity in 2009. It is possible that this federal program could be modified in an unfavorable manner having an adverse effect on our flood results, potentially affecting our continued participation in the program.

Changes in tax laws impacting marginal tax rates and/or the preferred tax treatment of municipal obligations could adversely impact our business.

Tax legislation which changes the tax preference of municipal obligations under current law could adversely affect the market value of municipal obligations. At December 31, 2008, 48% of our investment portfolio was invested in tax-exempt municipal obligations; as such, the value of our investment portfolio could be adversely affected by any such legislation. Additionally, any such changes in tax law could reduce the difference between tax-exempt interest rates and taxable rates.

Class action litigation could affect our business practices and financial results.

Our industries have been the target of class action litigation in areas including the following:

- After-market parts;
- Urban homeowner insurance underwriting practices;
- Credit scoring and predictive modeling pricing;
- Investment disclosure;
- Health maintenance organization practices;
- Discounting and payment of personal injury protection claims; and
- Shareholder class action suits.

A change in our market share in New Jersey could adversely impact the results of our private passenger automobile business.

New Jersey insurance regulations require New Jersey auto insurers to involuntarily write private passenger automobile insurance for individuals who are unable to obtain insurance in the voluntary market. These policies are priced according to a separate rating scheme that is established by the assigned risk plan and subject to approval by NJDOBI. The amount of involuntary insurance an insurer must write in New Jersey depends on the insurer s statewide market share the greater the market share, the more involuntary coverage the insurer is required to write. The underwriting of involuntary personal automobile insurance in New Jersey has been historically unprofitable. In addition to the assigned risk plan in New Jersey, there are ongoing attempts to address rate disparities between different geographic regions in the state, as well as judicial attempts to address limitations of lawsuits. In 2008, the NJDOBI implemented a new territorial rating structure to, in part, address the historical geographic subsidization. If our market share in New Jersey increases it could adversely impact the results of our private passenger automobile business if we are required to write more involuntary coverage.

We depend on key personnel.

To a large extent, the success of our businesses is dependent on our ability to attract and retain key employees, in particular our senior officers, key management, sales, information systems, underwriting, claims, HR Outsourcing, and corporate personnel. Competition to attract and retain key personnel is intense. While we have employment agreements with a number of key managers, we generally do not have employment contracts with our employees and cannot ensure that we will be able to attract and retain key personnel. In addition, our workforce is older, with an average age of 45 as of December 31, 2008. Approximately 18% of our workforce as of December 31, 2008 was retirement eligible under our retirement and benefit plans.

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We face risks from technology-related failures.

Our businesses are increasingly dependent on computer and Internet-enabled technology. Our inability to anticipate or manage problems with technology associated with scalability, security, functionality, or reliability could adversely affect our ability to write business and service accounts, and could adversely impact our results of operations and financial condition.

We face risks in the HR Outsourcing business.

Selective HR is affected by numerous federal and state laws and regulations relating to employment matters, benefits plans, and taxes. In performing services for its clients, Selective HR assumes some obligations of an employer under these laws and regulations. Regulation in HR Outsourcing is constantly evolving, which could result in the modification of laws and regulations from time to time. We cannot predict what additional government initiatives, if any, affecting Selective HR may be promulgated in the future. Consequently, we also cannot predict whether Selective HR will be able to adapt to new or modified regulatory requirements or obtain necessary licenses and government approvals.

The severe downturn in the U.S. economy has particularly affected small businesses, which are the core of Selective HR s customer base. Selective HR enters into agreements with these small businesses to establish a three-party relationship under which Selective HR and the small business are co-employers of the employees who work at the small business location (worksite employees). As these small businesses continue to feel the strain of liquidity issues, they may: (i) bring in-house the services that Selective HR provides to them; (ii) reduce their payrolls; or (iii) cease to continue their operations all together. The loss of these worksite employees will adversely affect Selective HR s revenues. Furthermore, since Selective HR is considered the co-employer of their clients employees, the rising unemployment rates in the U.S. will cause deterioration on Selective HR s SUTA margins. This rise in unemployment rates, coupled with anticipated extensions of unemployment benefits, could put pressure on many states unemployment funds and is anticipated to result in future SUTA rate increases. We are unable to predict the likely duration and severity of the current disruptions in financial markets and adverse economic conditions in the U.S.

We employ anti-takeover measures that may discourage potential acquirers and could adversely affect the value of the Parent common stock.

The Parent owns all of the shares of stock of the Insurance Subsidiaries. State insurance laws require prior approval by state insurance departments of any acquisition or control of a domestic insurance company or of any company that controls a domestic insurance company. Any purchase of 10% or more of the Parent s outstanding common stock would require prior action by all or some of the insurance commissioners of the Insurance Subsidiaries states of domicile.

Other factors also may discourage, delay, or prevent a change of control of us, including, among others, provisions in our certificate of incorporation (as amended), relating to:

- Supermajority voting and fair price to our business combinations;
- Supermajority voting requirements to amend the foregoing provisions; and
- The ability of the Board to issue blank check preferred stock.

The New Jersey Shareholders Protection Act provides that we, as a New Jersey corporation, may not engage in business combinations specified in the statute with a shareholder having indirect or direct beneficial ownership of 10% or more of the voting power of the Parent s outstanding stock (an interested shareholder) for a period of five years following the date on which the shareholder became an interested shareholder, unless the business combination is approved by the board of the corporation before the date the shareholder became an interested shareholder. In addition, we may not engage at any time in any business combination with any interested shareholder other than: (i) a business combination approved by the Board prior to the shareholder becoming an interested shareholder; (ii) a business combination approved by two-thirds of our shareholders (other than the interested shareholder); or (iii) a business combination that satisfies certain price criteria. These provisions also could have the effect of depriving our stockholders of an opportunity to receive a premium over the prevailing market price if a hostile takeover were attempted and may adversely affect the value of the Parent s common stock.

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Item 1B. Unresolved Staff Comments

None.

Item 2. Properties.

Our main office is located in Branchville, New Jersey, on a site owned by a subsidiary with approximately 114 acres and 315,000 square feet of operational space. We lease all of our other facilities. The principal office locations related to our three business segments are described in the Field Strategy, Investments Segment, and HR Outsourcing sections of Item 1. Business. We believe our facilities provide adequate space for our present needs and that additional space, if needed, would be available on reasonable terms.

Item 3. Legal Proceedings.

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

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

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

No matters were submitted to a vote of security holders, through the solicitation of proxies or otherwise, during the fourth quarter of 2008.

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PART II

Item 5. Market For Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

(a) Market Information

The Parent s common stock is traded on the NASDAQ Global Select Market under the symbol SIGI. The following table sets forth the high and low sales prices, as reported on the NASDAQ Global Select Market, for the Parent s common stock for each full quarterly period within the two most recent fiscal years:

	2008		2007	
	High	**Low**	High	Low
First Quarter	**$ 27.03**	**20.78**	29.07	23.25
Second Quarter	**26.22**	**18.74**	27.87	25.27
Third Quarter	**30.40**	**17.81**	27.33	19.04
Fourth Quarter	**26.49**	**16.33**	25.41	20.84

On February 20, 2009, the closing price of the Parent s common stock as reported on the NASDAQ Global Select Market was $12.67.

(b) Holders

As of February 13, 2009, there were approximately 2,555 holders of record of the Parent s common stock, including beneficial holders whose securities were held in the name of the registered clearing agency or its nominee.

(c) Dividends

Dividends on shares of the Parent s common stock are declared and paid at the discretion of the Board based on our operating results, financial condition, capital requirements, contractual restrictions, and other relevant factors. The following table provides information on the dividends declared for each quarterly period within our two most recent fiscal years:

Dividend per share	**2008**	2007
First Quarter	**$ 0.13**	$ 0.12
Second Quarter	**0.13**	0.12
Third Quarter	**0.13**	0.12
Fourth Quarter	**0.13**	0.13

Our ability to declare dividends is restricted by covenants contained in our 8.87% senior notes that we issued on May 4, 2000. See Note 9 to the consolidated financial statements entitled, Indebtedness. All such covenants were met during 2008 and 2007. At December 31, 2008, the amount available for dividends to holders of our common shares under such restrictions was $302.6 million for the 8.87% Senior Notes.

Our ability to receive dividends, loans, or advances from the Insurance Subsidiaries is subject to the approval and/or review of the insurance regulators in the respective domiciliary states of the Insurance Subsidiaries. Such approval and review is made under the respective domiciliary states insurance holding company acts, which generally require that any transaction between related companies be fair and equitable to the insurance company and its policyholders. Although our dividends have historically been met with regulatory approval, there is no assurance that future dividends will be approved given current market conditions. We currently expect to continue to pay quarterly cash dividends on shares of the Parent s common stock in the future.

(d) Securities Authorized for Issuance Under Equity Compensation Plans

The following table provides information about the Parent s common stock authorized for issuance under equity compensation plans as of December 31, 2008:

	(a)	**(c) Number of**

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights		(b) Weighted-average exercise price of outstanding options, warrants and rights	securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	1,158,847	$	18.73	5,041,512[1]

[1] Includes 116,873 shares available for issuance under the Employee Stock Purchase Savings Plan, 2,641,471 shares available for issuance under the Stock Purchase Plan for Independent Insurance Agencies, and 2,283,168 shares available for issuance under the 2005 Omnibus Stock Plan. Future grants under this plan can be made, among other things, as stock options, restricted stock units, or restricted stock.

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(e) Performance Graph

The following chart, produced by Research Data Group, Inc., depicts our performance for the period beginning December 31, 2003 and ending December 31, 2008, as measured by total stockholder return on the Parent s common stock compared with the total return of the NASDAQ Composite Index and a select group of peer companies comprised of NASDAQ-listed companies in SIC Code 6330-6339, Fire, Marine, and Casualty Insurance.

Notwithstanding anything to the contrary set forth in any of our previous filings under the Securities Act of 1933 or the Exchange Act that might incorporate future filings made by us under those statutes, the preceding performance graph will not be incorporated by reference into any of those prior filings, nor will such graph be incorporated by reference into any future filings made by us under those statutes except to the extent we specifically incorporate it by reference into any of such filings.

(f) Purchases of Equity Securities by the Issuer and Affiliated Purchasers

The following table provides information regarding our purchase of the Parent s common stock in the fourth quarter of 2008:

Period	Total Number of Shares Purchased[1]	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs[2]	Maximum Number of Shares that May Yet Be Purchased Under the Announced Plans or Programs[2]
October 1-31, 2008	46,429	$ 23.46		1,748,766
November 1-30, 2008	1,180	21.04		1,748,766
December 1-31, 2008	12,375	21.76		1,748,766
Total	59,984	$ 23.06		1,748,766

1 During the fourth quarter of 2008, 52,836 shares were purchased from employees in connection with the vesting of restricted stock and 7,148 shares were purchased from employees in connection with stock option exercises. These repurchases were made in connection with

satisfying tax withholding obligations with respect to those employees. These shares were not purchased as part of the publicly announced program. The shares that were purchased in connection with the vesting of restricted stock were purchased at the closing price on the dates of purchase. The shares purchased in connection with the option exercises were purchased at the current market prices of the Parent s common stock on the dates of the options were exercised.

2 On July 24, 2007, the Board authorized a share repurchase program for up to 4 million shares, which expires on July 26, 2009. During the fourth quarter of 2008, no shares were repurchased, leaving

1,748,766 shares remaining to be purchased under the authorized program.

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Item 6. Selected Financial Data.

