

SELECTIVE INSURANCE GROUP INC  
Form 10-K  
February 26, 2015

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-K  
(Mark One)

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

For the fiscal year ended: December 31, 2014  
or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-33067  
SELECTIVE INSURANCE GROUP, INC.  
(Exact Name of Registrant as Specified in Its Charter)  
New Jersey  
(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 Offices)

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  
Common Stock, par value \$2 per share

Name of each exchange on which registered  
NASDAQ Global Select Market

5.875% Senior Notes due February 9, 2043

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.  
 Yes  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.  
 Yes  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 (or for such shorter period that the registrant was

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

ý Yes    " No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

ý Yes    " No

1

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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.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

Yes  No

The aggregate market value of the voting company common stock held by non-affiliates of the registrant, based on the closing price on the NASDAQ Global Select Market, was \$1,364,092,316 on June 30, 2014. As of February 13, 2015, the registrant had outstanding 56,878,329 shares of common stock.

#### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for the 2015 Annual Meeting of Stockholders to be held on April 29, 2015 are incorporated by reference into Part III of this report.

2

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SELECTIVE INSURANCE GROUP, INC.  
Table of Contents

|  | Page No.   |
|--|------------|
| <b>PART I</b>  |            |
| Item 1. Business   | <u>4</u>   |
| Item 1A. Risk Factors  | <u>18</u>  |
| Item 1B. Unresolved Staff Comments   | <u>31</u>  |
| Item 2. Properties   | <u>31</u>  |
| Item 3. Legal Proceedings  | <u>31</u>  |
| <b>PART II</b>   |            |
| Item 5. Market For Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities | <u>32</u>  |
| Item 6. Selected Financial Data  | <u>35</u>  |
| Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations                        | <u>36</u>  |
| Forward-looking Statements   | <u>36</u>  |
| Introduction   | <u>36</u>  |
| Critical Accounting Policies and Estimates   | <u>37</u>  |
| Financial Highlights of Results for Years Ended December 31, 2014, 2013, and 2012                                    | <u>49</u>  |
| Results of Operations and Related Information by Segment   | <u>53</u>  |
| Federal Income Taxes   | <u>67</u>  |
| Financial Condition, Liquidity, Short-term Borrowings, and Capital Resources   | <u>67</u>  |
| Off-Balance Sheet Arrangements   | <u>70</u>  |
| Contractual Obligations, Contingent Liabilities, and Commitments   | <u>70</u>  |
| Ratings  | <u>72</u>  |
| Item 7A. Quantitative and Qualitative Disclosures About Market Risk  | <u>73</u>  |
| Item 8. Financial Statements and Supplementary Data  | <u>81</u>  |
| Consolidated Balance Sheets as of December 31, 2014 and 2013   | <u>82</u>  |
| Consolidated Statements of Income for the Years Ended  |            |
| December 31, 2014, 2013, and 2012  | <u>83</u>  |
| Consolidated Statements of Comprehensive Income for the Years Ended  |            |
| December 31, 2014, 2013, and 2012  | <u>84</u>  |
| Consolidated Statements of Stockholders’ Equity for the Years Ended  |            |
| December 31, 2014, 2013, and 2012  | <u>85</u>  |
| Consolidated Statements of Cash Flow for the Years Ended   |            |
| December 31, 2014, 2013, and 2012  | <u>86</u>  |
| Notes to Consolidated Financial Statements   | <u>87</u>  |
| Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure                         | <u>140</u> |
| Item 9A. Controls and Procedures   | <u>140</u> |
| Item 9B. Other Information   | <u>142</u> |
| <b>PART III</b>  |            |
| Item 10. Directors, Executive Officers and Corporate Governance  | <u>142</u> |
| Item 11. Executive Compensation  | <u>142</u> |
| Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters              | <u>142</u> |
| Item 13. Certain Relationships and Related Transactions, and Director Independence                                   | <u>142</u> |

Item 14. Principal Accounting Fees and Services 142

Part IV

Item 15. Exhibits and Financial Statement Schedules 143

3

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## PART I

### Item 1. Business.

#### Overview

Selective Insurance Group, Inc. (referred to as the “Parent”) is a New Jersey holding company that was incorporated in 1977. Our main office is located in Branchville, New Jersey and the Parent’s common stock is publicly traded on the NASDAQ Global Select Market under the symbol “SIGL.” The Parent has ten insurance subsidiaries, nine of which are licensed by various state departments of insurance to write specific lines of property and casualty insurance business in the standard market. The remaining subsidiary is authorized by various state insurance departments to write property and casualty insurance in the excess and surplus lines (“E&S”) market. Our ten insurance subsidiaries are collectively referred to as the “Insurance Subsidiaries.” The Parent and its subsidiaries are collectively referred to as “we,” “us,” or “our” in this document.

In 2014, we were ranked as the 44th largest property and casualty group in the United States based on 2013 net premium written (“NPW”) in A.M. Best and Company’s (“A.M. Best”) annual list of “Top 200 U.S. Property/Casualty Writers.”

Our Insurance Subsidiaries’ ratings by major rating agency are as follows:

| Rating Agency                              | Financial Strength Rating | Outlook  |
|--|---------------------------|----------|
| A.M. Best                                  | A                         | Stable   |
| Standard & Poor’s Ratings Services (“S&P”) | A-                        | Positive |
| Moody’s Investors Service (“Moody’s”)      | A2                        | Negative |
| Fitch Ratings (“Fitch”)                    | A+                        | Stable   |

For further discussion on our ratings, please see the “Ratings” section of Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” of this Form 10-K.

We have provided a glossary of terms as Exhibit 99.1 to this Form 10-K, which defines certain industry-specific and other terms that are used in this Form 10-K.

#### Segments

We classify our business into four reportable segments:

Standard Commercial Lines - comprised of insurance products and services provided in the standard marketplace to our commercial customers, who are typically businesses, non-profit organizations, and local government agencies. This business represents about 76% of our total insurance segments’ net premiums written.

- Standard Personal Lines - comprised of insurance products and services, including flood insurance coverage that we write through the National Flood Insurance Program (“NFIP”), provided primarily to individuals acquiring coverage in the standard marketplace. This business represents about 16% of our total insurance segments’ net premiums written.

E&S Lines - comprised of insurance products and services provided to customers who have not obtained coverage in the standard marketplace. We currently only write commercial lines E&S coverages and this business represents about 8% of our total insurance segments' net premiums written.

Investments - invests the premiums collected by our insurance segments, as well as amounts generated through our capital management strategies, which may include the issuance of debt and equity securities.

These segments are different from the segments that we have previously reported, which were Standard Insurance Operations, E&S Insurance Operations, and Investments. All prior year information contained in this Form 10-K has been restated to reflect our revised segments. For qualitative information behind the change, as well as quantitative information regarding these segments, such as revenue contributions and profitability measures, see Note 11.

"Segment Information" in Item 8. "Financial Statements and Supplementary Data." of this Form 10-K.

We derive substantially all of our income in three ways:

Underwriting income from our three insurance segments. Underwriting income is comprised of revenues, which are the premiums earned on our insurance products and services, less expenses. Gross premiums are direct premium written ("DPW") plus premiums assumed from other insurers. Gross premiums less premium ceded to reinsurers, is net premiums written ("NPW"). NPW is recognized as revenue ratably over a policy's term as net premiums earned ("NPE"). Expenses related to our insurance segments fall into three main categories: (i) losses associated with claims and various loss expenses incurred for adjusting claims (referred to as "loss and loss expenses"); (ii) expenses related to insurance policy issuance, such as commissions to our distribution partners, premium taxes, and other expenses incurred in issuing and maintaining policies, including employee compensation and benefits (referred to as "underwriting expenses"); and (iii) policyholder dividends.

Net investment income from the investment segment. We generate income from investing insurance premiums and amounts generated through our capital management strategies. Net investment income consists primarily of interest earned on fixed income investments, dividends earned on equity securities, and other income primarily generated from our alternative investment portfolio.

Net realized gains and losses on investment securities from the investments segment. Realized gains and losses from the investment portfolios of the Insurance Subsidiaries and the Parent are typically the result of sales, calls, and redemptions. They also include write downs from other-than-temporary impairments ("OTTI").

Our income is partially offset by general corporate expenses, including interest on our debt obligations, and tax payments.

We use the combined ratio as the key measure in assessing the performance of our insurance segments. Under U.S. generally accepted accounting principles ("GAAP"), the combined ratio is calculated by adding: (i) the loss and loss expense ratio, which is the ratio of incurred loss and loss expense to NPE; (ii) the expense ratio, which is the ratio of underwriting expenses to NPE; and (iii) the dividend ratio, which is the ratio of policyholder dividends to NPE. Statutory accounting principles ("SAP") provides a calculation of the combined ratio that differs from GAAP in that the statutory expense ratio is the ratio of underwriting expenses to NPW, not NPE. A combined ratio under 100% generally indicates an underwriting profit and a combined ratio over 100% generally indicates an underwriting loss. The combined ratio does not reflect investment income, federal income taxes, or other non-insurance related income or expense.

We use after-tax investment income and net realized gains or losses as the key measure in assessing the performance of our investments segment. Our investment philosophy includes setting certain risk and return objectives for the fixed income, equity, and other investment portfolios. We generally review our performance by comparing our returns for each of these components of our portfolio to a weighted-average benchmark of comparable indices.

Our operations are heavily regulated by the state insurance regulators in the states in which our Insurance Subsidiaries are organized and licensed or authorized to do business. In these states, the Insurance Subsidiaries are required to file financial statements prepared in accordance with SAP, which are promulgated by the National Association of Insurance Commissioners ("NAIC") and adopted by the various states. Because of these state insurance regulatory



requirements, we use SAP to manage our insurance operations. The purpose of these state insurance regulations is to protect policyholders, so SAP focuses on solvency and liquidation value unlike GAAP, which focuses on shareholder returns as a going concern. Consequently, significant differences exist between SAP and GAAP as discussed below:

• With regard to the underwriting expense ratio: As noted above, NPE is the denominator for GAAP; whereas NPW is the denominator for SAP.

• With regard to certain income:

Underwriting expenses that are incremental and directly related to the successful acquisition of insurance policies are deferred and amortized to expense over the life of an insurance policy under GAAP; whereas they are recognized when incurred under SAP.

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

Changes in the value of our alternative investments, which are part of our other investment portfolio on our Consolidated Balance Sheets, are recognized in income under GAAP; whereas they are recorded directly to surplus under SAP and only recognized in income when cash is received.

With regard to loss and loss expense reserves:

Under GAAP, reinsurance recoverables, net of a provision for uncollectible reinsurance, are presented as an asset on the Consolidated Balance Sheet, whereas under SAP, this amount is netted within the liability for loss and loss expense reserves.

Under GAAP, for those structured settlements for which we did not obtain a release, a deposit asset and the related loss reserve are included on the Consolidated Balance Sheet, whereas under SAP, the structured settlement transaction is recorded as a paid loss.

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

| (\$ in thousands)   | 2014        | 2013      |
|---|-------------|-----------|
| Statutory losses and loss expense reserves                  | \$2,892,041 | 2,797,459 |
| Provision for uncollectible reinsurance                     | 6,900       | 5,100     |
| Structured settlements                                      | 6,951       | 6,372     |
| GAAP losses and loss expense reserves – net                 | 2,905,892   | 2,808,931 |
| Reinsurance recoverables on unpaid losses and loss expenses | 571,978     | 540,839   |
| GAAP losses and loss expense reserves – gross               | \$3,477,870 | 3,349,770 |

With regard to equity under GAAP and statutory surplus under SAP:

The timing difference in income due to the GAAP/SAP differences in expense recognition creates a difference between GAAP equity and SAP statutory surplus.

Regarding unrealized gains and losses on fixed income securities:

Under GAAP, unrealized gains and losses on available-for-sale (“AFS”) fixed income securities are recognized in equity; but they are not recognized in equity on purchased held-to-maturity (“HTM”) securities. Unrealized gains and losses on HTM securities transferred from an AFS designation are amortized from equity as a yield adjustment.

Under SAP, unrealized gains and losses on fixed income securities assigned certain NAIC Security Valuation Office ratings (specifically designations of one or two, which generally equate to investment grade bonds) are not recognized in statutory surplus. However, unrealized losses on fixed income securities that have a designation of three or higher are recognized as an adjustment to statutory surplus.

Certain assets are designated under insurance regulations as “non-admitted,” including, but not limited to, certain deferred tax assets, overdue premium receivables, furniture and equipment, and prepaid expenses. These assets are excluded from statutory surplus under SAP, but are recorded in the Consolidated Balance Sheets net of applicable

allowances under GAAP.

Regarding the recognition of the liability for our defined benefit plans, under both GAAP and SAP, the liability is recognized in an amount equal to the excess of the projected benefit obligation over the fair value of the plan assets. However, changes in this balance not otherwise recognized in income are recognized in equity as a component of other comprehensive income (“OCI”) under GAAP and in statutory surplus under SAP.

6

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Our combined insurance segments' GAAP results for the last three completed fiscal years are shown on the following table:

| (\$ in thousands)                   | Year Ended December 31, |           |           |
|-------------------------------------|-------------------------|-----------|-----------|
|                                     | 2014                    | 2013      | 2012      |
| Combined Insurance Segments Results |                         |           |           |
| NPW                                 | \$1,885,280             | 1,810,159 | 1,666,883 |
| NPE                                 | \$1,852,609             | 1,736,072 | 1,584,119 |
| Losses and loss expenses incurred   | 1,157,501               | 1,121,738 | 1,120,990 |
| Net underwriting expenses incurred  | 610,783                 | 571,294   | 523,688   |
| Policyholder dividends              | 6,182                   | 4,274     | 3,448     |
| Underwriting income (loss)          | \$78,143                | 38,766    | (64,007 ) |
| Ratios:                             |                         |           |           |
| Loss and loss expense ratio         | 62.5                    | % 64.6    | 70.8      |
| Underwriting expense ratio          | 33.0                    | 33.0      | 33.0      |
| Policyholder dividends ratio        | 0.3                     | 0.2       | 0.2       |
| GAAP combined ratio                 | 95.8                    | % 97.8    | 104.0     |
| Statutory combined ratio            | 95.7                    | % 97.5    | 103.5     |

For revenue and profitability measures for each of our three insurance segments, see Note 11. "Segment Information" in Item 8. "Financial Statements and Supplementary Data." of this Form 10-K. We do not allocate assets to individual segments. In addition, for analysis of our insurance segments' results, see "Results of Operations and Related Information by Segment" in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations." of this Form 10-K.

## Insurance Segments

### Overview

We derive all of our insurance operations revenue from selling insurance products and services to businesses and individuals for premium. The majority of our sales are annual insurance policies. Our most significant cost associated with the sale of insurance policies is our loss and loss expenses.

To that end, we establish loss and loss expense reserves that are estimates of the amounts that we will need to pay in the future for claims and related expenses for insured losses that have already occurred. Estimating reserves as of any given date involves a considerable degree of judgment and is inherently uncertain. We regularly review our reserving techniques and our overall amount of reserves. For disclosures concerning our unpaid loss and loss expenses, as well as a full discussion regarding our loss reserving process, 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. Additionally, for an analysis of changes in our loss reserves over the most recent three-year period, see Note 9. "Reserves for Losses and Loss Expenses" in Item 8. "Financial Statements and Supplementary Data." of this Form 10-K.

As part of our risk management efforts associated with the sale of our products and services, we use reinsurance to protect our capital resources and insure us against losses on the risks that we underwrite. We use two main reinsurance vehicles: (i) a reinsurance pooling agreement among our Insurance Subsidiaries in which each company agrees to share in premiums and losses based on certain specified percentages; and (ii) reinsurance contracts and arrangements with third parties that cover various policies that we issue to our customers. For information regarding reinsurance

treaties and agreements, see "Reinsurance" in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations." of this Form 10-K.

7

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### Insurance Segments Products and Services

The types of insurance we sell in our insurance segments fall into three broad categories:

• **Property insurance**, which generally covers the financial consequences of accidental loss of an insured's real and/or personal property. Property claims are generally reported and settled in a relatively short period of time.

• **Casualty insurance**, which generally covers the financial consequences of employee injuries in the course of employment and bodily injury and/or property damage to a third party as a result of an insured's negligent acts, omissions, or legal liabilities. Casualty claims may take several years to be reported and settled.

• **Flood insurance**, which generally covers property losses under the Federal Government's Write Your Own ("WYO") program of the NFIP. Flood insurance premiums and losses are 100% ceded to the NFIP.

We underwrite our business primarily through traditional insurance. The following table shows the principal types of policies we write:

| Types of Policies                                       | Category of Insurance | Standard Commercial Lines | Standard Personal Lines | E&S Lines |
|---|-----------------------|---------------------------|-------------------------|-----------|
| Commercial Property                                     | Property              | X                         |                         | X         |
| Commercial Automobile                                   | Property/Casualty     | X                         |                         | X         |
| General Liability (including Excess Liability/Umbrella) | Casualty              | X                         |                         | X         |
| Workers Compensation                                    | Casualty              | X                         |                         |           |
| Businessowners' Policy                                  | Property/Casualty     | X                         |                         |           |
| Bonds (Fidelity and Surety)                             | Casualty              | X                         |                         |           |
| Homeowners  | Property/Casualty     |                           | X                       |           |
| Personal Automobile                                     | Property/Casualty     |                           | X                       |           |
| Personal Umbrella                                       | Casualty              |                           | X                       |           |
| Flood <sup>1</sup>                                      | Flood/Property        |                           | X                       |           |

<sup>1</sup>Flood insurance premiums and losses are 100% ceded to the federal government's WYO program. Certain other policies contain minimal flood or flood related coverages.

### Product Development and Pricing

Our insurance policies are contracts that specify our coverages - what we will pay to or for an insured upon a specified loss. We develop our coverages internally and by adopting and modifying forms and statistical data licensed from third party aggregators, notably Insurance Services Office, Inc. ("ISO"), American Association of Insurance Services, Inc. ("AAIS"), and the National Council on Compensation Insurance, Inc. ("NCCI"). Determining the price to charge for our coverages involves consideration of many variables. At the time we underwrite and issue a policy, we do not know what our actual costs for the policy will be in the future. To calculate and project future costs, we examine and analyze historical statistical data and factor in expected changes in loss trends. Additionally, we have developed predictive models for certain of our Standard Commercial and Standard Personal Lines. Predictive models analyze historical statistical data regarding our customers and their loss experience, rank our policies, or potential policies, based on this analysis, and apply this risk data to current and future customers to predict the likely profitability of an account. A model's predictive capabilities are limited by the amount and quality of the statistical data available. As a regional insurance group, our loss experience is not always statistically large enough to analyze and project future costs. Consequently, we use ISO, AAIS, and NCCI data to supplement our proprietary data.



#### Customers and Customer Markets

We categorize our Standard Commercial Lines customers into the following strategic business units ("SBUs"):

|                                 | Percentage of Standard Commercial Lines | Description   |
|---------------------------------|---|---|
| Manufacturing and Wholesale     | 18%                                     | Includes manufacturers, wholesalers, and distributors                                 |
| Contracting                     | 34%                                     | General contractors and subcontractors  |
| Community and Public Services   | 23%                                     | Focuses on public entities, social services, golf courses, and religious institutions |
| Mercantile and Services         | 24%                                     | Focuses on retail, office, service businesses, restaurants, and hotels                |
| Bonds                           | 1%                                      | Includes fidelity and surety  |
| Total Standard Commercial Lines | 100%                                    |   |

We do not categorize our Standard Personal Line customers or our E&S Line customers by class.