Eleven-Year Financial Highlights[1]

(All presentations are in accordance with GAAP unless noted otherwise, number of weighted average shares and dollars in thousands, except per share amounts)	**2008**	2007	2006	2005	2004
Net premiums written	**$ 1,484,041**	1,554,867	1,535,961	1,459,474	1,365,148
Net premiums earned	**1,495,490**	1,517,306	1,499,664	1,418,013	1,318,390
Net investment income earned	**131,032**	174,144	156,802	135,950	120,540
Net realized (losses) gains	**(49,452)**	33,354	35,479	14,464	24,587
Diversified Insurance Services revenue from continuing operations[2,3]	**116,346**	115,566	110,526	98,711	86,484
Total revenues	**1,695,979**	1,846,228	1,807,867	1,671,012	1,553,624
Underwriting (loss) profit	**(15,226)**	15,957	57,978	69,728	40,768
Diversified Insurance Services income (loss) from continuing operations[2,3]	**14,527**	18,623	17,808	14,793	11,921
Net income from continuing operations[3]	**43,758**	146,498	163,574	147,452	127,177
Total discontinued operations, net of tax[3]				546	1,462
Cumulative effect of change in account principle, net of tax				495	
Net income	**43,758**	146,498	163,574	148,493	128,639
Comprehensive (loss) income	**(136,741)**	131,940	159,802	112,078	134,723
Total assets	**4,941,332**	5,001,992	4,767,705	4,375,625	3,912,411
Notes payable and debentures[6]	**273,878**	295,067	362,602	339,409	264,350
Stockholders equity	**890,493**	1,076,043	1,077,227	981,124	882,018
Statutory premiums to surplus ratio[4]	**1.7**	1.5	1.5	1.6	1.7
Statutory combined ratio[2,5]	**99.2**	97.5	95.4	94.6	95.9
Combined ratio[2,5]	**101.0**	98.9	96.1	95.1	96.9
Yield on investment, before-tax	**3.6**	4.8	4.6	4.6	4.7
Debt to capitalization	**23.5**	21.5	25.2	25.7	23.1
Return on average equity	**4.5**	13.6	15.9	15.9	15.8
Per share data:					
Net income from continuing operations[3]:					
Basic	**$ 0.84**	2.80	2.98	2.72	2.38
Diluted	**0.82**	2.59	2.65	2.33	2.01
Net income:					
Basic	**$ 0.84**	2.80	2.98	2.74	2.41
Diluted	**0.82**	2.59	2.65	2.35	2.04
Dividends to stockholders	**$ 0.52**	0.49	0.44	0.40	0.35
Stockholders equity	**$ 16.84**	19.81	18.81	17.34	15.79
Price range of Common Stock:					
High	**$ 30.40**	29.07	29.18	29.64	22.98
Low	**16.33**	19.04	24.89	20.88	15.86

Close	**22.93**	22.99	28.65	26.55	22.12
Number of weighted average shares:					
Basic	**52,104**	52,382	54,986	54,342	53,462
Diluted	**53,319**	57,165	62,542	64,708	64,756

1 See the Glossary of Terms attached to this Form 10-K as Exhibit 99.1.

2 Flood business is included in statutory underwriting results in accordance with prescribed statutory accounting practices. On a GAAP basis only, flood servicing revenue and expense has been reclassified from underwriting results to Diversified Insurance Services.

3 See Item 8. Financial Statements and Supplementary Data, Note 12 to the consolidated financial statements for the components of of income. In 2002, we sold our ownership interest in PDA Software Services, Inc.

and in 2005, we sold our ownership interest in CHN Solutions (Alta Services, LLC and Consumer Health Network Plus, LLC), both of which had historically been reported as components of the Diversified Insurance Services segment.

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2003	2002	2001	2000	1999	1998
1,219,159	1,053,487	925,420	843,604	811,677	748,873
1,133,070	988,268	883,048	821,265	799,065	722,992
114,748	103,067	96,767	99,495	96,531	99,196
12,842	3,294	6,816	4,191	29,377	(2,139)
70,780	59,399	51,783	43,463	22,554	8,562
1,335,056	1,157,553	1,041,177	972,153	950,669	831,791
(25,252)	(38,743)	(60,638)	(65,122)	(54,147)	(24,986)
6,194	3,103	(3,819)	2,112	4,257	1,765
64,375	40,310	24,112	24,487	53,483	53,277
1,969	1,659	1,581	2,048	234	293
66,344	41,969	25,693	26,535	53,717	53,570
99,362	59,366	24,405	49,166	16,088	78,842
3,423,925	3,016,335	2,673,721	2,590,903	2,507,545	2,432,168
238,621	262,768	156,433	163,634	81,585	88,791
749,784	652,102	591,160	577,797	569,964	607,583
1.8	1.9	1.8	1.7	1.6	1.5
101.5	103.2	106.7	108.2	105.7	103.2
102.2	103.9	106.9	107.9	106.8	103.6
5.1	5.4	5.4	5.8	5.6	5.7
24.1	28.7	21.0	22.1	12.5	13.2
9.5	6.8	4.4	4.6	9.1	9.1
1.23	0.80	0.50	0.50	0.99	0.94
1.07	0.74	0.46	0.47	0.93	0.87
1.27	0.83	0.53	0.54	0.99	0.94
1.10	0.77	0.49	0.51	0.94	0.87
0.31	0.30	0.30	0.30	0.30	0.28
13.74	12.26	11.58	11.46	10.73	10.65
16.50	15.74	14.11	12.94	11.25	14.63
10.91	9.68	9.97	7.32	8.25	8.35

16.18	12.59	10.87	12.13	8.60	10.07
52,262	50,602	49,166	49,814	54,162	56,960
63,206	55,990	52,848	53,144	57,754	60,824

4 Regulatory and rating agencies use the statutory premiums to surplus ratio as a measure of solvency, viewing an increase in the ratio as a possible increase in solvency risk. Management and analysts also view this ratio as a measure of the effective use of capital because, as the ratio increases, revenue per dollar of capital increases, indicating the possibility of increased returns or increased losses due to the effects of leverage.

5 Changes in both the GAAP and statutory combined ratios are viewed by management and analysts as indicative of changes in the profitability of underwriting

operations. A ratio over 100% is indicative of an underwriting loss, and a ratio below 100% is indicative of an underwriting profit.

6 See Item 8. Financial Statements and Supplementary Data, Note 9 to the consolidated financial statements for a discussion of notes payable and debentures.

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

Forward-looking Statements

Certain statements in this report, including information incorporated by reference, are forward-looking statements as that term is defined in the Private Securities Litigation Reform Act of 1995 (PSLRA). The PSLRA provides a safe harbor under the Securities Act of 1933 and the Exchange Act for forward-looking statements. These statements relate to our intentions, beliefs, projections, estimations or forecasts of future events or future financial performance and involve known and unknown risks, uncertainties and other factors that may cause us or the industry s actual results, levels of activity, or performance to be materially different from those expressed or implied by the forward-looking statements. In some cases, forward-looking statements may be identified by use of words such as may, will, could, would, should, expect, plan, anticipate, target, project, intend, believe, estimate, predict, pote likely or continue or other comparable terminology. These statements are only predictions, and we can give no assurance that such expectations will prove to be correct. We undertake no obligation, other than as may be required under the federal securities laws, to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Factors that could cause our actual results to differ materially from those we have projected, forecasted or estimated in forward-looking statements are discussed in further detail in Item 1A. Risk Factors. These risk factors may not be exhaustive. We operate in a continually changing business environment, and new risk factors emerge from time to time. We can neither predict such new risk factors nor can we assess the impact, if any, of such new risk factors on our businesses or the extent to which any factor or combination of factors may cause actual results to differ materially from those expressed or implied in any forward-looking statements in this report. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this report might not occur.

Introduction

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

The purpose of the Management s Discussion and Analysis (MD&A) is to provide an understanding of the consolidated results of operations and financial condition and known trends and uncertainties that may have a material impact in future periods.

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

- Critical Accounting Policies and Estimates;
- Financial Highlights of Results for years ended December 31, 2008, 2007, and 2006;
- Results of Operations and Related Information by Segment;
- Federal Income Taxes;
- Financial Condition, Liquidity, and Capital Resources;
- Off-Balance Sheet Arrangements;
- Contractual Obligations and Contingent Liabilities and Commitments; and
- Adoption of Accounting Pronouncements.

Critical Accounting Policies and Estimates

We have identified the policies and estimates described below as critical to our business operations and the understanding of the results of our operations. Our preparation of the Consolidated Financial Statements requires us to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of our Consolidated Financial Statements, and the reported amounts of revenue and expenses during the reporting period. There can be no assurance that actual results will not differ from those estimates. Those estimates that were most critical to the preparation of the Consolidated Financial Statements involved the following: (i) reserve for losses and loss expenses; (ii) deferred policy acquisition costs; (iii) pension and post-retirement benefit plan actuarial assumptions; (iv) OTTI; (v) goodwill; and (vi) reinsurance.

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Reserves for Losses and Loss Expenses

Significant periods of time can elapse between the occurrence of an insured loss, the reporting of the loss to the insurer, and the insurer s payment of that loss. To recognize liabilities for unpaid losses and loss expenses, insurers establish reserves as balance sheet liabilities representing estimates of amounts needed to pay reported and unreported net losses and loss expenses. As of December 31, 2008, we had accrued $2.6 billion of gross loss and loss expense reserves compared to $2.5 billion at December 31, 2007.

How reserves are established

When a claim is reported to an insurance subsidiary, claims personnel establish a case reserve for the estimated amount of the ultimate payment. The amount of the reserve is primarily based upon a case by case evaluation of the type of claim involved, the circumstances surrounding each claim, and the policy provisions relating to the type of losses. The estimate reflects the informed judgment of such personnel based on their knowledge, experience, and general insurance reserving practices. Until the claim is resolved, these estimates are revised as deemed appropriate by the responsible claims personnel based on subsequent developments and periodic reviews of the case.

In addition to case reserves, we maintain estimates of reserves for losses and loss expenses IBNR. Using generally accepted actuarial reserving techniques, we project our estimate of ultimate losses and loss expenses at each reporting date. The difference between: (i) projected ultimate loss and loss expense reserves and (ii) case loss reserves and loss expense reserves thereon are carried as the IBNR reserve. The actuarial techniques used are part of a comprehensive reserving process that includes two primary components. The first component is a detailed quarterly reserve analysis performed by our internal actuarial staff, which is managed independently from the operating units. In completing this analysis, the actuaries are required to make numerous assumptions, including, for example, the selection of loss development factors and the weight to be applied to each individual actuarial indication. These indications include paid and incurred versions for the following actuarial methodologies: loss development, Bornhuetter-Ferguson, Berquist-Sherman, and frequency/severity. Additionally, the actuaries must gather substantially similar data in sufficient volume to ensure the statistical credibility of the data. The second component of the analysis is the projection of the expected ultimate loss ratio for each line of business for the current accident year. This projection is part of our planning process wherein we review and update expected loss ratios each quarter. This review includes actual versus expected pricing changes, loss trend assumptions, and updated prior period loss ratios from the most recent quarterly reserve analysis.

In addition to the most recent loss trends, a range of possible IBNR reserves is determined annually and continually considered, among other factors, in establishing IBNR for each reporting period. Loss trends include, but are not limited to, large loss activity, environmental claim activity, large case reserve additions or reductions for prior accident years, and reinsurance recoverable issues. We also consider factors such as: (i) per claim information; (ii) company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the imposition of damages, and changes in political attitudes; and (iv) trends in general economic conditions, including the effects of inflation. Based on the consideration of the range of possible IBNR reserves, recent loss trends, uncertainty associated with actuarial assumptions and other factors, IBNR is established and the ultimate net liability for losses and loss expenses is determined. Such an assessment requires considerable judgment given that it is frequently not possible to determine whether a change in the data is an anomaly until some time after the event. Even if a change is determined to be permanent, it is not always possible to reliably determine the extent of the change until some time later. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of reserves because the eventual deficiency or redundancy is affected by many factors. The changes in these estimates, resulting from the continuous review process and the differences between estimates and ultimate payments, are reflected in the consolidated statements of income for the period in which such estimates are changed. Any changes in the liability estimate may be material to the results of operations in future periods.