The following are general guidelines that can be used as indicators of the size of our customers:

- The average Standard Commercial Lines account size is approximately \$10,000.
- The average Standard Personal Lines account size is approximately \$1,500.
- The average E&S Lines policy is approximately \$3,100.

No one customer accounts for 10% or more of our insurance segments in the aggregate.

#### Geographic Markets

We principally sell in the following geographic markets:

Standard Commercial Lines products and services are primarily sold in 22 states and the District of Columbia in the Eastern and Midwestern regions of the United States.

Standard Personal Lines products and services are primarily sold in 13 states in the Eastern and Midwestern regions of the United States, except for the flood portion of this segment, which is sold in all 50 states and the District of Columbia.

E&S Lines are sold in all 50 states and the District of Columbia.

We believe this geographic diversification lessens our exposure to regulatory, competitive, and catastrophic risk. The following table lists the principal states in which we write business and the percentage of total NPW each represents for the last three fiscal years:

| % of NPW   | Year Ended December 31, |        |      |
|------------|-------------------------|--------|------|
|            | 2014                    | 2013   | 2012 |
| New Jersey | 22.6                    | % 23.1 | 23.3 |



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|                |       |         |       |
|----------------|-------|---------|-------|
| Pennsylvania   | 11.4  | 11.5    | 12.0  |
| New York       | 7.1   | 6.9     | 7.6   |
| Maryland       | 5.6   | 5.7     | 5.7   |
| Virginia       | 4.6   | 4.7     | 4.9   |
| Indiana        | 4.5   | 4.8     | 5.0   |
| Illinois       | 4.0   | 4.5     | 4.9   |
| Georgia        | 3.8   | 3.5     | 3.1   |
| North Carolina | 3.4   | 3.2     | 3.1   |
| Michigan       | 3.3   | 3.4     | 3.5   |
| South Carolina | 3.1   | 3.0     | 3.0   |
| Connecticut    | 3.0   | 2.9     | 2.7   |
| Other states   | 23.6  | 22.8    | 21.2  |
| Total          | 100.0 | % 100.0 | 100.0 |

9

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We support these geographic locations from our corporate headquarters in Branchville, New Jersey, and our six regional branches (referred to as our “Regions”). The table below lists our Regions and where they have office locations:

| 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                         |
| E&S          | Horsham, Pennsylvania and Scottsdale, Arizona     |

#### Distribution and Marketing

We sell and distribute our Standard Commercial and Standard Personal Lines products and services through our distribution partners, who in the case of our standard market business are independent retail insurance agents. Independent retail insurance agents and brokers write approximately 80% of Standard Commercial Lines insurance in the United States according to a study released in 2014 by the Independent Insurance Agents & Brokers of America. Approximately 35% of Standard Personal Lines insurance is sold through independent retail insurance agents, according to the same survey. We believe that independent retail insurance agents will remain a significant force in overall insurance industry premium production because they represent more than one insurance carrier and therefore are able to provide a wider choice of commercial lines and personal lines insurance products and risk-based consultation to customers. We have agreements with approximately 1,100 distribution partners in the commercial lines standard market as of December 31, 2014. Of these distribution partners, 700 of them also sell personal lines, excluding flood. The distribution partners have approximately 2,000 office locations that sell our products to our standard market customers. In addition, we have approximately 5,000 distribution partners selling our flood insurance products.

E&S Lines are written almost exclusively through approximately 80 wholesale general agents, who are our distribution partners in the E&S market. We have granted contract binding authority to these partners for business that meets our prescribed underwriting and pricing guidelines.

We pay our distribution partners commissions and other consideration for business placed with us. We seek to compensate our distribution partners fairly and consistent with market practices. No one distribution partner is responsible for 10% or more of our combined insurance segments' premium.

In our most recent survey of our retail distribution partners, which was conducted in 2014, we received an overall satisfaction score of 8.6 out of 10, which, we believe, highlighted our distribution partners' satisfaction with our Standard Commercial Lines and Standard Personal Lines products, the ease of reporting claims, and the professionalism and effectiveness of our employees.

As our customers rely heavily on our distribution partners, it is sometimes difficult to develop brand recognition with our customers, who cannot always differentiate between their insurance agents and their insurance carriers. We continue to evolve our service model, post-acquisition, with an increasing focus on the customer. While we currently offer customers a shared experience with our distribution partners, we are moving towards a model that positions us to more directly demonstrate our value proposition to our customers.

Our primary marketing strategy is to:

Use an empowered field model to provide our retail distribution partners with resources within close geographic proximity to their businesses and our customers. For further discussion on this, see the “Field Model and Technology” section below.

- Develop close relationships with each distribution partner, as well as their principals and producers: (i) by soliciting their feedback on products and services; (ii) by advising them concerning product developments; and (iii) through interaction with them focusing on producer recruitment, sales training, enhancing customer experience, online marketing, and distribution operations.

Develop with each distribution partner, and then carefully monitor, annual goals regarding: (i) types and mix of risks placed with us; (ii) amount of premium or number of policies placed with us; (iii) customer service and retention levels; and (iv) profitability of business placed with us.

Develop brand recognition with our customers through our marketing efforts, which include radio and television advertising, as well as advertising at certain national and local sporting events.

#### Field Model and Technology

We use the service mark “High-tech x High-touch = HT<sup>SM</sup>” to describe our business strategy. “High-tech” refers to our technology that we use to make it easy for our distribution partners and customers to do business with us. “High-touch” refers to the close relationships that we have with our distribution partners and customers through our field business model.

#### High Tech

We leverage the use of technology in our business. We have made significant investments in information technology platforms, integrated systems, internet-based applications, and predictive modeling initiatives. We do this to provide:

- Our distribution partners and our customers with access to accurate business information and the ability to process certain transactions from their locations, seamlessly integrating those transactions into our systems;
- Our underwriters with targeted underwriting and pricing tools to enhance profitability while growing the business;
- Our Special Investigations Unit (“SIU”) investigators access our business intelligence systems to better identify claims with potential fraudulent activities;
- Our claims recovery and subrogation departments with the ability to expand and enhance their models through the use of our business intelligence systems; and
- Our customers with 24/7 access to transactional capabilities and information through a web-based customer portal and a customer mobile app.

In 2014, we received the Interface Partner Award from Applied Systems, an automated solutions provider to independent retail insurance agents, for the seventh consecutive year. The award recognizes our leadership and innovation in our interface advancements in download and real-time rating.

We manage our information technology projects through an Enterprise Project Management Office (“EPMO”) governance model. The EPMO is supported by certified individuals who apply methodologies to: (i) communicate project management standards; (ii) provide project management training and tools; (iii) manage projects; (iv) review

project status and cost; and (v) provide non-technology project management consulting services to the rest of the organization. The EPMO, which includes senior management representatives from all major business areas, corporate functions, and information technology, meets regularly to review all major initiatives and receives reports on the status of other projects. We believe the EPMO is an important factor in the success of our technology implementation.

Our primary technology operations are located in Branchville, New Jersey and Glastonbury, Connecticut. We have agreements with multiple consulting, information technology, and service providers for supplemental staffing services. Collectively, these providers supply approximately 36% of our skilled technology capacity. We retain management oversight of all projects and ongoing information technology production operations. We believe we would be able to manage an efficient transition to new vendors without significant impact to our operations if we terminated an existing vendor.

### High Touch

To support our distribution partners, we employ a field model for both underwriting and claims, with various employees in the field, usually working from home offices near our distribution partners. We believe that we build better and stronger relationships with our distribution partners because of the close proximity of our field employees, and the resulting direct interaction with our distribution partners and our customers. At December 31, 2014, we had approximately 2,200 employees, about 320 of which worked in the field, and another 850 that worked in one of our regional offices noted above.

### Underwriting Process

Our underwriting process requires communication and interaction among:

Our distribution partners, who provide front-line underwriting, our Agency Management Specialists (“AMSs”) and Safety Management Specialists (“SMSs”), our Standard Personal Lines marketing representatives, and our corporate and regional underwriters. Our AMSs continue to be a central focus of the field model, with responsibility for: (i) managing the growth and profitability of their distribution partners with us; and (ii) performing field underwriting for new Standard Commercial Lines business. In the fourth quarter of 2014, a strategic decision was made to eliminate our field marketing specialist role, which had been a multi-purpose role focused on Standard Personal Lines, small Standard Commercial Lines business, and technology training. This role was replaced with dedicated Standard Personal Lines marketing representatives with the primary responsibility of growing Standard Personal Lines, dedicated field technical coordinators responsible solely for technology assistance and training and over a dozen additional AMSs. In addition, we broadened the scope of, and enhanced the talent in, our small business teams. These teams were previously responsible for handling business in need of review that was submitted through our automated underwriting platform, One & Done<sup>®</sup>. They now also handle small accounts with low underwriting complexity, which enables our AMSs to spend more time underwriting middle market accounts.

• Our 5,000 flood distribution partners for our Standard Personal Lines business under the NFIP's WYO program.

- Our corporate underwriting department, which develops our products, policy forms, pricing, and underwriting guidelines in conjunction with the Regions.

Our Regions, which establish: (i) annual premium and pricing goals in consultation with the corporate underwriting department; (ii) new business targets for our distribution partners; and (iii) profit improvement plans for our distribution partners.

• Our Actuarial Department, located primarily in our corporate headquarters, which assists in the determination of rate and pricing levels, while monitoring pricing and profitability.

We have an underwriting service center (“USC”) located in Richmond, Virginia. The USC assists our distribution partners by servicing certain Standard Personal Lines and smaller Standard Commercial Lines accounts. At the USC, many of our employees are licensed agents who respond to customer inquiries about insurance coverage, billing transactions, and other matters. For the convenience of using the USC and our handling of certain transactions, our distribution partners agree to receive a slightly lower than standard commission for the premium associated with the USC. As of December 31, 2014, our USC was servicing Standard Commercial Lines NPW of \$49.6 million and Standard Personal Lines NPW of \$26.3 million. The \$75.9 million total serviced by the USC represents 4% of our total NPW.

We believe that our field model has a distinct advantage in its ability to provide a wide range of front-line safety management services focused on improving a Standard Commercial Lines insured’s safety and risk management

programs and we have obtained the service mark “Safety Management: Solutions for a safer workplace<sup>SM</sup>” Safety management services include: (i) risk evaluation and improvement surveys intended to evaluate potential exposures and provide solutions for mitigation; (ii) internet-based safety management educational resources, including a large library of coverage-specific safety materials, videos and online courses, such as defensive driving and employee educational safety courses; (iii) thermographic infrared surveys aimed at identifying electrical hazards; and (iv) Occupational Safety and Health Administration 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 work with our customers to identify and eliminate potential loss exposures.

### Claims Management

Effective, fair, and timely claims management is one of the most important services that we provide to our customers and distribution partners. It is also one of the critical factors in achieving underwriting profitability. We have structured our claims organization to emphasize: (i) cost-effective delivery of claims services and control of loss and loss expenses; and (ii) maintenance of timely and adequate claims reserves. In connection with our Standard Commercial Lines and Standard Personal Lines, we believe that we can achieve lower claims expenses through our field model by locating claims representatives in close proximity to our customers and distribution partners. For our E&S Line, we use external adjusters who are situated close to claimants and work with our corporate E&S claims adjusters to manage individual claims for this segment.

We have a claims service center ("CSC"), co-located with the USC, in Richmond, Virginia. The CSC receives first notices of loss from our customers and claimants related to our Standard Commercial Lines and Standard Personal Lines. The CSC is designed to help: (i) reduce the claims settlement time on first- and third-party automobile property damage claims; (ii) increase the use of body shops, glass repair shops, and car rental agencies that have contracted with us at discounted rates; (iii) handle and settle small property claims; and (iv) investigate and negotiate auto liability claims. Upon receipt of a claim, the CSC, as appropriate, will assign the matter to the appropriate Region or specialized area at our corporate headquarters.

Claims management specialists ("CMSs") are responsible for investigating and resolving the majority of our standard marketplace commercial automobile bodily injury, general liability, and property losses with low to moderate severities. Strategically located throughout our footprint, CMSs are able to provide highly responsive customer and distribution partner service to quickly resolve claims within their authority. We have implemented specialized claims handling as follows:

Workers compensation claim handling is centralized in Charlotte, North Carolina. Jurisdictionally trained and aligned medical only and lost-time adjusters manage non-complex workers compensation claims within our footprint. Claims with high exposure and/or significant escalation risk are referred to the workers compensation strategic case management unit.

Property claims with high severity or technically complex losses are handled by either the Property Flex Unit or the Large Loss Unit. Both of these groups specifically handle only higher exposure property claims. The Large Loss Unit, which is comprised of seasoned general adjusters, handles claims above \$100,000. During 2014, we established the Property Flex Unit to: (i) handle claims between \$25,000 to \$100,000; and (ii) form the core of a catastrophe team.

Liability claims with high severity or technically complex losses are handled by the Complex Claims Unit ("CCU"). The CCU specialists are primarily field based and handle losses based on injury type or with severities greater than \$250,000. Litigated matters not meeting the CCU criteria are handled within our regional offices by our litigation teams. These teams are aligned based upon jurisdictional knowledge and technical experience.

All asbestos and environmental claims are referred to our specialized corporate Environmental Unit, which also handles latent claims.

This structure allows us to provide experienced adjusting to each claim category.

For all of our insurance segments, we have an 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 take action on potentially fraudulent claims. It is our practice to notify the proper authorities of SIU findings, which we believe sends a clear message that we will not tolerate fraud against us or our

customers. The SIU supervises anti-fraud training for all claims adjusters and AMSs.



### Insurance Operations Competition

Our insurance segments face competition from both public companies and mutual companies, which may have lower operating costs or cost of capital than we do. Some, like us, rely on partners for the distribution of their products and services and have competition within their distribution channel, making growth in market share difficult. Others either employ their own agents who only represent one insurance carrier or use a combination of distribution partners, captive agents, and direct marketing. The following provides information on the competition facing our insurance segments:

#### Standard Commercial Lines

The Standard Commercial Lines property and casualty insurance market is highly competitive and market share is fragmented among many companies. We compete with two types of companies, primarily on the basis of price, coverage terms, claims service, customer experience, safety management services, ease of technology, and financial ratings:

Regional insurers, such as Cincinnati Financial Corporation, Erie Indemnity Company, The Hanover Insurance Group, Inc., and United Fire Group, Inc.; and

National insurers, such as Liberty Mutual Holding Company Inc., The Travelers Companies, Inc., The Hartford Financial Services Group, Inc., Nationwide Mutual Insurance Company, and Zurich Insurance Group, Ltd.

#### Standard Personal Lines

While we face competition in Standard Personal Lines, carriers have been more successful at obtaining rate increases. Our Standard Personal Lines face competition primarily from the regional and national carriers noted above, as well as companies such as State Farm and Allstate Corporation. In addition, we face competition from direct insurers such as GEICO and The Progressive Corporation, which primarily offer personal auto coverage and market through a direct-to-consumer model.

#### E&S Lines

Our E&S Lines face competition from insurers such as Scottsdale Insurance Company, Nautilus Insurance Group, Colony Specialty, a member of the Argo Group International Holding Ltd, Markel Corporation, Western World Insurance Group, Century Insurance Group, a member of the Meadowbrook Insurance Group, Burlington Insurance Company, and Cincinnati Financial Corporation. In addition, we face competition from E&S insurers who work directly with retail agencies such as United States Liability Insurance Group.

### Industry Comparison

A comparison of certain statutory ratios for our combined insurance segments and our industry are shown in the following table:

|   | Simple<br>Average of<br>All Periods<br>Presented | 2014 | 2013   | 2012   | 2011   | 2010   |
|---|--|------|--------|--------|--------|--------|
| <b>Insurance Operations Ratios:<sup>1</sup></b> |  |      |        |        |        |        |
| Loss and loss expense                           | 68.3   | 62.4 | 64.5   | 70.7   | 74.6   | 69.3   |
| Underwriting expense                            | 32.4   | 33.0 | 32.8   | 32.6   | 31.7   | 32.0   |
| Policyholder dividends                          | 0.3  | 0.3  | 0.2    | 0.2    | 0.4    | 0.3    |
| Statutory combined ratio                        | 101.0  | 95.7 | 97.5   | 103.5  | 106.7  | 101.6  |
| Growth in NPW                                   | 5.9  | 4.1  | 8.7    | 12.2   | 7.0    | (2.4 ) |
| <b>Industry Ratios:<sup>1, 2</sup></b>          |  |      |        |        |        |        |
| Loss and loss expense                           | 72.2   | 69.6 | 67.7   | 73.7   | 77.9   | 72.0   |
| Underwriting expense                            | 27.9   | 27.0 | 28.0   | 28.2   | 28.0   | 28.5   |
| Policyholder dividends                          | 0.6  | 0.6  | 0.7    | 0.6    | 0.6    | 0.7    |
| Statutory combined ratio                        | 100.7  | 97.2 | 96.4   | 102.5  | 106.5  | 101.1  |
| Growth in NPW                                   | 3.4  | 3.9  | 4.4    | 4.4    | 3.3    | 0.9    |
| <b>Favorable (Unfavorable)<br/>to Industry:</b> |  |      |        |        |        |        |
| Statutory combined ratio                        | (0.3 )   | 1.5  | (1.1 ) | (1.0 ) | (0.2 ) | (0.5 ) |
| Growth in NPW                                   | 2.5  | 0.2  | 4.3    | 7.8    | 3.7    | (3.3 ) |

Note: Some amounts may not foot due to rounding.

<sup>1</sup>The ratios and percentages are based on SAP prescribed or permitted by state insurance departments in the states in which the Insurance Subsidiaries are domiciled.

<sup>2</sup>Source: A.M. Best. The industry ratios for 2014 have been estimated by A.M. Best.

### Insurance Regulation

#### Primary Oversight by the States in Which We Operate

Our insurance segments are heavily regulated. The primary public policy behind insurance regulation is the protection of policyholders and claimants over all other constituencies, including shareholders. By virtue of the McCarran-Ferguson Act, Congress has largely delegated insurance regulation to the various states. The primary market conduct and financial regulators of our Insurance Subsidiaries are the departments of insurance in the states in which they are organized and are licensed. For a discussion of the broad regulatory, administrative, and supervisory powers of the various departments of insurance, refer to the risk factor that discusses regulation in Item 1A. "Risk Factors." of this Form 10-K.

Our various state insurance regulators are members of the NAIC. The NAIC has codified SAP and other accounting reporting formats and drafts model insurance laws and regulations governing insurance companies. An NAIC model only becomes law when it is enacted in the various state legislatures. The adoption of certain NAIC model laws and regulations, however, is a key aspect of the NAIC Financial Regulations Standards and Accreditation Program.

#### NAIC Monitoring Tools

Among the NAIC's various financial monitoring tools that are material to the regulators in states in which our Insurance Subsidiaries are organized are the following:

The Insurance Regulatory Information System (“IRIS”). IRIS identifies 13 industry financial ratios and specifies “usual values” for each ratio. Departure from the usual values on four or more of the financial ratios can lead to inquiries from individual state insurance departments about certain aspects of the insurer's business. Our Insurance Subsidiaries have consistently met the majority of the IRIS ratio tests.

**Risk-Based Capital.** Risk-based capital is measured by 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 face a steadily increasing amount of regulatory scrutiny and potential intervention as their total adjusted capital declines below two times their "Authorized Control Level". Based on our 2014 statutory financial statements, which have been prepared in accordance with SAP, the total adjusted capital for each of our Insurance Subsidiaries substantially exceeded two times their Authorized Control Level at 4.5:1.