Major trends by line of business creating additional loss and loss expense reserve uncertainty

The Insurance Subsidiaries are multi-state, multi-line property and casualty insurance companies and, as such, are subject to reserve uncertainty stemming from a variety of sources. These uncertainties are considered at each step in the process of establishing loss and loss expense reserves. However, as market conditions change, certain trends are identified that management believes create an additional amount of uncertainty. A discussion of recent trends, by line of business, that have been recognized by management follows:

Workers Compensation

At December 31, 2008, our workers compensation line of business recorded reserves, net of reinsurance, of $850 million, or 35% of our total recorded reserves. In addition to the uncertainties associated with actuarial assumptions and methodologies described above, the workers compensation line of business can be impacted by a variety of issues such as unexpected changes in medical cost inflation, changes in overall economic conditions and company specific initiatives. From 2005 through 2008, we experienced an unusual amount of volatility associated with our workers compensation medical costs. In 2008 overall economic conditions were extremely unstable. Finally, in the past few years the company implemented a multi-faceted workers compensation strategy which incorporated knowledge management and predictive modeling initiatives. From 2005 through 2008, we experienced an unusual amount of volatility in our prior year reserve development ranging from $42 million of adverse development in 2005 to $24 million of favorable development in 2008. Even though medical cost development returned to a more customary level in 2007 and 2008, the unusual amount of volatility over the previous few years does create additional uncertainty. In addition, potential impacts from changing economic conditions and unforeseen expected results from our company-specific strategies are potential sources of additional uncertainty in the future. If the higher than historical increases in medical costs in 2005 do not return and/or external economic conditions improve and/or our workers compensation strategies exceed our expectations, the result could be favorable development in the future. However, if higher medical trends return and/or economic conditions remain poor and/or our internal strategies are less effective than anticipated, the result could be adverse reserve development in the future.

General Liability

At December 31, 2008, our general liability line of business had recorded reserves, net of reinsurance of $891 million, which represented 37% of our total net reserves. This line of business includes excess policies which provide additional limits above underlying automobile and general liability coverages. While prior year development in recent years has been relatively minor, two recent changes in our book of business relating to excess coverage could create additional volatility in our results: (i) we have grown the number of our commercial excess policies at a greater rate than the rest of our commercial lines of business; and (ii) we have raised the net retention of our reinsurance covering these policies over the past several accident years. Both of these changes raise the average limits of losses that we retain on a net basis. While management has not identified any specific trends relating to additional reserve uncertainty, our increase in average net retention does create the potential for additional volatility in our reserves.

Commercial Automobile

At December 31, 2008, our commercial automobile line of business had recorded reserves, net of reinsurance, of $346 million, which represented 14% of our total net reserves. This line of business experienced only $0.4 million of favorable development in 2008 which is significantly less than the $19 million and $15 million it experienced in 2007 and 2006, respectively. The significant favorable prior year loss development from 2005 to 2007 was driven by a downward trend in large claims. The number of large claims has a high degree of volatility from year to year and, therefore, requires a longer period before true trends are recognized and can be acted upon. We experienced lower than expected severity in accident years 2002 through 2005 which has not continued in the most recent three accident years. While management has not identified any specific trends related to this line, the volatility of large claims does create additional uncertainty in our analysis for our most recent accident years.

General Liability and Commercial Automobile (Claims Initiatives Impact)

In addition to the line of business specific issues mentioned above, both of these lines of business have been impacted by a number of initiatives undertaken by our claims department which have resulted in the quicker development of case reserves. This change in the average level of case reserves increases the uncertainty in both the positive and negative directions in the short run, but the longer term benefit is a more refined management of the claims process.

Personal Automobile

At December 31, 2008, our personal automobile line of business had recorded reserves, net of reinsurance, of $159 million, which represented 7% of our total net reserves. The majority of this business is written in New Jersey, where the judicial and regulatory environment has been subject to significant changes over the past few decades. The most recent change occurred in June 2005, when the New Jersey Supreme Court ruled that the serious life impact standard does not apply to the AICRA limitation on lawsuit threshold. As a result of this decision, we increased reserves for this line of business by a net amount of $10 million, the majority of which was reflected in 2005 results. This recent judicial decision has increased the uncertainty surrounding our personal automobile reserves, particularly for accident years 2006 through 2008, since much of the historical information used to make assumptions has been rendered less effective as a basis for projecting future results.

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Other Lines of Business

At December 31, 2008, no other individual line of business had recorded reserves of more than $67 million, net of reinsurance. We have not identified any recent trends that would create additional significant reserve uncertainty for these other lines of business.

The following tables provide case and IBNR reserves for losses, reserves for loss expenses, and reinsurance recoverable on unpaid losses and loss expenses as of December 31, 2008 and 2007:

As of December 31, 2008 ($ in thousands)	**Case Reserves**	**Loss Reserves IBNR Reserves**	**Total**	**Loss Expense Reserves**	**Reinsurance Recoverable on Unpaid Losses and Loss Expenses**	**Net Reserves**
Commercial automobile	$ 131,038	187,804	318,842	36,868	9,351	346,359
Workers compensation	396,345	431,549	827,894	103,952	81,556	850,290
General liability	203,487	538,591	742,078	185,434	36,978	890,534
Commercial property	39,570	1,978	41,548	3,669	2,214	43,003
Business owners policies	25,988	35,309	61,297	10,073	5,256	66,114
Bonds	2,135	4,314	6,449	2,215	387	8,277
Other	719	1,323	2,042		686	1,356
Total commercial lines	799,282	1,200,868	2,000,150	342,211	136,428	2,205,933
Personal automobile	123,964	62,141	186,105	35,239	62,699	158,645
Homeowners	18,589	22,729	41,318	4,628	883	45,063
Other	13,730	15,026	28,756	2,566	24,182	7,140
Total personal lines	156,283	99,896	256,179	42,433	87,764	210,848
Total	$ 955,565	1,300,764	2,256,329	384,644	224,192	2,416,781

As of December 31, 2007 ($ in thousands)	Case Reserves	Loss Reserves IBNR Reserves	Total	Loss Expense Reserves	Reinsurance Recoverable on Unpaid Losses and Loss Expenses	Net Reserves
Commercial automobile	$ 117,299	188,294	305,593	36,236	12,255	329,574
Workers compensation	382,364	424,528	806,892	102,315	76,747	832,460
General liability	198,636	500,806	699,442	162,098	46,434	815,106
Commercial property	44,520	2,030	46,550	3,572	5,895	44,227
Business owners policies	23,469	30,967	54,436	8,604	5,281	57,759
Bonds	4,008	3,509	7,517	2,217	296	9,438
Other	907	1,601	2,508		863	1,645
Total commercial lines	771,203	1,151,735	1,922,938	315,042	147,771	2,090,209

Personal automobile	127,646	70,989	198,635	38,221	65,541	171,315
Homeowners	17,889	21,227	39,116	4,511	944	42,683
Other	7,479	14,404	21,883	2,201	13,545	10,539
Total personal lines	153,014	106,620	259,634	44,933	80,030	224,537
Total	$ 924,217	1,258,355	2,182,572	359,975	227,801	2,314,746

Range of reasonable reserves

We established a range of reasonably possible reserves for net claims of approximately $2,267 million to $2,545 million at December 31, 2008 and of $2,180 million to $2,414 million at December 31, 2007. A low and high reasonable reserve selection was derived primarily by considering the range of indications calculated using generally accepted actuarial techniques. Such techniques assume that past experience, adjusted for the effects of current developments and anticipated trends, are an appropriate basis for predicting future events. Although this range reflects likely scenarios, it is possible that the final outcomes may fall above or below these amounts. Based on internal stochastic modeling, we feel that a reasonable estimate of the likelihood that the final outcome falls within the current range is approximately 75%. This range does not include a provision for potential increases or decreases associated with environmental reserves. Our best estimate is consistent with the actuarial best estimate. We do not discount to present value that portion of our loss reserves expected to be paid in future periods; however, the loss reserves take into account anticipated recoveries for salvage and subrogation claims.

Sensitivity Analysis: Potential impact on reserve volatility due to changes in key assumptions

Our process to establish reserves includes a variety of key assumptions, including, but not limited to, the following:

- The selection of loss development factors;
- The weight to be applied to each individual actuarial indication;
- Projected future loss trend; and
- Expected ultimate loss ratios for the current accident year.

The importance of any single assumption depends on several considerations, such as the line of business and the accident year. If the actual experience emerges differently than the assumptions used in the process to establish reserves, changes in our reserve estimate are possible and may be material to the results of operations in future periods. Set forth below is a discussion of the potential impact of using certain key assumptions that differ from those used in our latest reserve analysis. It is important to note that the following discussion considers each assumption individually, without any consideration of correlation between lines of business and accident years, and therefore, does not constitute an actuarial range. While the following discussion represents possible volatility from variations in key assumptions as identified by management, there is no assurance that the future emergence of our loss experience will be consistent with either our current or alternative set of assumptions. By the very nature of the insurance business, loss development patterns have a certain amount of normal volatility.

Workers Compensation

In addition to the normal amount of volatility, medical loss development factors for workers compensation are particularly sensitive to assumptions relating to medical inflation. Actual medical loss development factors could be significantly different than those which are selected from historical loss experience if actual medical inflation is materially different than what was observed in the past. In addition, workers compensation has been the focus of a multi-faceted underwriting strategy designed to significantly reduce the loss ratio over time. The combination of the sensitivity of workers compensation results to medical inflation and changes in underwriting could lead to actual experience emerging differently than the assumptions used in the process to establish reserves. In our judgment, it is possible that actual medical loss development factors could range from 6% below to 8% above those selected in our latest reserve analysis and expected loss ratios could range from 5% below to 7% above those selected in our latest reserve analysis. The combination of reducing the assumptions for medical loss development by 6% and the expected loss ratio by 5% could decrease our indicated workers compensation reserves by approximately $58 million for accident years 2007 and prior. Alternatively, the combination of increasing the medical loss development factors by 8% and the expected loss ratio by 7% could increase our indicated workers compensation reserves by approximately $81 million for accident years 2007 and prior.

General Liability

In addition to the normal amount of volatility, general liability loss development factors have greater uncertainty due to the complexity of the coverages and the possibly significant periods of time that can elapse between the occurrence of an insured loss, the reporting of the loss to the insurer, and the insurer s payment of that loss. In our judgment, it is possible that general liability loss development factors could be +/- 6% from those actually selected in our latest reserve analysis. If the loss development assumptions were changed by +/- 6%, that would increase/decrease our indicated general liability reserves by approximately $92 million for accident years 2007 and prior.

Commercial Automobile

In addition to the normal amount of volatility, our commercial automobile line of business has realized significant favorable development in 2005 to 2007, which leveled off to a minimal amount in 2008. This favorable development was driven in large part by a reduction in our bodily injury large loss experience. The actual number of large claims has a high degree of volatility from year to year in terms of timing and ultimate final emergence. Even if ultimate large losses are ultimately consistent from year to year, if they are identified at different times than previous years, traditional loss development factors may overstate or understate actuarial indications. If the timing of large losses is significantly variable, it is our judgment that actual loss development factors could be +/- 6% different from those selected in our reserve review, which would increase/decrease our indicated commercial auto reserves by approximately $59 million for accident years 2007 and prior.