**Annual Financial Reporting Regulation** (referred to as the "Model Audit Rule"). The Model Audit Rule, which is modeled closely on the Sarbanes-Oxley Act of 2002, as amended, regulates: (i) auditor independence; (ii) corporate governance; and (iii) internal control over financial reporting. As permitted under the Model Audit Rule, the Audit Committee of the Board of Directors (the "Board") of the Parent also serves as the audit committee of each of our Insurance Subsidiaries.

**Own Risk Solvency Assessment ("ORSA") Model Law.** ORSA requires insurers to maintain a framework for identifying, assessing, monitoring, managing, and reporting on the "material and relevant risks" associated with the insurers' (or insurance groups') current and future business plans. ORSA, which has been adopted by the state insurance regulators of our Insurance Subsidiaries, requires companies to file an internal assessment of their solvency with insurance regulators annually beginning in 2015. Although no specific capital adequacy standard is currently articulated in ORSA, it is possible that such standard will be developed over time and may increase insurers' minimum capital requirements, which could adversely impact our growth and return on equity.

#### Federal Regulation

Federal legislation and administrative policies affect the insurance industry. Among the most notable are the Terrorism Risk Insurance Program Reauthorization Act ("TRIPRA"), the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), and various privacy laws that apply to us because we have personal non-public information, including the Gramm-Leach-Bliley Act, the Fair Credit Reporting Act, the Drivers Privacy Protection Act, and the Health Insurance Portability and Accountability Act. Like all businesses, we are required to enforce the economic and trade sanctions of the Office of Foreign Assets Control ("OFAC"). FEMA oversees the WYO Program enacted by Congress, which is currently set to expire in August 2017. Congress sets the WYO Program's budgeting, rules, and rating parameters. The Homeowner Flood Insurance Affordability Act enacted in 2014 repealed and modified certain provisions of the Biggert-Waters Flood Insurance Act regarding premium adjustments.

In response to the financial markets crises in 2008 and 2009, the Dodd-Frank Act was enacted in 2010. This law provides for, among other things, the following:

- The establishment of the Federal Insurance Office ("FIO") under the United States Department of the Treasury;
- Federal Reserve oversight of financial services firms designated as systemically important; and
- Corporate governance reforms for publicly traded companies.

The FIO continues to establish itself on national and international insurance issues after having issued its initial report regarding the modernization of insurance regulation in the United States. The report concluded that insurance regulation in the United States is best viewed in terms of a hybrid model, in which state and federal oversight play complementary roles defined by the strengths each brings to improving solvency and market conduct regulation. The FIO, Federal Reserve, and the NAIC are currently looking at oversight and solvency standards as they coordinate with international regulators regarding the future regulation of financial entities. For additional information on the potential impact of the Dodd-Frank Act, refer to the risk factor related to legislation within Item 1A. "Risk Factors." of this Form 10-K.



### Investment Segment

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 prices, and the change in market value of our alternative investment portfolio. A decline in investment income and/or our investment portfolio asset values could occur as a result of, among other things, decreased dividend payment rates, negative market perception of credit risk with respect to types of securities in our portfolio, volatile interest rates, a decrease in market liquidity, a decline in the performance of the underlying collateral of our structured securities, reduced returns on our alternative investment portfolio, or general market conditions.

Our Investment segment invests insurance premiums, as well as amounts generated through our capital management strategies, which may include the issuance of debt and equity securities, to generate investment income and to satisfy obligations to our customers, our shareholders, and our debt holders, among others. At December 31, 2014, our investment portfolio consisted of the following:

### Category of Investment

| (\$ in millions)                          | Carrying Value | % of Investment Portfolio |
|---|----------------|---------------------------|
| Fixed income securities                   | \$4,384.3      | 91                        |
| Equity securities                         | 191.4          | 4                         |
| Short-term investments                    | 131.9          | 3                         |
| Other investments, including alternatives | 99.2           | 2                         |
| Total                                     | \$4,806.8      | 100                       |

Our investment strategy includes setting certain return and risk objectives for the fixed income, equity, and other investment portfolios. The primary fixed income 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 strategy is designed to generate consistent dividend income and long term capital appreciation benchmarked to the S&P 500 Index. 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 predominantly “buy-and-hold” approach. The return objective of the other investment portfolio, which includes alternative investments, is to meet or exceed the S&P 500 Index.

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 5. of this Form 10-K.

### Reports to Security Holders

We file with the SEC all required disclosures, including 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 under Sections 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (“Exchange Act”). We provide access to these filed materials on our Internet website, [www.selective.com](http://www.selective.com).



Item 1A. Risk Factors.

Any of the following risk factors could cause our actual results to differ materially from historical or anticipated results. They could have a significant impact on our business, liquidity, capital resources, results of operations, financial condition, and debt ratings. These risk factors might affect, alter, or change actions that we might take in executing our long-term capital strategy, including but not limited to, contributing capital to any or all of the Insurance Subsidiaries, issuing additional debt and/or equity securities, repurchasing our equity securities, redeeming our fixed income securities, or increasing or decreasing stockholders' dividends. The following list of risk factors is not exhaustive, and others may exist.

Risks Related to Insurance Segments

The failure of our risk management strategies could have a material adverse effect on our financial condition or results of operations.

As an insurance provider, it is our business to take on risk from our customers. Our long term strategy includes use of above average operational leverage, which can be measured as the NPW to our equity or policyholders surplus. We balance operational leverage risk with a number of risk management strategies to achieve a balance of growth and profit and to reduce our exposure that include, but are not limited to, the following:

• Being disciplined in our underwriting practices;

• Being prudent in our claims management practices, establishing adequate loss and loss expense reserves, and placing appropriate reliance on our claims analytics;

• Continuing to develop and implement various underwriting tools and automated analytics to examine historical statistical data regarding our customers and their loss experience to: (i) classify such policies based on that information; (ii) apply that information to current and prospective accounts; and (iii) better predict account profitability;

• Continuing to develop our customer experience platform as we grow in our understanding of customer segmentation;

• Purchasing reinsurance and using catastrophe modeling;

• Being prudent in managing our investment portfolio, which supports our liabilities and underwriting strategies; and

• Being prudent in our financial planning process, which supports our underwriting strategies.

All of these strategies have inherent limitations. We cannot be certain that an unanticipated event or series of unanticipated events will not occur and result in losses greater than we expect and have a material adverse effect on our results of operations, liquidity, financial condition, financial strength, and debt ratings.

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

We are required to maintain loss and loss expense reserves for our estimated liability for losses and loss expenses associated with reported and unreported insurance claims. Our estimates of reserve amounts are based on facts and circumstances that we know, including our expectations of the ultimate settlement and claim administration expenses, including inflationary trends particularly regarding medical costs, 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. From time-to-time, we increase reserves if they are inadequate or reduce them if they are redundant. We cannot be certain that the reserves we establish are adequate or will be adequate in the future. An increase in reserves: (i) reduces net income and stockholders' equity for the period in which the reserves are increased; and (ii) could have a material adverse effect on our results of operations, liquidity, financial condition, financial strength, and debt ratings.

We are subject to losses from catastrophic events.



Our results are subject to losses from natural and man-made 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. One year may be relatively free of such events while another may have multiple events. For further discussion regarding man-made catastrophes that relate to terrorism, see the risk factor directly below regarding the potential for significant losses from acts of terrorism.

There is widespread interest among scientists, legislators, regulators, and the public regarding the effect that greenhouse gas emissions may have on our environment, including climate change. If greenhouse gases continue to impact our climate, it is possible that more devastating catastrophic events could occur.

The magnitude of catastrophe losses is determined by the severity of the event and the total amount of insured exposures in the area affected by the event as determined by Property Claim Services<sup>®</sup>. Most of the risks underwritten by our insurance segments are concentrated geographically in the Eastern and Midwestern regions of the United States, particularly in New Jersey, which represented approximately 23% of our total NPW during the year ended December 31, 2014. Catastrophes in the Eastern and Midwestern regions of the United States could adversely impact our financial results, as was the case in 2010, 2011, and 2012.

Although catastrophes can cause losses in a variety of property and casualty insurance lines, most of our historic catastrophe-related claims have been from commercial property and homeowners coverages. In an effort to limit our exposure to catastrophe losses, we purchase catastrophe reinsurance. Reinsurance could prove inadequate if: (i) the various modeling software programs that we use to analyze the Insurance Subsidiaries' risk result in an inadequate purchase of reinsurance by us; (ii) a major catastrophe loss exceeds the reinsurance limit or the reinsurers' financial capacity; or (iii) the frequency of catastrophe losses results in our Insurance Subsidiaries exceeding the aggregate limits provided by the catastrophe treaty. Even after considering our reinsurance protection, our exposure to catastrophe risks could have a material adverse effect on our results of operations, liquidity, financial condition, financial strength, and debt ratings.

We are subject to potential significant losses from acts of terrorism.

As a Standard Commercial Lines and E&S Lines writer, we are required to participate in TRIPRA, which was extended to December 31, 2020. TRIPRA requires private insurers and the United States government to share the risk of loss on future acts of terrorism certified by the U.S. Secretary of the Treasury. A risk exists that certain future terrorist events would not be certified by the U.S. Secretary of Treasury and TRIPRA would not cover them and we would be required to pay in the event of a covered loss. For example, the 2013 Boston Marathon bombing was not a certified event. Under TRIPRA, insureds with non-workers compensation commercial policies have the option to accept or decline our terrorism coverage or negotiate with us for other terms. In 2014, 87% of our Standard Commercial Lines non-workers compensation policyholders purchased terrorism coverage that included nuclear, biological, chemical, and radioactive ("NBCR") events. In addition, terrorism coverage is mandatory for all primary workers compensation policies. The TRIPRA back-stop applies to these coverages when they are written.