Claims Initiatives Impact on General Liability and Commercial Automobile

In addition to the line of business specific assumptions discussed above, a number of claims initiatives have increased average case reserves for both the general liability and commercial auto lines of business. This increase in case reserves causes larger differences between some indications than would normally be experienced. In our judgment, it is possible that the selections for these lines of business in our latest reserve review could increase by $57 million or decrease by $46 million depending on how various methodologies converge for these lines of business in accident years 2007 and 2008.

Personal Automobile

In addition to the normal amount of volatility, the uncertainty of personal automobile loss development factors is greater than usual due to the number of judicial and regulatory changes in the New Jersey personal automobile market over the years. In our judgment, it is possible that personal auto bodily injury loss development factors could range from 4% below those actually selected in our latest reserve analysis to 3% above those selected in our latest reserve analysis. If the loss development assumptions were reduced by 4%, that would decrease our indicated personal automobile reserves by approximately $28 million for accident years 2007 and prior. Alternatively, if the loss development factors were increased by 3%, that would increase our indicated personal automobile reserves by approximately $21 million for accident years 2007 and prior.

Current Accident Year

For the 2008 accident year, the expected ultimate loss ratio by line of business is a key assumption. This assumption is based upon a large number of inputs that are assessed periodically, such as historical loss ratios, projected future loss trend, and planned pricing amounts. In our judgment, it is possible that the actual ultimate loss ratio for the 2008 accident year could be +/-7% from the one selected in our latest reserve analysis for each of our four major long-tailed lines of business. The table below summarizes the possible impact on our reserves of varying our expected loss ratio assumption by +/-7% by line of business for the 2008 accident year.

Reserve Impact of Changing Current Year Expected Ultimate Loss Ratio Assumption

($in millions)	If Assumption Was Reduced by 7%	If Assumption Was Raised by 7%
Workers Compensation	(21)	21
General Liability	(28)	28
Commercial Automobile Liability	(17)	17
Personal Automobile Liability	(7)	7

Prior year reserve development

In light of the many uncertainties associated with establishing the estimates and making the assumptions necessary to establish reserve levels, we review our reserve estimates on a regular basis as described above and make adjustments in the period that the need for such adjustment is determined. These reviews could result in the identification of information and trends that would require us to increase some reserves and/or decrease other reserves for prior periods and could also lead to additional increases in loss and loss adjustment expense reserves, which could have a material adverse effect our results of operations, equity, business, insurer financial strength, and debt ratings. In 2008, we experienced favorable loss development in accident years 2006 and prior of $46.2 million partially offset by unfavorable loss development in accident year 2007 of $26.9 million, netting to total favorable prior year development of $19.3 million. In 2007, we experienced net favorable prior year development of $18.8 million, and in 2006, we experienced net favorable prior year development of $7.3 million. For further discussion on the prior year development in loss and loss expense reserves, see the discussion on Net Loss and Loss Expense Reserves in Item 1. Business and Note 8 of Item 8. Financial Statements and Supplementary Data of this Form 10-K.

Asbestos and Environmental Reserves

Included in our loss and loss expense reserves are amounts for environmental claims, both asbestos and non-asbestos. Carried net loss and loss expense reserves for environmental claims were $44.1 million as of December 31, 2008 and $51.4 million as of December 31, 2007. Our asbestos and non-asbestos environmental claims have arisen primarily from insured exposures in municipal government, small commercial risks, and homeowners policies. The emergence of these claims is slow and highly unpredictable. Over the past few years, we also experienced adverse development in our homeowners line of business as a result of unfavorable trends in claims for groundwater contamination caused by leakage of certain underground heating oil storage tanks in New Jersey. In addition, certain landfill sites are included on the National Priorities List (NPL) by the United States Environmental Protection Agency (USEPA). Once on the NPL, the USEPA determines an appropriate remediation plan for these sites. A landfill can remain on the NPL for many years until final approval for the removal of the site is granted from the USEPA. The USEPA also has the authority to re-open previously closed sites and return them to the NPL. We currently have reserves for several claims related to sites on the NPL. During 2008, 43 of our past and present insureds filed formal consent decrees with the New Jersey Department of Environmental Protection, resolving our largest landfill claim, which resulted in our payment of approximately $4.7 million on behalf of these insureds.

IBNR reserve estimation for environmental claims is often difficult because, in addition to other factors, there are significant uncertainties associated with critical assumptions in the estimation process, such as average clean-up costs, third-party costs, potentially responsible party shares, allocation of damages, insurer litigation costs, insurer coverage defenses, and potential changes to state and federal statutes.

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However, we are not aware of any emerging trends that could result in future reserve adjustments. Moreover, normal historically based actuarial approaches are difficult to apply because relevant history is not available. While models can be applied, such models can produce significantly different results with small changes in assumptions. As a result, we do not calculate a specific environmental loss range, as we believe it would not be meaningful.

The table below summarizes the number of asbestos and non-asbestos claims outstanding at December 31, 2008, 2007, and 2006. For additional information about our environmental reserves, see Item 1. Business, and Item 8. Financial Statements and Supplementary Data, Note 8 to the Consolidated Financial Statements.

Environmental Claims Activity

	2008	2007	2006
Asbestos Related Claims[1]			
Claims at beginning of year	**2,177**	2,273	2,089
Claims received during year	**124**	114	358
Claims closed during year[2]	**(264)**	(210)	(174)
Claims at end of year	**2,037**	2,177	2,273
Average gross loss settlement on closed claims	**$ 32**	81	914
Gross amount paid to administer closed claims	**$ 110,582**	51,868	66,710
Net survival ratio[3]	**15**	16	20
Non-Asbestos Related Claims[1]			
Claims at beginning of year	**271**	302	293
Claims received during year	**269**	108	111
Claims closed during year [2]	**(215)**	(139)	(102)
Claims at end of year	**325**	271	302
Average gross loss settlement on closed claims	**$ 14,803**	4,149	555
Gross amount paid to administer closed claims	**$ 115,562**	62,874	26,321
Net survival ratio[3]	**6**	14	9

1 The number of environmental claims includes all multiple claimants who are associated with the same site or incident.

2 Includes claims dismissed, settled, or otherwise resolved.

3 The net survival ratio was

calculated using
a three-year
average for net
losses and
expenses paid.

Deferred Policy Acquisition Costs

Policy acquisition costs, which include commissions, premium taxes, fees, and certain other costs of underwriting policies, are deferred and amortized over the same period in which the related premiums are earned. Deferred policy acquisition costs are limited to the estimated amounts recoverable after providing for losses and loss expenses that are expected to be incurred, based upon historical and current experience. Anticipated investment income is considered in determining whether a premium deficiency exists. The methods of making such estimates and establishing the deferred costs are continually reviewed, and any adjustments are made in the accounting period in which the adjustment arose. We measure the recoverability of deferred policy acquisition costs at the operating segment level. We had deferred policy acquisition costs of $212.3 million at December 31, 2008 compared to $226.4 million at December 31, 2007.

Pension and Post-retirement Benefit Plan Actuarial Assumptions

Our pension benefit and post-retirement life benefit obligations and related costs are calculated using actuarial concepts, within the framework of Statement of Financial Accounting Standards No. 87, *Employers Accounting for Pensions* (SFAS 87); and Statement of Financial Accounting Standards No. 106, *Employers Accounting for Post-retirement Benefits Other than* Pension (SFAS 106), respectively. Two key assumptions, the discount rate and the expected return on plan assets, are important elements of expense and/or liability measurement. We evaluate these key assumptions annually. Other assumptions involve demographic factors such as retirement age, mortality, turnover, and rate of compensation increases.

The discount rate enables us to state expected future cash flow as a present value on the measurement date. The guideline for setting this rate is a high-quality long-term corporate bond rate. A lower discount rate increases the present value of benefit obligations and increases pension expense. We decreased our discount rate to 6.24% for 2008, from 6.50% for 2007 to reflect market interest rate conditions. To determine the expected long-term rate of return on the plan assets, we consider the current and expected asset allocation, as well as historical and expected returns on each plan asset class. A lower expected rate of return on pension plan assets would increase pension expense. Our long-term expected return on plan assets was 8.00% in 2008 and 2007. We had a pension and post-retirement benefit plan obligation of $188.0 million at December 31, 2008 compared to $161.2 million at December 31, 2007.

Our pension assets lost approximately 20% of their value in 2008 due to the volatility in the financial markets. As a result of this, coupled with the decrease in our pension discount rate, we recorded a charge to equity of approximately $38 million, after tax, as of December 31, 2008. In 2007, we recorded an equity increase of $5.7 million, after-tax, primarily due to an increase of our pension discount rate. In 2006, in relation to our adoption of Statement of Financial Accounting Standards No. 158, *Employers Accounting for Defined Benefit Pension and Other Post-retirement Plans An amendment to FASB Statements No. 87, 88, 106, and 132(r)*, we recorded a charge to equity of $13.7 million, after-tax, representing the recognition of the funded status of our plans. Changes in the related pension and post-retirement benefit expense may occur in the future due to changes in these assumptions.

For additional information regarding our pension and post-retirement benefit plan obligations, see Item 8. Financial Statements and Supplementary Data, Note 15(d) of this Form 10-K.

Other-Than-Temporary Investment Impairments

An investment in a fixed maturity, equity security or an other investment (i.e., an alternative investment), is impaired if its fair value falls below its book value and the decline is considered to be other than temporary. We regularly review our entire investment portfolio for declines in fair value. If we believe that a decline in the value of a particular investment is temporary, we record the decline as an unrealized loss in accumulated other comprehensive income. If we believe the decline is other than temporary, we write down the carrying value of the investment and record a realized loss in our Consolidated Statements of Income. Our assessment of a decline in fair value includes judgment as to the financial position and future prospects of the entity that issued the investment security. Broad changes in the overall market or interest rate environment generally will not lead to a write-down provided that we have the ability and intent to hold such a security to maturity.

Our evaluation for OTTI of a fixed maturity security or a short-term investment includes, but is not limited to, the evaluation of the following factors:

- Whether the decline appears to be issuer or industry specific;
- The degree to which an issuer is current or in arrears in making principal and interest payments on the fixed maturity security;
- The issuer s current financial condition and ability to make future scheduled principal and interest payments on a timely basis;
- Stress testing of projected cash flows under various economic and default scenarios.
- Buy/hold/sell recommendations published by outside investment advisors and analysts;
- Relevant rating history, analysis and guidance provided by rating agencies and analysts; and
- Our ability and intent to hold a security to maturity given interest rate fluctuations.

We perform impairment assessments for the structured securities included in our fixed maturity portfolio (including, but not limited to, commercial mortgaged-backed securities (CMBS), residential mortgaged-backed securities (RMBS), asset-backed securities (ABS), and collateralized debt obligations (CDOs)), comprising an evaluation of the underlying collateral of these structured securities. This assessment, although considering the length of time for which the security has been in an unrealized loss position, focuses on the performance of the underlying collateral under various economic and default scenarios which may involve subjective judgments and estimates determined by management. Considering various factors in our modeling of these structured securities, such as projected default rates, the nature and realizable value of the collateral, the ability of the security to make scheduled payments, historical performance and other relevant economic and performance factors, we determine if an impairment is other than temporary in circumstances where our projection of losses extends into the tranche of the security in which we are invested.

Our evaluation for OTTI of an equity security, includes, but is not limited to, the evaluation of the following factors:

Whether the decline appears to be issuer or industry specific;

The relationship of market prices per share to book value per share at the date of acquisition and date of evaluation;

The price-earnings ratio at the time of acquisition and date of evaluation;

The financial condition and near-term prospects of the issuer, including any specific events that may influence the issuer s operations;

The recent income or loss of the issuer;

The independent auditors report on the issuer s recent financial statements;

The dividend policy of the issuer at the date of acquisition and the date of evaluation;

Any buy/hold/sell recommendations or price projections published by outside investment advisors;

Any rating agency announcements; and

The length of time and the extent to which the fair value has been less than the carrying value.

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Our evaluation for OTTI of an other investment (i.e., an alternative investment) includes, but is not limited to, conversations with the management of the alternative investment concerning the following:

- The current investment strategy;
- Changes made or future changes to be made to the investment strategy;
- Emerging issues that may affect the success of the strategy; and
- The appropriateness of the valuation methodology used regarding the underlying investments.

In 2008, we recorded a pre-tax impairment charge of $53.1 million for investments that we concluded were impaired for other-than-temporary declines in fair value. This charge was comprised of $41.7 million related to our fixed maturity securities, $6.6 million related to our equity securities, and $4.8 million related to our alternative investments. We recorded a pre-tax impairment charge of $4.9 million in 2007 and had no impairment charges during 2006. For further information regarding the impairment charges, see the section entitled Investments in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations. of this Form 10-K.

Goodwill

Goodwill results from business acquisitions where the cost of assets acquired exceeds the fair value of those assets. We test goodwill for impairment annually, or more frequently if events or changes in circumstances indicate that goodwill may be impaired. Goodwill is allocated to the reporting units for the purposes of the impairment test. In the fourth quarter of 2008, we recorded a pre-tax impairment charge of $4.0 million for Selective HR as our near-term financial projections for this subsidiary were not sufficient to support its carrying cost. We did not record any impairments during 2007 or 2006.

Reinsurance

Reinsurance recoverables on paid and unpaid losses and loss expenses represent estimates of the portion of such liabilities that will be recovered from reinsurers. Each reinsurance contract is analyzed to ensure that the transfer of risk exists to properly record the transactions in the financial statements. Amounts recoverable from reinsurers are recognized as assets at the same time and in a manner consistent with the paid and unpaid losses associated with the reinsurance policies. An allowance for estimated uncollectible reinsurance is recorded based on an evaluation of balances due from reinsurers and other available information. This allowance totaled $2.5 million at December 31, 2008 and $2.8 million at December 31, 2007. We continually monitor developments that may impact recoverability from our reinsurers and have available to us contractually provided remedies if necessary.

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Financial Highlights of Results for Years Ended December 31, 2008, 2007, and 2006 [1]

($ in thousands, except per share amounts)	**2008**	2007	**2008 vs. 2007**	2006	2007 vs. 2006
Revenues	**$ 1,695,979**	1,846,228	**(8)%**	1,807,867	2%
Net income	**43,758**	146,498	**(70)**	163,574	(10)
Diluted net income per share	**0.82**	2.59	**(68)**	2.65	(2)
Diluted weighted-average outstanding shares	**53,319**	57,165	**(7)**	62,542	(9)
GAAP combined ratio	**101.0%**	98.9	**2.1pts**	96.1	2.8pts
Statutory combined ratio	**99.2%**	97.5	**1.7**	95.4	2.1
Return on average equity	**4.5%**	13.6	**(9.1)**	15.9	(2.3)

1 Refer to the Glossary of Terms attached to this Form 10-K as Exhibit 99.1 for definitions of terms used in this financial review, which exhibit is incorporated by reference.

Net income decreased in 2008 compared to 2007 and 2006 primarily due to the following:

Net realized losses in our investment portfolio of $49.5 million, pre-tax, compared to net realized gains of $33.4 million in 2007 and $35.5 million in 2006. The losses in 2008 include non-cash OTTI charges of $53.1 million, as well as lower realized gains on our equity portfolio, due to continuing market volatility and unprecedented collateral deterioration across credit markets. In addition, certain equity securities were sold at a loss to take advantage of financial and tax planning strategies. For additional information on our realized losses, including OTTI charges, refer to the Investments section below.

Net realized gains in 2007 and 2006 reflect the sale of several equity positions which resulted in re-weighting various sector exposures. Partially offsetting the 2007 realized gains were pre-tax OTTI charges of $4.9 million. There were no OTTI charges in 2006.

Net investment income earned of $131.0 million, pre-tax, in 2008 compared to $174.1 million in 2007 and $156.8 million in 2006. Reduced income levels in 2008 were primarily due to losses on our other investments portfolio, which includes alternative investments, as well as losses on our externally-managed equity trading portfolio. The lower returns on our alternative investments, compared to strong returns a year ago, resulted from the current volatility in the capital markets, the dislocation of the credit markets, and reduced values of financial assets globally. Although these assets resulted in a negative return for the year, they outperformed the S&P 500 by approximately 2,700 basis points in 2008. Our equity trading portfolio has experienced a reduction in fair value due to the continued sell off in the equity markets, as well as the collapse in commodity prices in the second half of 2008. For additional information on our other investment portfolio, which includes our alternative investments, as well as for information regarding our trading portfolio, refer to the Investments section below.

The increase in pre-tax net investment income earned in 2007 compared to 2006 is primarily attributable to a higher invested asset base, coupled with higher interest rates and strong returns from our other investment portfolio during the year.

Underwriting losses of $15.2 million, pre-tax, in 2008 compared to underwriting gains of $16.0 million in 2007 and $58.0 million in 2006. The underwriting loss in 2008 reflects higher catastrophe losses and reduced NPE. Catastrophe losses increased by $16.8 million, to $31.7 million in 2008 driven by storm activity in the Southern and Midwestern states. NPE decreased by $21.8 million, or 1%, to $1.5 billion in 2008 reflecting pricing pressure stemming from a highly competitive insurance marketplace and the slowing economy. The following factors also contributed to the decline in NPE:

- Direct new business written, excluding flood, decreased $41.7 million to $310.6 million in 2008 compared to $352.3 million in 2007.

- Audit and endorsement activity decreased $38.2 million to a net premium return to policyholders of $22.3 million in 2008.

As a result of the various expense savings initiatives we implemented in 2008, net underwriting expenses incurred in 2008 were slightly lower than 2007. We acted early in 2008 to manage expenses with a workforce reduction initiative, changes to our agent commission programs, and the re-domestication of two of the Insurance Subsidiaries to Indiana. In addition to helping to manage expenses in 2008, these initiatives will continue to benefit expenses going forward.

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The decrease in pre-tax underwriting results in 2007 compared to 2006 is the result of lower pricing and higher claim severity, particularly property losses, partially offset by profitability improvements in our workers compensation line of business and increases in net favorable prior year loss and loss expense development within our casualty lines of business.

A pre-tax goodwill impairment charge of $4.0 million related to Selective HR due to the fact that our near-term financial projections for this reporting unit were not sufficient to support its carrying value in light of current economic conditions. We did not record any goodwill impairments charges during 2007 or 2006.

The aforementioned pre-tax items resulted in a reduction in tax expense of $50.6 million in 2008 compared to 2007, resulting in a 2008 total tax benefit of $4.4 million compared to expenses of $46.3 million in 2007 and $56.9 million in 2006.

Results of Operations and Related Information by Segment

Insurance Operations

Our Insurance Operations segment writes property and casualty insurance business through the Insurance Subsidiaries primarily in 22 states in the Eastern and Midwestern U.S. through approximately 940 independent insurance agencies. Our Insurance Operations segment consists of two components: (i) Commercial Lines, which markets primarily to businesses, and represents approximately 86% of NPW, and (ii) Personal Lines, which markets primarily to individuals, and represents approximately 14% of NPW. The underwriting performances of these lines are generally measured by four different statutory ratios: (i) loss and loss expense ratio; (ii) underwriting expense ratio; (iii) dividend ratio; and (iv) combined ratio.

Summary of Insurance Operations

All Lines

($ in thousands)	**2008**	2007	**2008 vs. 2007**	2006	2007 vs. 2006
GAAP Insurance Operations Results:					
NPW	**$ 1,484,041**	1,554,867	**(5)%**	1,535,961	1%
NPE	**1,495,490**	1,517,306	**(1)**	1,499,664	1
Less:					
Losses and loss expenses incurred	**1,013,816**	999,206	**1**	959,983	4
Net underwriting expenses incurred	**491,689**	494,941	**(1)**	475,776	4
Dividends to policyholders	**5,211**	7,202	**(28)**	5,927	22
Underwriting (loss) income	**$ (15,226)**	15,957	**(195)%**	57,978	(72)%
GAAP Ratios:					
Loss and loss expense ratio	**67.8%**	65.9	**1.9pts**	64.0	1.9pts
Underwriting expense ratio	**32.9**	32.5	**0.4**	31.7	0.8
Dividends to policyholders ratio	**0.3**	0.5	**(0.2)**	0.4	0.1
Combined ratio	**101.0**	98.9	**2.1**	96.1	2.8
Statutory Ratios[1]:					
Loss and loss expense ratio	**67.2**	65.4	**1.8**	63.7	1.7
Underwriting expense ratio	**31.7**	31.6	**0.1**	31.3	0.3

Dividends to policyholders ratio	**0.3**	0.5	**(0.2)**	0.4	0.1
Combined ratio[1]	**99.2%**	97.5	**1.7pts**	95.4	2.1pts

[1] The statutory ratios include our flood line of business, which is included in the Diversified Insurance Services Segment on a GAAP basis and therefore excluded from the GAAP ratios. The total statutory combined ratio excluding flood was 99.9% for 2008, 98.2% for 2007, and 96.1% for 2006.

NPW decreased in 2008 compared to 2007 as the result of the highly competitive insurance marketplace and the slowing economy. These factors were evidenced by: (i) our direct new business, which decreased $41.7 million to $310.6 million; (ii) a 3.1% decrease in Commercial Lines renewal pure pricing; and (iii) endorsement and audit activity which decreased $38.2 million.

As mentioned above, Commercial Lines renewal pure pricing in 2008 decreased 3.1% on renewal premiums, which we consider an achievement in the current competitive marketplace where many carriers are taking much larger rate decreases. Several commercial lines pricing studies indicate that, over the past 15 quarters, we have outperformed the industry, by as much as 6.5 points in the case of one survey. In addition, our Commercial Lines retention has remained relatively stable at 77% in 2008 compared to 78% in 2007 and 2006. In response to the highly competitive marketplace, our agents are actively managing our books of business by renewing accounts as much as 60 days in advance of the policy expiration date.

Personal lines premiums grew 4% in 2008 compared to 2007 as we successfully received approval for rate increases during the year and have plans to implement additional rate increases in 2009. Partially offsetting our rate increases in this book of business was the disruption caused by the elimination of rate caps that had been in place while our MATRIX^{SM} pricing system was implemented for our personal automobile business in New Jersey. This disruption was evidenced by car counts in New Jersey, which decreased by approximately 6,000 to approximately 65,000 at year-end 2008. As we further transition our entire Personal Lines book into MATRIX^{SM}, we could see some modest downward pressure on retention which currently stands at a strong 81%.

NPW increased in 2007 compared to 2006, driven by increases in direct new business of 14%, to $352.3 million partially offset by: (i) Commercial Lines renewal pure price decrease of 3.9% in 2007; (ii) a slight reduction in Commercial Lines retention; (iii) a $17.9 million reduction in audit and endorsement premium activity; and (iv) a decline in NPW for our New Jersey personal automobile business of $12.6 million, to $80.1 million, driven by a reduction in the number of New Jersey personal automobiles that we insure, primarily as a result of repricing at higher levels through our MATRIX^{SM} pricing system.

As the result of decreased NPW over the last 12 months, NPE declined in 2008 compared to 2007. There was a slight increase in NPE in 2007 compared to 2006 reflecting the 2007 increases in NPW discussed above.