Under TRIPRA, each participating insurer is responsible for paying a deductible of specified losses before federal assistance is available. This deductible is based on a percentage of the prior year's applicable Standard Commercial Lines and E&S Lines premiums. In 2015, our deductible is approximately \$254 million. For losses above the deductible, the federal government will pay 85% of losses to an industry limit of \$100 billion, and the insurer retains 15%. The federal share of losses will be reduced by 1% each year to 80% by 2020. Although TRIPRA's provisions will mitigate our loss exposure to a large-scale terrorist attack, our deductible is substantial and could have a material adverse effect on our results of operations, liquidity, financial condition, financial strength, and debt ratings.

TRIPRA rescinded all previously approved coverage exclusions for terrorism. Many of the states in which we write commercial property insurance mandate that we cover fire following an act of terrorism regardless of whether the insured specifically purchased terrorism coverage. Likewise, terrorism coverage cannot be excluded from workers compensation policies in any state in which we write.

Personal lines of business have never been covered under TRIPRA. Homeowners policies within our Standard Personal Lines exclude nuclear losses, but do not exclude biological or chemical losses.

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

We transfer a portion of our underwriting risk exposure to reinsurance companies. Through our reinsurance arrangements, a specified portion of our losses and loss expenses are assumed by the reinsurer in exchange for a

specified portion of premiums. The availability, amount, and cost of reinsurance depend on market conditions, which may vary significantly. Most of our reinsurance contracts renew annually and may be impacted by the market conditions at the time of the renewal that are unrelated to our specific book of business or experience. Any decrease in the amount of our reinsurance will increase our risk of loss. Any increase in the cost of reinsurance that cannot be included in renewal price increases will 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. Either could adversely affect our ability to write future business or result in the assumption of more risk with respect to those policies we issue.

We are exposed to credit risk.

We are exposed to credit risk in several areas of our insurance segments, including from:

Our reinsurers, who are obligated to us under our reinsurance agreements. The relatively small size of the reinsurance market and our objective to maintain an average weighted rating of “A” by A.M. Best on our current reinsurance programs constrains our ability to diversify this credit risk. However, some of our reinsurance credit risk is collateralized.

Certain life insurance companies that are obligated to our customers, as we have purchased annuities from them under structured settlement agreements.

Some of our distribution partners, who collect premiums from our customers and are required to remit the collected premium to us.

Some of our customers, who are responsible for payment of deductibles and/or premiums directly to us.

The invested assets in our defined benefit plan, which partially serve to fund the insurance segments liability associated with this plan. To the extent that credit risk adversely impacts the valuation and performance of the invested assets within our defined benefit plan, the funded status of the defined benefit plan could be adversely impacted and, as result, could increase the cost of the plan to us.

Our exposure to credit risk could have a material adverse effect on our results of operations, liquidity, financial condition, financial strength, and debt ratings.

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.

General economic conditions in the United States and throughout the world and volatility in financial and insurance markets may materially affect our results of operations. Concerns over such issues as the availability and cost of credit, the stability of the United States mortgage market, weak real estate markets, high unemployment, volatile energy and commodity prices, and geopolitical issues, may lead to declines in business and consumer confidence. Declines in business and consumer confidence limit economic growth, which decreases insurance purchases and limits our ability to achieve price increases.

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. Elevated unemployment, lower family income, lower corporate earnings, lower business investment, and lower consumer spending adversely affect the demand for insurance products. In addition, we are impacted by the slow improvement in commercial and new home construction and home ownership because 34% of DPW in our Standard Commercial Lines business during 2014 were generated through insurance policies written to cover contractors. In addition, 35% of DPW in our Standard Commercial Lines business during 2014 were based on payroll/sales of our underlying customers. An economic downturn in which our customers decline in revenue or employee count can adversely affect our audit and endorsement premium in our Standard Commercial Lines. 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. Challenging economic conditions may impair the ability of our customers to pay premiums as they come due. Although economic conditions have consistently improved over the last two years, many fundamental concerns still exist, which may have a material effect on our results of operations, liquidity, financial condition, financial strength, and debt ratings.



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 on our financial condition and results of operations.

Our financial strength ratings, as issued by the following Nationally Recognized Statistical Rating Organizations ("NRSROs"), are as follows:

| NRSRO                     | Financial Strength Rating | Outlook  |
|---------------------------|---------------------------|----------|
| A.M. Best                 | "A"                       | Stable   |
| Standard & Poor's         | "A-"                      | Positive |
| Moody's Investor Services | "A2"                      | Negative |
| Fitch Ratings             | "A+"                      | Stable   |

A significant rating downgrade, particularly from A.M. Best, would affect our ability to write new or renewal 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. In addition, our \$30 million line of credit ("Line of Credit") requires our Insurance Subsidiaries to maintain an A.M. Best rating of at least "A-" (one level below our current rating) and a default could lead to acceleration of any outstanding principal. Such an event could trigger default provisions under certain of our other debt instruments and negatively impact our ability to borrow in the future. As a result, any significant downgrade in our financial strength ratings could have a material adverse effect on our results of operations, liquidity, financial condition, financial strength, and debt ratings.

NRSROs also rate our long-term debt creditworthiness. Credit ratings indicate the ability of debt issuers to meet debt obligations in a timely manner and are important factors in our overall funding profile and ability to access certain types of liquidity. Our current senior credit ratings are as follows:

| NRSRO                     | Credit Rating | Long Term Credit Outlook |
|---------------------------|---------------|--------------------------|
| A.M. Best                 | "bbb+"        | Stable                   |
| Standard & Poor's         | "BBB-"        | Positive                 |
| Moody's Investor Services | "Baa2"        | Negative                 |
| Fitch Ratings             | "BBB+"        | Stable                   |

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. We cannot predict possible actions NRSROs may take regarding our ratings that could adversely affect our business or the possible actions we may take in response to any such actions.

We have many competitors and potential competitors.

Demand for insurance is influenced by prevailing general economic conditions. The supply of insurance is related to prevailing prices, the levels of insured losses and the levels of industry capital which, in turn, may fluctuate in response to changes in rates of return on investments being earned in the insurance industry. In addition, pricing is influenced by the operating performance of insurers as increased pricing may be necessary to meet return on equity objectives. As a result, the insurance industry historically has been through cycles characterized by periods of intense price competition due to excessive underwriting capacity and periods when shortages of capacity and poor operating performance by insurers drives favorable premium levels. If competitors price business below technical levels, we might reduce our profit margin in order to retain our best business.

Pricing and loss trends impact our profitability. For example, assuming retention and all other factors remain constant:

- ▲ A pure price decline of approximately 1% would increase our statutory combined ratio by approximately 0.77 points;
- ▲ A 3% increase in our expected claim costs for the year would cause our loss and loss expense ratio to increase by approximately two points; and

• A combination of the two could raise the combined ratio by approximately three points.

We compete with regional, national, and direct-writer property and casualty insurance companies for customers, distribution partners, and employees. Some competitors are public companies and some are mutual companies. Many competitors are larger and may have lower operating costs or costs of capital. They may have the ability to absorb greater risk while maintaining their financial strength ratings. Consequently, some competitors may be able to price their products more competitively. These competitive pressures could result in increased pricing pressures on a number of our products and services, particularly as competitors seek to win market share, and may impair our ability to maintain or increase our profitability. Because of its relatively low cost of entry, the internet has emerged as a significant place of new competition, both from existing competitors and new competitors. It is possible that reinsurers, who have significant knowledge of the primary property and casualty insurance business because they reinsure it, could enter the market to diversify their operations. New competition could cause changes in the supply or demand for insurance and adversely affect our business.

We have less loss experience data than our larger competitors.

We believe that insurance companies are competing and will continue to compete on their ability to use reliable data about their customers and loss experience in complex analytics and predictive models to assess profitability of the risk, as well as the potential for adverse claim development, recovery opportunities, fraudulent activities, and customer buying habits. With the consistent expansion of computing power and the decline in its cost, we believe that data and analytics use will continue to increase and become more complex and accurate. As a regional insurance group, the loss experience from our insurance operations is not large enough in all circumstances to analyze and project our future costs. In addition, we have limited data regarding our E&S business, which we assumed in 2011 and began writing directly in 2012. We use data from ISO, NCCI, and AASI to obtain sufficient industry loss experience data. While statistically relevant, that data is not specific to the performance of risks we have underwritten. Larger competitors, particularly national carriers, have significantly more data regarding the performance of risks that they have underwritten. The analytics of their loss experience data may be more predictive of profitability of their risks than our analysis using, in part, general industry loss experience. For the same reason, should Congress repeal the McCarran-Ferguson Act, which provides an anti-trust exemption for the aggregation of loss data, and we are unable to access data from ISO, NCCI, and AASI, we will be at a competitive disadvantage to larger insurers who have more sufficient loss experience data on their own customers.

We depend on distribution partners.

We market and sell our insurance products through distribution partners who are not our employees. We believe that these partners will remain a significant force in overall insurance industry premium production because they can provide customers with a wider choice of insurance products than if they represented only one insurer. That, however, creates competition in our distribution channel and we must market our products and services to our distribution partners before they sell them to our mutual customers. Additionally, there has been a trend towards increased levels of consolidation of these distribution partners in the marketplace, which increases competition among fewer distributors. Our Standard Personal Lines production is further limited by the fact that independent retail insurance agencies only write approximately 35% of this business in the United States. Our financial condition and results of operations are tied to the successful marketing and sales efforts of our products by our distribution partners. In addition, under insurance laws and regulations and common law, we potentially can be held liable for business practices or actions taken by our distribution partners.

We face risks regarding our flood business because of uncertainties regarding the NFIP.

We are the fifth largest insurance group participating in the WYO arrangement of the NFIP, which is managed by the Mitigation Division of Federal Emergency Management Agency (“FEMA”) in the U.S. Department of Homeland Security. For WYO participation, we receive an expense allowance for policies written and a servicing fee for claims administered. Under the program, all losses are 100% reinsured by the Federal Government. Currently, the expense allowance is 30.8% of direct premiums written. The servicing fee is the combination of 0.9% of DPW and 1.5% of



incurred losses.

The NFIP is funded by Congress and in 2012, Congress passed, and the President signed, the Biggert-Waters Flood Insurance Reform Act of 2012 (“Biggert-Waters Act”). The Biggert-Waters Act: (i) extended NFIP funding to September 30, 2017; and (ii) moved the program to more market based rates for certain flood policyholders. FEMA implemented these rates throughout 2013, which created significant public discontent and Congressional concern over the impact of the new rates on NFIP customers.

Consequently, Congress passed and, on March 21, 2014, the President signed into law, the Homeowner Flood Insurance Affordability Act of 2014 (“Flood Affordability Act”). The Flood Affordability Act substantially modifies certain provisions of the Biggert-Waters Act, including the reversal of certain rate increases resulting in premium refunds for many NFIP policyholders that began after October 1, 2014. Additional changes are expected to occur in April 2015, such as an increase in the Reserve Fund Assessment, implementation of an annual surcharge on all new and renewal policies, an additional deductible option, and increases in the federal policy fee and basic rates.

As a WYO carrier, we are required to follow certain NFIP procedures when administering flood policies and claims. Some of these requirements may differ from our normal business practices and may present a reputational risk to our brand. Insurance companies are regulated by states; however, the NFIP is a federal program. Consequently, we have the risk that regulatory positions taken by the NFIP and a state regulator on the same issue may conflict.

Despite the passage of the Flood Affordability Act, the role of the NFIP program remains under scrutiny by policymakers. The uncertainty behind the public policy debate and politics of flood insurance reform make it difficult for us to predict the future of the NFIP and our continued participation in the program.

We are heavily regulated and changes in regulation may reduce our profitability, increase our capital requirements, and/or limit our growth.

Our Insurance Subsidiaries are heavily regulated by extensive laws and regulations that may change on short notice. The primary public policy behind insurance regulation is the protection of policyholders and claimants over all other constituencies, including shareholders. Historically, and by virtue of the McCarran-Ferguson Act, our Insurance Subsidiaries are primarily regulated by the states in which they are domiciled and licensed. State insurance regulation is generally uniform throughout the U.S. by virtue of similar laws and regulations required by the NAIC to accredit state insurance departments so their examinations can be given full faith and credit by other state regulators. Despite their general similarity, various provisions of these laws and regulations vary from state to state. At any given time, there may be various legislative and regulatory proposals in each of the 50 states and District of Columbia that, if enacted, may affect our Insurance Subsidiaries.

The broad regulatory, administrative, and supervisory powers of the various state departments of insurance include the following:

Related to our financial condition, review and approval of such matters as minimum capital and surplus requirements, standards of solvency, security deposits, methods of accounting, form and content of statutory financial statements, reserves for unpaid loss and loss adjustment expenses, reinsurance, payment of dividends and other distributions to shareholders, periodic financial examinations, and annual and other report filings.

Related to our general business, review and approval of such matters as certificates of authority and other insurance company licenses, licensing and compensation of distribution partners, premium rates (which may not be excessive, inadequate, or unfairly discriminatory), policy forms, policy terminations, reporting of statistical information regarding our premiums and losses, periodic market conduct examinations, unfair trade practices, participation in mandatory shared market mechanisms, such as assigned risk pools and reinsurance pools, participation in mandatory state guaranty funds, and mandated continuing workers compensation coverage post-termination of employment.

Related to our ownership of the Insurance Subsidiaries, we are required to register as an insurance holding company system in each state where an insurance subsidiary is domiciled and report information concerning all of our operations that may materially affect the operations, management, or financial condition of the insurers. As an insurance holding company, the appropriate state regulatory authority may: (i) examine us or our Insurance Subsidiaries at any time; (ii) require disclosure or prior approval of material transactions of any of the Insurance Subsidiaries with its affiliates; and (iii) require prior approval or notice of certain transactions, such as payment of dividends or distributions to us.

Although Congress has largely delegated insurance regulation to the various states by virtue of the McCarran-Ferguson Act, we are also subject to federal legislation and administrative policies, such as disclosure under the securities laws, including the Sarbanes-Oxley Act and the Dodd-Frank Act, TRIPRA, OFAC, and various privacy laws, including the Gramm-Leach-Bliley Act, the Fair Credit Reporting Act, the Drivers Privacy Protection

Act, the Health Insurance Portability and Accountability Act, and the policies of the Federal Trade Commission. As a result of issuing workers compensation policies, we are subject to Mandatory Medicare Secondary Payer Reporting under the Medicare, Medicaid, and SCHIP Extension Act of 2007.

The European Union has enacted Solvency II, which sets out new requirements on capital adequacy and risk management for insurers, which is expected to be implemented in 2016. The strengthened regime is intended to reduce the possibility of consumer loss or market disruption in insurance. In addition, in 2014, the International Association of Insurance Supervisors proposed Basic Capital Standards for Global Systemically Important Insurers as well as a uniform capital framework for internationally active insurers. Although Solvency II does not govern domestic American insurers and we do not have international operations, we believe that development of global capital standards will influence the development of similar standards by domestic regulators. The NAIC has recently adopted the ORSA Model Law, which requires insurers to maintain a framework for identifying, assessing, monitoring, managing and reporting on the “material and relevant risks” associated with the insurer's (or insurance group's) current and future business plans. ORSA, which has been adopted by the state insurance regulators of our Insurance Subsidiaries, requires companies to file an internal assessment of their solvency with insurance regulators annually beginning in 2015. Although no specific capital adequacy standard is currently articulated in ORSA, it is possible that such standard will be developed over time and may increase insurers' minimum capital requirements, which could adversely impact our growth and return on equity.

We are subject to non-governmental regulators, such as the NASDAQ Stock Market and the New York Stock Exchange where we list our securities. Many of these regulators, to some degree, overlap with each other on various matters. They have different regulations on the same legal issues that are subject to their individual interpretative discretion. Consequently, we have the risk that one regulator's position may conflict with another regulator's position on the same issue. As compliance is generally reviewed in hindsight, we are subject to the risk that interpretations will change over time.

We believe we are in compliance with all laws and regulations that have a material effect on our results of operations, but the cost of complying with various, potentially conflicting laws and regulations, and changes in those laws and regulations could have a material adverse effect on our results of operations, liquidity, financial condition, financial strength, and debt ratings.

We are subject to the risk that legislation will be passed that significantly changes insurance regulation and adversely impacts our business, financial condition, and/or the results of operations.

In 2009, the Dodd-Frank Act was enacted to address the financial markets crises in 2008 and 2009 and the issues regarding the American International Group, Inc. scandal. The Dodd-Frank Act created the FIO as part of the U.S. Department of Treasury to advise the federal government regarding insurance issues. The Dodd-Frank Act also requires the Federal Reserve through the Financial Services Oversight Council (“FSOC”) to supervise financial services firms designated as systemically important financial institutions (“SIFI”). The FSOC has not designated Selective as a SIFI. The Dodd-Frank Act also included a number of corporate governance reforms for publicly traded companies, including proxy access, say-on-pay, and other compensation and governance issues. We anticipate that there will continue to be legislative proposals in Congress that could result in the federal government becoming directly involved in the regulation of insurance. There are also legislative and regulatory proposals in the various states that seek to limit the ability of carriers to properly assess insurance risk.

Repeal of the McCarran-Ferguson Act. While recent proposals for McCarran-Ferguson Act repeal have been directed primarily at health insurers, if enacted and applicable to property and casualty insurers, such repeal would significantly reduce our ability to compete and materially affect our results of operations because we rely on the anti-trust exemptions the law provides to obtain loss data from third party aggregators, such as ISO and NCCI, to predict future losses. Our inability to access data from ISO and NCCI would put us at a competitive disadvantage compared to larger insurers who have more sufficient loss experience data with their own customers.

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Healthcare reform. The enactment of the Patient Protection and Affordable Care Act of 2010 (the "Healthcare Act") may have an impact on various aspects of our business, including our insurance segments. The Healthcare Act reduces the reimbursement to healthcare providers, which may result in healthcare providers charging more to insurers not covered under the Healthcare Act. This could increase our cost to provide workers compensation, automobile Personal Injury Protection ("PIP") and general liability coverages, among others. In addition, we will continue to be impacted as a business enterprise by potential tax issues and changes in employee benefits. The Healthcare Act has been adopted, its implementation is ongoing, and we continue to monitor and assess its impact.

Changes in rules for Department of Housing and Urban Development ("HUD"). In 2013, HUD finalized a new "Disparate Impact" regulation that may adversely impact insurers' ability to differentiate pricing for homeowners policies using traditional risk selection analysis. Three insurance industry trade associations are challenging the regulation in two separate Federal lawsuits, one by the American Insurance Association ("AIA") and the National Association of Mutual Insurance Companies ("NAMIC") in the District of Columbia and the other by Property Casualty Insurers Association of America ("PCI") in Chicago. In the PCI case, the court ruled that HUD acted arbitrarily in considering comments regarding the application of the McCarran-Ferguson Act and has remanded the regulation back to HUD for review and reconsideration. Subsequently, the court in the AIA and NAMIC case vacated the regulation on summary judgment. HUD has filed an appeal of this ruling. It is uncertain to what extent the application of this regulation will impact the property and casualty industry and underwriting practices, but it could increase litigation costs, force changes in underwriting practices, and impair our ability to write homeowners business profitably. The outcome of the litigations and potential rulemaking cannot be predicted at this time.

**State Regulatory and Legislative Limits to Underwriting.** From time-to-time, there are proposals in various states seeking to limit the ability of insurers to use certain factors or predictive measures in the underwriting of property and casualty risks. Among the proposed legislation and regulation have been limits on the use of insurance scores and marketplace considerations. These proposals, if enacted, could impact underwriting pricing and results.

We expect the debate about the role of the federal government in regulating insurance to continue.

We cannot predict whether any of the above discussed proposed rules or legislation will be adopted, or what impact, if any, such proposals or the cost of compliance with such proposals, could have on our results of operations, liquidity, financial condition, financial strength, and debt ratings if enacted.