The increase in the GAAP loss and loss expense ratio in 2008 compared to 2007 reflects higher catastrophe losses related to 2008 storm activity primarily in our Midwestern and Southern regions. Total catastrophe losses for the year added $31.7 million, or 2.1 points, to losses in 2008. For 2007, catastrophe losses added $14.9 million, or 1.0 point, to losses. In 2008, net favorable prior year loss and loss expense development, driven primarily by our workers compensation line of business, was flat at approximately $19 million, or 1.3 points, compared to approximately $19 million, or 1.2 points, in 2007 driven by our commercial automobile line of business.

The increase in the GAAP loss and loss expense ratio in 2007 compared to 2006 is primarily attributable to lower pricing on our Commercial and Personal Lines business, as well as increases in property losses and overall higher loss costs in 2007 compared to 2006. The increases in property losses were driven by higher non-catastrophe losses and were partially offset by: (i) improved profitability in our workers compensation line of business; and (ii) net favorable prior year loss and loss expense development within our casualty lines of business of approximately $19 million in 2007, compared to approximately $7 million in 2006.

While loss activity is part of the normal volatility in our property lines of business, we continue to manage our claims process in an effort to reduce our loss and loss expense ratio. To that end, we have instituted a number of initiatives that are focused on best practices in the following areas:

- Claims automation;
- Enhancement of claims quality and control;
- Litigation management;
- Enhancement of compliance and bill review;
- Enhancement of workers compensation review; and
- Enhancement of salvage and subrogation review.

As these initiatives are anticipated to accelerate the timing of reserve establishment, we ultimately expect lower loss costs to be realized through reduced legal and loss adjustment expenses. This acceleration inflates our severity statistics in the near term, but we expect the longer-term benefit to be a refined management of the claims process.

The GAAP underwriting expense ratio increased in 2008 compared to 2007 primarily as the result of the pre-tax restructuring charge of $5.0 million, or 0.3 points, related to reductions in our workforce during 2008. Absent this charge, the expense ratio remained relatively flat, reflecting a 1% decrease in NPE partially offset by lower overall underwriting expenses year over year. These reduced expenses are the result of lower expected payments of profit-based incentives to our agents and employees, reflecting lower NPW and underwriting results during 2008, and benefits realized from our cost containment initiatives including: (i) targeted changes to our agency commission program implemented in July 2008 and expected to generate annual savings of $7 million, pre-tax; (ii) our workforce reductions during 2007 and 2008, expected to generate annual savings of $7 million, pre-tax; and (iii) the re-domestication of two of the Insurance Subsidiaries effective June 30, 2008, to achieve operational efficiencies with an anticipated pre-tax savings of $2 million annually.

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The increase in the GAAP underwriting expense ratio in 2007 compared to 2006 was attributable to increases in underwriting expenses that outpaced premium growth. These underwriting expense increases were driven by higher labor costs.

Insurance Operations Outlook

Historically, the results of the property and casualty insurance industry have experienced significant fluctuations due to competition, economic conditions, interest rates, loss cost trends, and other factors. Since 2006, the industry has been experiencing a softening market under which both personal and commercial lines pricing are declining. In its report entitled, U.S. Property/Casualty Review & Preview , A.M. Best increased its projection for the property and casualty industry-wide combined ratio for 2008 to 104.7% up from its initial projection of 98.6%, with commercial and personal lines projected to end the year at 106.5% and 103.3%, respectively. The initial projections for these lines were 97.5% and 99.5%, respectively.

During 2008, the Insurance Operations segment outperformed both A.M. Best s projection of 104.7% and an industry-wide projection of 104.8% by Fitch Ratings (Fitch), provided in their report entitled Review and Outlook for 2008 and 2009, with a statutory combined ratio of 99.2% for the year. Our Commercial Lines business reported a statutory combined ratio of 98.5% and our Personal Lines business reported a statutory combined ratio of 103.7% for the year. In an effort to write profitable business in the current commercial and personal lines market conditions, we have implemented a clearly defined plan to improve risk selection and mitigate higher frequency and severity trends to complement our strong agency relationships and unique field-based model.

In addition, our focus in 2008 included the following:

Efforts to manage expenses with a workforce reduction initiative, changes to our agent commission programs, and the re-domestication of two of the Insurance Subsidiaries to Indiana. In addition to helping to manage our expense ratios this year, the ongoing impact of these initiatives will continue to benefit expenses going forward. While the cost-savings generated by these efforts are recognized immediately on a statutory basis, they are recognized on a GAAP basis over a 12-month period, thereby somewhat delaying their impact.

Claims management initiative with a focus on best practices in the areas of: (i) claims automation; (ii) enhancement of claims quality and control; (iii) litigation management; (iv) enhancement of compliance and bill review; (v) enhancement of workers compensation review; and (vi) enhancement of salvage and subrogation review.

Sales management efforts including our market planning tools and leads program. Our market planning tools allow us to identify and strategically appoint additional independent agencies in and hire AMSs for underpenetrated territories. During 2008, the Insurance Subsidiaries independent agency count grew by approximately 60, bringing our total agency count to approximately 940. These independent insurance agencies are serviced by approximately 100 field-based AMSs who make hands-on underwriting decisions on a daily basis.

Technology that allows agents and our field teams to input business seamlessly into our systems, including our One & Done® small business system and our xSELerate® straight-through processing system. Premiums of approximately $273,000 per workday were processed through our One & Done® small business system during 2008, up 9% from the same period in 2007.

Organic expansion including entering our 22nd state, Tennessee, in June 2008. In the first seven months of operations in this state, we wrote premium of $5.5 million. In addition, we wrote $14.6 million of premium in Massachusetts during 2008, our first full year of operations in this state.

Commercial lines pricing continued to soften in 2008, although there were early signs of rate stabilization as the year wore on. Our commercial lines pure renewal pricing decreased 3.1% for the year, which we consider an achievement when viewed in conjunction with our retention, which remained relatively stable at 77% compared to last year. In the current competitive marketplace, where many carriers are taking larger rate decreases in order to grow their revenues, our cycle management tools that we have in place performed as they were intended; they protected us from writing business that we believe will be unprofitable. As many of our competitors have more financial and operating resources than we do, they have greater scalability and more information regarding their risks which, coupled with the use of statistical and computer models, may give them a greater ability to make pricing and underwriting decisions. We believe that while the short-term downside of the use of our cycle management tools was a 5% decline in NPW for the year, over the longer run, by accepting this short-term decline, we will be in a better position to return to targeted return on equity levels.

Looking forward into 2009, Fitch is projecting an industry-wide statutory combined ratio of 104.0% for the year, reflecting their belief that underwriting results will not improve significantly as premiums are projected to grow by less than 1% due to premium rate declines. In addition, Fitch anticipates that underwriting results will be adversely impacted by higher expense ratios and less favorable reserve development, offset by a return to historical average catastrophe loss experience.

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Considering the ongoing impact of the 3.1% decrease in commercial lines pure renewal pricing in 2008, coupled with anticipated normal loss cost trends, we have provided guidance for 2009 that includes a GAAP combined ratio below 103.5% and a statutory combined ratio below 102.5%, both of which reflect catastrophe losses of 1.4 points.

Review of Underwriting Results by Line of Business

Commercial Lines

($ in thousands)	**2008**	2007	**2008 vs. 2007**	2006	2007 vs. 2006
GAAP Insurance Operations Results:					
NPW	**$ 1,270,856**	1,350,798	**(6)%**	1,318,873	2%
NPE	**1,285,547**	1,314,002	**(2)**	1,285,876	2
Less:					
Losses and loss expenses incurred	**852,697**	838,577	**2**	811,326	3
Net underwriting expenses incurred	**421,536**	426,118	**(1)**	405,141	5
Dividends to policyholders	**5,211**	7,202	**(28)**	5,927	22
Underwriting income	**$ 6,103**	42,105	**(86)%**	63,482	(34)%
GAAP Ratios:					
Loss and loss expense ratio	**66.3%**	63.8	**2.5pts**	63.1	0.7pts
Underwriting expense ratio	**32.8%**	32.5	**0.3**	31.5	1.0
Dividends to policyholders ratio	**0.4%**	0.5	**(0.1)**	0.5	
Combined ratio	**99.5%**	96.8	**2.7**	95.1	1.7
Statutory Ratios:					
Loss and loss expense ratio	**65.9%**	63.4	**2.5**	62.9	0.5
Underwriting expense ratio	**32.2%**	32.0	**0.2**	31.6	0.4
Dividends to policyholders ratio	**0.4%**	0.5	**(0.1)**	0.5	
Combined ratio	**98.5%**	95.9	**2.6pts**	95.0	0.9pts

NPW decreased in 2008 compared to 2007 and 2006 due to the highly competitive insurance marketplace and the slowing economy. These factors were evidenced by: (i) Commercial Lines direct new business that decreased $46.1 million to $267.2 million; (ii) a 3.1% decrease in renewal pure pricing; and (iii) endorsement and audit activity that decreased $37.7 million.

As mentioned above, Commercial Lines renewal pure pricing in 2008 decreased 3.1% on renewal premiums, which we consider an achievement in the current competitive marketplace, especially when viewed in conjunction with our retention, which remained relatively flat at 77% during the year. In response to the highly competitive marketplace, our agents are actively managing our books of business by renewing accounts as much as 60 days in advance of the policy expiration date.

NPW increased in 2007 compared to 2006, driven by increases in direct new business of $36.4 million, to $313.3 million, partially offset by: (i) renewal pure price decreases of 3.9%; (ii) a slight reduction in retention; and (iii) decreases in audit and endorsement premium activity of $11.5 million and $6.3 million, respectively.

As the result of decreased NPW over the last 12 months, NPE declined in 2008 compared to 2007. There was a slight increase in NPE in 2007 compared to 2006 reflecting the 2007 increases in NPW discussed above.

The increase in the GAAP loss and loss expense ratio in 2008 compared to 2007 reflects higher catastrophe losses related to 2008 storm activity primarily in our Midwestern and Southern regions and a reduction in favorable prior year loss and loss expense development of approximately $6 million, from approximately $20 million, or 1.5 points in 2007 to approximately $14 million, or 1.1 points in 2008. Total catastrophe losses for the year added $27.0 million, or 2.1 points, to losses in 2008. For 2007, catastrophe losses added $12.0 million, or 0.9 points, to losses. The favorable prior year development in 2008 was driven by improvement in our workers compensation line of business, while the prior year development in 2007 was driven by lower than expected severity on our commercial automobile line of business.

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The increase in the GAAP loss and loss expense ratio in 2007 compared to 2006 is primarily attributable to lower pricing on our commercial book of business as well as increases in property losses. Included in property losses were catastrophe losses that decreased $3.6 million, or 0.3 points, to $12.0 million in 2007 compared to $15.6 million in 2006. These increases were partially offset by net favorable prior year loss and loss expense development, primarily in our commercial automobile line of business, that amounted to approximately $20 million, or 1.5 points in 2007, compared to approximately $2 million, or 0.1 points, of net favorable prior year loss and loss expense development in 2006.

The GAAP underwriting expense ratio increased in 2008 compared to 2007 primarily as the result of the pre-tax restructuring charge of $4.4 million, or 0.3 points, related to reductions in our workforce during 2008. Absent this charge, the expense ratio remained flat, reflecting a decrease in NPE partially offset by lower overall underwriting expenses year over year. These reduced expenses are the result of lower expected payments of profit-based incentives to our agents and employees, reflecting lower NPW and underwriting results during 2008, and benefits realized from our cost containment initiatives including: (i) targeted changes to our agency commission program implemented in July 2008; (ii) our workforce reductions during 2007 and 2008; and (iii) the re-domestication of two of the Insurance Subsidiaries effective June 30, 2008, to achieve operational efficiencies.

The increase in the GAAP underwriting expense ratio in 2007 compared to 2006 was attributable to increases in underwriting expenses that outpaced premium growth. These underwriting expense increases were driven by higher labor costs.

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

General Liability

($ in thousands)	**2008**	2007	**2008 vs. 2007**	2006	2007 vs. 2006
Statutory NPW	**$ 393,012**	420,388	**(7)%**	413,381	2%
Statutory NPE	**396,066**	410,024	**(3)**	402,745	2
Statutory combined ratio	**102.0%**	98.8	**3.2pts**	96.5	2.3pts
% of total statutory commercial NPW	**31%**	31		31	

NPW for this line of business decreased in 2008 compared to 2007, primarily due to: (i) a decrease in direct voluntary new business premiums of $15.7 million, or 17%; (ii) a renewal pure price decrease of 2.0%; and (iii) a decrease in our audit and endorsement premiums of $17.7 million, to a return premium of $7.8 million. As of December 31, 2008, approximately 58% of our premium is subject to audit whereby actual exposure units (usually sales or payroll) are compared to estimates and a return premium or additional premium transaction occurs. In 2007, NPW increased compared to 2006, with a direct voluntary new business increase of 14%. In this line of business, we are experiencing the highest level of competition in our middle market and large account business. Despite this competition, overall policy counts increased 5% in 2008 compared to 2007 and 9% in 2007 compared to 2006, reflecting moderate growth in our small account business, which we define as policies with premiums less than $25,000. Retention on this line was 74% in 2008 compared to 75% in 2007 and 77% in 2006.

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

Workers Compensation

($ in thousands)	2008	2007	2008 vs. 2007	2006	2007 vs. 2006
Statutory NPW	**$ 303,783**	336,189	**(10)%**	325,008	3%
Statutory NPE	**308,618**	325,657	**(5)**	314,221	4
Statutory combined ratio	**96.1%**	101.6	**(5.5)pts**	108.4	(6.8)pts
% of total statutory commercial NPW	**24%**	25		25	

NPW for this line of business decreased in 2008 compared to 2007, primarily as the result of: (i) competitive pressure from monoline carriers willing to write workers compensation policies, mainly on the upper end of our middle market business and our large account business that led to a direct voluntary new business premium decrease of $17.0 million, or 21%; (ii) a decrease in audit and endorsement premium of $15.5 million; and (iii) renewal pure price decreases of 2.1% in 2008. Retention decreased one point to 78% partially due to initiatives that have allowed us to target price increases for our worst performing business, thereby improving the quality of our retained business. Policy counts increased by 5% in 2008 compared to 2007 as we are writing more, smaller premium policies.
In 2007, NPW for this line increased from 2006, reflecting a 28% increase in direct new voluntary policy premiums. As in 2008, retention decreased one point in 2007 compared to 2006, while policy counts increased 9%.
The improvement in the statutory combined ratio of 5.5 points in 2008 compared to 2007 and 6.8 points in 2007 compared to 2006 reflects: (i) favorable prior year development of approximately $23 million, or 7.6 points, in 2008 compared to $3 million, or 0.8 points, in 2007 and $2 million, or 0.7 points in 2006; and (ii) the ongoing progress resulting from our improvement initiative including the use of our business analytics tools enabling us to price and retain our best accounts, coupled with the impact of medical trends that have returned to a more normalized level, and the redesign and recontracting of our managed care process. The prior year development in 2008 reflects favorable development in accident years 2004 to 2006, as a result of our improvement initiatives on this line as mentioned above, partially offset by adverse development in the 2007 accident year driven by higher than expected severity.
Commercial Automobile

($ in thousands)	2008	2007	2008 vs. 2007	2006	2007 vs. 2006
Statutory NPW	**$ 300,391**	319,176	**(6)%**	319,710	%
Statutory NPE	**307,388**	315,259	**(2)**	319,921	(1)
Statutory combined ratio	**99.7%**	88.1	**11.6pts**	88.1	pts
% of total statutory commercial NPW	**23%**	23		24	

NPW for this line of business decreased in 2008 compared to 2007, while it remained flat in 2007 compared to 2006. The 2008 decrease was primarily driven by: (i) lower direct voluntary new business premiums, which were $52.3 million in 2008, down $9.2 million, or 15% from 2007; and (ii) renewal pure price decreases of 5.0%. In managing our pure price decreases in 2008, we lost only one point in retention and ended the year at 79% compared to 80% in 2007. Pure price decreases on this line were 5.4% in 2007 and 4.1% in 2006 while retention was 80% and 81%, respectively. As with the general liability line of business, we are experiencing the highest level of competition in our middle market and large account business, while our small account business, which we define as policies with premiums less than $25,000, experienced moderate growth. Overall policy counts for this line increased 5% in 2008 compared to 2007. In 2007, as compared to 2006, policy counts increased 8%.
The increase in the statutory combined ratio in 2008 compared to 2007 for the commercial automobile line is primarily due to: (i) favorable prior year statutory development in 2007 of approximately $19 million due to improved severity trends; (ii) physical damage losses that were $6.2 million, or 2.3 points, higher in 2008; and (iii) pure price

decreases as discussed above.

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Commercial Property

($ in thousands)	2008	2007	2008 vs. 2007	2006	2007 vs. 2006
Statutory NPW	**$ 194,550**	198,903	**(2)%**	188,839	5%
Statutory NPE	**196,189**	190,681	**3**	182,351	5
Statutory combined ratio	**92.9%**	92.7	**0.2pts**	82.1	10.6pts
% of total statutory commercial NPW	**15%**	15		14	

NPW for this line of business decreased in 2008 compared to 2007 driven by a new business premium decrease of $2.4 million, or 5%, coupled with a one point reduction in retention to 76%, and renewal pure pricing that decreased 4.1%. Partially offsetting these items is a 6% increase in policy counts in 2008 compared to 2007. NPW for this line of business increased in 2007 compared to 2006 due to increases in total policy counts of 11% in 2007 compared to 2006. Partially offsetting the 2007 increase were renewal pure price decreases of 5.9% during the year.

The statutory combined ratio remained relatively flat in 2008 as compared to 2007, despite increased catastrophe losses of $11.9 million, or 5.9 points, to $22.6 million related to storm activity in our Southern and Midwestern regions, including the effects of Hurricane Ike, which added $6.6 million, or 3.4 points, to the combined ratio for the year. These catastrophes were partially offset by a decrease in non-catastrophe property losses, reflecting normal volatility inherent in this line of business.

Although profitable, the increased statutory ratio in 2007 from 2006 reflects lower pricing and increased property losses especially compared to the unusually low experience in 2006. The increase in property losses in 2007 was primarily the result of an increase in the severity of losses, mainly attributable to flood events and electrical fires. As opposed to the increased catastrophe losses in 2008, catastrophes decreased $2.5 million in 2007 compared to 2006.

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Personal Lines

($ in thousands)	2008	2007	2008 vs. 2007	2006	2007 vs. 2006
GAAP Insurance Operations Results:					
NPW	**$ 213,185**	204,069	**4%**	217,088	(6)%
NPE	**209,943**	203,304	**3**	213,788	(5)
Less:					
Losses and loss expenses incurred	**161,119**	160,629		148,657	8
Net underwriting expenses incurred	**70,153**	68,823	**2**	70,635	(3)
Underwriting loss	**$ (21,329)**	(26,148)	**18%**	(5,504)	(375)%
GAAP Ratios:					
Loss and loss expense ratio	**76.7%**	79.0	**(2.3)pts**	69.5	9.5pts
Underwriting expense ratio	**33.5%**	33.9	**(0.4)**	33.1	0.8
Combined ratio	**110.2%**	112.9	**(2.7)**	102.6	10.3
Statutory Ratios[1]:					
Loss and loss expense ratio	**75.7%**	78.2	**(2.5)**	68.5	9.7
Underwriting expense ratio	**28.0%**	29.7	**(1.7)**	29.7	
Combined ratio	**103.7%**	107.9	**(4.2)pts**	98.2	9.7pts

1 The statutory ratios include our flood line of business, which is included in the Diversified Insurance Services segment on a GAAP basis and therefore excluded from the GAAP ratios. The total statutory combined ratio excluding flood was 108.7% for 2008, 113.0%

for 2007, and
102.9% for
2006.

The increase in NPW in 2008 compared to 2007 is primarily due to the impact of rate actions that became effective during the year. These rate actions resulted in an overall rate increase of 7.7% in Personal Lines, comprised of 11.1% in our personal automobile line of business and 1.1% in our homeowners line of business. Specific to our New Jersey personal automobile business, we have received rate increases of 6.8% effective in May 2008 and 6.5% effective in October 2008.

Our rate increases were partially offset by a decline in retention of approximately one point, to 81%, on our overall Personal Lines book. In addition, the number of automobiles that we insure in New Jersey decreased by approximately 6,000, to 65,000 cars, at December 31, 2008.

NPW decreased in 2007 compared to 2006. Excluding the impact from the cancellation of the New Jersey Homeowners Quota Share Treaty, which increased 2006 NPW by $11.3 million, NPW decreased 1% in 2007 compared to 2006. This modest 1% decrease was driven by the implementation of our MATRIX℠ pricing system, which caused a dislocation in our New Jersey personal automobile line of business as renewal policies were repriced at higher levels. Partially offsetting this decrease were increases in our personal automobile business outside of New Jersey of $5.4 million, to $50.0 million, coupled with increases in our homeowners business of $4.5 million, to $65.4 million, in 2007.

The fluctuations in NPE reflect the fluctuations in NPW as discussed above.

The improvement in the GAAP loss and loss expense ratio in 2008 compared to 2007 is primarily driven by the 3% increase in NPE, coupled with favorable prior year development in our casualty lines of approximately $5 million, or 2.2 points, in 2008, compared to unfavorable prior year development of approximately $1 million, or 0.4 points, in 2007. The 2008 development reflected a better quality of business being written through our MATRIX℠ pricing system, coupled with normal volatility, while the 2007 development included the impact of unfavorable trends in groundwater contamination caused by the leakage of certain underground oil storage tanks in our homeowners line of business. This improvement in the loss and loss expense ratio was partially offset by increases in: (i) catastrophe losses of $1.9 million, to $4.7, million in 2008; and (ii) non-catastrophe property losses of $4.5 million, to $56.5 million, in 2008.

The deterioration in the GAAP loss and loss expense ratio in 2007 compared to 2006 was primarily driven by decreased pricing in our New Jersey personal automobile line of business coupled with the following:

- An increase of $6.7 million in non-catastrophe property losses in 2007 compared to 2006.

- Unfavorable prior year development in our casualty lines of $1 million in 2007 compared to favorable prior year development of $6 million in 2006. The unfavorable development in 2007 reflects: (i) higher severity in accident year 2006 for our personal automobile line of business; (ii) adverse prior year development due to unfavorable trends in claims for groundwater contamination caused by the leakage of certain underground oil storage tanks in our homeowners line of business; and (iii) several significant losses in our personal excess line of business, partially offset by lower than expected loss emergence for accident years prior to 2006. The favorable prior year development in 2006 primarily related to lower than expected frequency in personal automobile claims.

The deterioration in the 2007 loss and loss expense ratio was partially offset by a reduction in catastrophe losses of $2.2 million, to $2.9 million, in 2007.

The GAAP underwriting expense ratio improved in 2008 compared to 2007 primarily due to costs associated with the reorganization of the Personal Lines department in May of 2007, which reduced the staffing level by 31 employees and, added 0.6 points to the underwriting expense ratio in 2007. The deterioration in the GAAP underwriting expense ratio in 2007 compared to 2006 was primarily attributable to overhead costs that have outpaced premiums earned.

We continue to focus on improving our Personal Lines results and continue to diligently take steps in that regard. The significant rate increases that we achieved in 2008 will generate an additional $15 million in annual premium. In addition, we have more rate increases planned in 2009 that are expected to generate approximately $9 million in additional premium, including 21 anticipated rate increases of 3% or more. In December of 2008, we implemented territory rate changes for our New Jersey personal automobile business. The number of territories in the state was increased from 40 to 60 and, as we move into these new territories for our renewal book of business, price increases or decreases in any given year are capped at 10%. We anticipate having the majority of the price adjustments reflected in our renewal book by year-end 2010, and we believe the new territory rates will provide more adequate pricing in territories that have historically not been profitable for us.

In early 2009, we will be completing implementation of our MATRIX℠ pricing system for our homeowners line of business. Through this system, we are able to better manage our coastal exposure by pricing risks at levels that we believe are more adequate.

Reinsurance

We have reinsurance contracts that cover both property and casualty business. We use traditional forms of reinsurance and do not utilize finite risk reinsurance. Available reinsurance can be segregated into the following key categories:

- *Property Reinsurance* - includes our Property Excess of Loss treaty purchased for protection against large individual property losses and our Property Catastrophe treaty purchased to provide protection for the overall property portfolio against severe catastrophic events. Facultative reinsurance is also used for property risks that are in excess of our treaty capacity.

- *Casualty Reinsurance* - purchased to provide protection for both individual large casualty losses and catastrophic casualty losses involving multiple claimants or insureds. Facultative reinsurance is also used for casualty risks that are in excess of our treaty capacity.

- *Terrorism Reinsurance* - available as a federal backstop related to terrorism losses as provided under the TRIA. For further information regarding this legislation, see Item 1A. Risk Factors of this Form 10-K.

- *Flood Reinsurance* - as a servicing carrier in the WYO Program, we receive a fee for writing flood business, for which the related premiums and losses are ceded to the federal government.

Other Reinsurance - includes smaller treaties, such as our Surety and Fidelity Excess of Loss and our Equipment Breakdown Coverage treaties, which do not fall within the categories above.

Additional information regarding the terms and related coverage associated with each of our categories of reinsurance can be found in Item 1. Business of this Form 10-K.

We regularly reevaluate our overall reinsurance program and try to develop the most effective ways to manage our risk. Our analysis is based on a comprehensive process that includes periodic analysis of modeling results, aggregation of exposures, exposure growth, diversification of risks, limits written, projected reinsurance costs, financial strength of reinsurers and projected impact on earnings and statutory surplus. We strive to balance sometimes opposing considerations of reinsurer credit quality, price, terms, and our appetite for retaining a certain level of risk.

Property Reinsurance

The Property Catastrophe treaty renewed effective January 1, 2009 with a 7.8% increase in premium. The current treaty structure remains the same providing per occurrence coverage for 95% of $310.0 million in excess of $40.0 million retention. The annual aggregate limit net of our co-participation is $589.0 million.

In 2008, we managed our hurricane exposures through the implementation of a Catastrophe (CAT) strategy initiative. It focused on policies with high Annual Average Loss (AAL) to premium ratios which were targeted for increases in deductibles and premium, and in certain cases non-renewals. The strategy led to the implementation of a variety of underwriting system tools that provide CAT management information to the underwriters for a more granular portfolio management of our property book of business. The July 2008 modeling results included a 4.4% reduction in gross AAL, while insured values increased 3.5% when compared to June 2007, clearly showing that the strategy has taken hold.

We continue to assess our property catastrophe exposure aggregations, modeled results and effects of growth on our property portfolio and strive to manage our exposure to individual large events balanced against the cost of reinsurance protection.

The following table presents Risk Management Solutions, Inc. s (RMS) v.8.0 modeled hurricane losses based on the Insurance Subsidiaries property book of business as of July 1, 2008:

($ in thousands)	Historical Basis			Near Term Basis		
Occurrence Exceedence Probability	**Gross Losses RMS v.8.0**	**Net Losses[1]**	**Net Losses as a Percent of Equity[2]**	**Gross Losses RMS v.8.0**	**Net Losses[1]**	**Net Losses as a Percent of Equity[2]**
4.0% (1 in 25 year event)	$ 48,695	26,820	3%	$ 68,994	28,733	3%
2.0% (1 in 50 year event)	99,455	31,604	4	132,327	33,903	4
1.0% (1 in 100 year event)	185,855	37,626	4	235,608	40,537	5
0.40% (1 in 250 year event)	377,497	64,600	7	455,380	115,224	13

1 Losses are after tax and include applicable reinstatement premium.

2 Equity as of December 31, 2008

RMS v.8.0 allows modeling based on the long-term averages (historic view) and modeling based on a near-term view that includes an assumption of elevated hurricane activity in the North Atlantic Basin in the short to medium-term. Results of both models are provided above for select probabilities. Our current catastrophe program provides protection for a 1 in 225 year event, or an event with 0.4% probability according to the RMS v8.0 historic model, and

for a 1 in 171 year event, or an event with 0.6% probability according to RMS v.8.0 near term model.
The Property Excess of Loss treaty was renewed on July 1, 2008 and is effective through June 30, 2009, with a $28.0 million limit in excess of a $2.0 million retention, compared to the prior treaty of $23.0 million limit in excess of a $2.0 million retention.

The per-occurrence cap on the first layer of this treaty was $24.0 million in both the current and expiring treaty and the per occurrence cap on the second layer was increased to $40.0 million from $22.5 million, bringing the total per-occurrence limit for the program to $64.0 million compared to the $46.5 million limit in the expiring treaty.

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

Consistent with the prior year contract, all NBCR losses are excluded from the Property Excess of Loss treaty. Terrorism (excluding NBCR) and per-occurrence aggregate limits were increased to $64.0 million from $46.5 million.

Casualty Reinsurance

The Casualty Excess of Loss treaty (Casualty Treaty) was restructured effective July 1, 2008 into one treaty encompassing all casualty lines, including workers compensation. This treaty expires on June 30, 2009. As a result, the Workers Compensation Only treaty was not renewed at July 1, 2008. The current program provides the following coverage:

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

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

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

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

The cost of the second through sixth layers of this treaty have decreased 2% to $10 million. On a fiscal year basis, the ceded premium for the entire casualty program will be approximately $10 million above the expiring premium due to the significant extension in coverage. The overall impact of the restructured program will be to improve insurance operations by about $2.0 million with lower investment income being offset due to higher ceded premium. In addition, we expect reduced volatility in our results as the first layer of this treaty was expanded to cover all lines of business, including our excess lines.

Other Reinsurance

Our Surety and Fidelity Excess of Loss treaty was renewed effective January 1, 2009, with essentially no changes in coverage and an 11.4% decrease in estimated ceded premium due to a decrease in projected subject premium and an increase in the rate.

Effective January 1, 2009, we renewed the NWCRP treaty which covers our participation in the involuntary National Council on Compensation Insurance (NCCI) pool, a residual workers compensation market. The NWCRP treaty provides 100% Quota Share coverage, including terrorism coverage, for the 2009 and 2008 underwriting years, assumed business from the NCCI and has an aggregate combined ratio limit of approximately 152% and 142%, respectively for each of the underwriting years. The 2009 treaty is placed with three carriers with ratings of A or A+ by A. M. Best. Due to our decision to participate in the New Jersey residual workers compensation market through the NCCI in 2009, the treaty now covers this state. We believe that the continued protection provided within this treaty for residual market business is especially beneficial given current market conditions and the expected deterioration in the experience of the NCCI pool.

Counter-Party Credit Risk

During the second half of 2008, AIG entered into agreements with the U.S. Treasury Department and the Federal Reserve that include both ongoing financing facilities and one-time transactions designed to address AIG s liquidity issues. As we maintain reinsurance relationships with the following AIG subsidiaries through three currently in-force treaties, we closely monitor developments regarding AIG s liquidity concerns: (i) The Hartford Steam Boiler Inspection and Insurance Company (HSB), (ii) National Union Fire Insurance Company, and (iii) Transatlantic Reinsurance Company (collectively referred to as the AIG Subsidiaries). On December 22, 2008, AIG announced the sale of the HSB Group, Inc., HSB s parent, to Munich Re Group.

The AIG Subsidiaries are rated A by A.M. Best and National Union Fire Insurance Company and Transatlantic Reinsurance Company have S&P credit ratings of A+ as of December 31, 2008. Uncollateralized reinsurance recoverables on paid and unpaid loss and loss adjustment expenses, including IBNR losses, amounted to $2.3 million at year-end 2008, representing 1.3%, of our total uncollateralized reinsurance recoverables and less than one percent of our stockholders equity. Some of the reinsurance arrangements that the AIG Subsidiaries participate in involve upper layers of casualty business (known as clash layers) for which historical experience does not exist. Due to the uncertainty associated with casualty business, and specifically losses reaching those clash layers, current reinsurance recoverables from AIG Subsidiaries may change materially in the event of a significant loss event well in excess of our historical levels. As we continually monitor developments that may impact our prospects for recovery from the AIG Subsidiaries, we are prepared to avail ourselves of certain contractually provided remedies available to us if we determine it to be appropriate.

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In early 2009, the A+ financial strength rating of Swiss Reinsurance Company and its similarly rated subsidiaries (collectively referred to as Swiss Re), was placed under review by A.M. Best with negative implications. Swiss Re is currently one of our top five reinsurance groups. A.M. Best placed Swiss Re s ratings under review due to the announcement of planned actions to initiate several asset de-risking and capital strengthening initiatives, including an anticipated capital infusion agreement with Berkshire Hathaway, Inc. of approximately $2.6 billion. This comes after Swiss Re s announcement of an expected net loss for fiscal year 2008 and a fourth quarter decline of its capital balance of approximately $4 to $5 billion as of December 31, 2008. A.M. Best had previously assigned a negative outlook to Swiss Re s ratings due to concerns that the continuing turmoil in the financial markets could further erode their capital position and negatively impact earnings in 2009. As of December 31, 2008, Swiss Re s uncollateralized reinsurance recoverables on paid and unpaid loss and loss adjustment expenses, including IBNR losses, amounted to $17.6 million, representing 20%, of our total uncollateralized reinsurance recoverables and approximately 2% of our stockholders equity.

Investments

Our investment results have been significantly affected by conditions in the global capital markets and the overall economy, in both the U.S. and abroad. As widely reported, financial markets in the U.S., Europe, and Asia have been experiencing extreme disruption since the second half of 2007. Concerns over the availability and cost of credit, the U.S. mortgage market, a declining global real estate market, increased unemployment, volatile energy and commodity prices and geopolitical issues, among other factors, have contributed to increased volatility and diminished expectations for the economy and the financial markets going forward. These concerns have led to declines in business and consumer confidence, which have precipitated an economic slowdown and fears of a sustained recession. These factors have had, and could continue to have, an adverse effect on our investment portfolio.

Our investment philosophy includes certain return and risk objectives for the fixed maturity and equity portfolios. The primary fixed maturity portfolio return objective is to maximize after-tax investment yield and income while balancing risk. A secondary objective is to meet or exceed a weighted-average benchmark of public fixed income indices. The equity portfolio return objective is to meet or exceed a weighted-average benchmark of public equity indices. Although yield and income generation remain the key drivers to our investment strategy, our overall philosophy is to invest with a long-term horizon along with a buy-and-hold principle. Tactically, we also plan to further increase our portfolio allocation to government and agency holdings in the near-term in an effort to increase liquidity and capital preservation.

For additional information regarding market risk related to our investment portfolio, see Item 7A. Quantitative and Qualitative Disclosures About Market Risk of this Form 10-K.

The following table presents information regarding our investment portfolio:

($ in thousands)	**2008**	2007	**2008 vs. 2007**	2006	2007 vs. 2006
Total invested assets	**$ 3,540,309**	3,733,029	**(5)%**	3,596,102	4%
Net investment income before tax	**131,032**	174,144	**(25)**	156,8	