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

Our industry has been the target of class action litigation, including the following areas:

• After-market parts;

• Urban homeowner insurance underwriting practices, including those related to architectural or structural features and attempts by federal regulators to expand the Federal Housing Administration's guidelines to determine unfair discrimination;

• Credit scoring and predictive modeling pricing;

• Cybersecurity breaches;

• Investment disclosure;

• Managed care practices;

• Timing and discounting of personal injury protection claims payments;

• Direct repair shop utilization practices;

• Flood insurance claim practices; and

• Shareholder class action suits.

If we were to be named in such class action litigation, we could suffer reputational harm with purchasers of insurance and have increased litigation expenses that could have a materially adverse effect on our operations or results.

## Risks Related to Our Investment Segment

The failure of our risk management strategies could have a material adverse effect on our financial condition or results of operations.

Our long-term strategy includes the use of above average operational leverage, which results in above average investment leverage, or higher invested assets as a percent of our equity or policyholder surplus. Therefore, we maintain a conservative approach to our investment portfolio management and employ a number of risk management strategies to reduce our exposure to risk that include, but are not limited to, the following:

- Being prudent in establishing our investment policy and appropriately diversifying our investments;
- Using complex financial and investment models to analyze historic investment performance and predict future investment performance under a variety of scenarios using asset concentration, asset volatility, asset correlation, and systematic risk; and
- Closely monitoring investment performance, general economic and financial conditions, and other relevant factors.

All of these strategies have inherent limitations. We cannot be certain that an event or series of unanticipated events will not occur and result in losses greater than we expect and have a material adverse effect on our results of operations, liquidity, financial condition, financial strength, and debt ratings.

We are exposed to interest rate and credit risk in our investment portfolio.

We are exposed to interest rate risk primarily related 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 income investments and declines in interest rates may result in an increase in the fair value of our existing fixed income investments. Our fixed income investment portfolio, which currently has a duration of 3.8 years excluding short term investments, 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 decrease the net unrealized gain position of the investment portfolio, partially offset by our ability to earn higher rates of return on funds reinvested in new investments. Conversely, a decline in interest rates would increase the net unrealized gain position of the investment portfolio, partially offset by lower rates of return on new and reinvested cash in the portfolio. Changes in interest rates have an effect on the calculated duration of certain securities in the portfolio. We seek to mitigate our interest rate risk associated with holding fixed income 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, particularly our loss reserves. In addition, our pension and post-retirement benefit obligations include a discount rate assumption, which is an important element of expense and/or liability measurement. Changes in the discount rate assumption could materially impact our pension and post-retirement life valuation.

The value of our investment portfolio is subject to credit risk from the issuers and/or guarantors of the securities in the portfolio, other counterparties in certain transactions and, for certain securities, insurers that guarantee specific issuer's obligations. Defaults by the issuer or an issuer's guarantor, insurer, or other counterparties regarding any of our investments, could reduce our net investment income and net realized investment gains or result in investment losses. We are subject to the risk that the issuers, or guarantors, of fixed income securities we own may default on principal and interest payments due under the terms of the securities. At December 31, 2014, our fixed income securities portfolio represented approximately 91% of our total invested assets. The occurrence of a major economic downturn, acts of corporate malfeasance, widening credit spreads, budgetary deficits, municipal bankruptcies spurred by, among other things, pension funding

issues, or other events that adversely affect the issuers or guarantors of these securities could cause the value of our fixed income securities portfolio and our net income to decline and the default rate of our fixed income 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 cause the value of our fixed income securities portfolio and our net income to decrease. As our stockholders' equity is leveraged at 3.77:1 to our investment portfolio, a reduction in the value of our investment portfolio could have a material adverse effect on our business, results of operations, financial condition, and debt ratings. Levels of write downs 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 that have declined in value until recovery. If we reposition or realign portions of the portfolio so that we determine not to hold certain securities in an unrealized loss position to recovery, we will incur an OTTI charge. For further information regarding credit and interest rate risk, see Item 7A. "Quantitative and Qualitative Disclosures About Market Risk." of this Form 10-K.



Our statutory surplus may be materially affected by rating downgrades on investments held in our portfolio. We are exposed to significant financial and capital markets risks, primarily relating to interest rates, credit spreads, equity prices, 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, fluctuations in 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 alternative investment portfolio, or general market conditions. A global decline in asset values will be more amplified in our financial condition, as our statutory surplus is leveraged at a 3.6:1 ratio to our investment portfolio.

With economic uncertainty, the credit quality and ratings of securities in our portfolio could be adversely affected. The NAIC could potentially apply a more adverse class code on a security than was originally assigned, which could adversely affect statutory surplus because securities with NAIC class codes three through six require securities to be marked-to-market for statutory accounting purposes, as compared to securities with NAIC class codes of one or two that are carried at amortized cost.

Deterioration in the public debt and equity markets, the private investment marketplace, and the economy could lead to investment losses, which may adversely affect our results of operations, financial condition, liquidity, and debt ratings.

Like many other property and casualty insurance companies, we depend on income from our investment portfolio for a significant portion of our revenue and earnings. Our investment portfolio is exposed to significant financial and capital market risks, both in the U.S. and abroad, and volatile changes in general market or economic conditions could lead to a decline in the market value of our portfolio as well as the performance of the underlying collateral of our structured securities. Concerns over weak economic growth globally, elevated unemployment, volatile energy and commodity prices, and geopolitical issues, among other factors, contribute to increased volatility in the financial markets, increased potential for credit downgrades, and decreased liquidity in certain investment segments.

Our notes payable and Line of Credit are subject to certain debt-to-capitalization restrictions and net worth covenants, which could be impacted by a significant decline in investment value. 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.

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

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

Over the past several years, the Federal Reserve has taken a number of actions related to interest rates and purchasing of financial instruments intended to spur economic recovery. The Federal Reserve has recently signaled that it will be "patient in beginning to normalize the stance of monetary policy," but continued low interest rates have an adverse effect on our investment income as higher yielding securities mature and we reinvest the proceeds at lower yields. At the same time, increased pressure on the price of our fixed income and equity portfolios may occur if these economic stimulus actions by the Federal Reserve are not as effective as originally intended. These results could materially and adversely affect our results of operations, financial condition, liquidity, and the trading price of our 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.

In addition, our investment activities 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 economic conditions, some of these authorities have implemented, or may in the future implement, new or enhanced regulatory requirements, such as those included in the Dodd-Frank Act, intended to restore confidence in financial institutions and reduce the likelihood of similar economic events in the future. These authorities may seek to exercise their supervisory and 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 have a material adverse effect on our results of operations, liquidity, financial condition, financial strength, and debt ratings.

We are subject to the types of risks inherent in investing in private limited partnerships.

Our other investments include investments in private limited partnerships that invest in various strategies, such as secondary private equity, private equity, energy, mezzanine debt, real estate, and distressed debt. 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 is subject to a higher level of subjectivity and unobservable inputs than substantially all of our other investments and as such, is subject to greater scrutiny and reconsideration from one reporting period to the next. As these investments are recorded under the equity method of accounting, any decreases in the valuation of these investments would negatively impact our results of operations.

We value our investments using methodologies, estimations, and assumptions that are subject to differing interpretations. Changes in these interpretations could result in fluctuations in the valuations of our investments that may adversely affect our results of operations or financial condition.

Fixed income, equity, and short-term investments, which are reported at fair value on our Consolidated Balance Sheet, represented the majority of our total cash and invested assets as of December 31, 2014. 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 is 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). The lowest priority in the fair value hierarchy is 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 an independent pricing service and broker quotes to price our investment securities. At December 31, 2014, approximately 8% and 92% of these securities represented Level 1 and Level 2, respectively. However, prices provided by an independent pricing service 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 ("Financial Statements") and the period-to-period changes in value could vary significantly. Decreases in value may result in an increase in non-cash OTTI charges, which could have a material adverse effect on our results of operations, liquidity, financial condition, financial strength, and debt ratings.

The determination of the amount of impairments taken on our investments is highly subjective and could materially impact our results of operations or our 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 management has accurately assessed the level of impairments taken as 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. For further information regarding our evaluation and considerations for determining whether a security is other-than-temporarily impaired, please refer to "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.



## Risks Related to Our Corporate Structure and Governance

We are a holding company and our ability to declare dividends to our shareholders, pay indebtedness, and enter into affiliate transactions may be limited because our Insurance Subsidiaries are regulated.

Restrictions on the ability of the Insurance Subsidiaries to pay dividends, make loans or advances to us, or enter into transactions with affiliates may materially affect our ability to pay dividends on our common stock or repay our indebtedness.

As of December 31, 2014, the Parent had stand-alone retained earnings of \$1.3 billion. Of this amount, \$1.2 billion is related to investments in our Insurance Subsidiaries and debt. The Insurance Subsidiaries have the ability to provide for \$162 million in annual dividends to us; however, as they are regulated entities, their ability to pay dividends or make loans or advances to us is subject to the approval or review of the insurance regulators in the states where they are domiciled. The standards for review of such transactions are whether: (i) the terms and charges are fair and reasonable; and (ii) after the transaction, the Insurance Subsidiary's surplus for policyholders is reasonable in relation to its outstanding liabilities and financial needs. Although dividends and loans to us from our Insurance Subsidiaries historically have been approved, we can make no assurance that future dividends and loans will be approved. For additional details regarding dividend restrictions, see Note 20. "Statutory Financial Information, Capital Requirements, and Restrictions on Dividends and Transfers of Funds" in Item 8. "Financial Statements and Supplementary Data." of this Form 10-K.

Because we are an insurance holding company and a New Jersey corporation, we may be less attractive to potential acquirers and the value of our common stock could be adversely affected.

Because we are an insurance holding company that owns insurance subsidiaries, anyone who seeks to acquire 10% or more of our stock must seek prior approval from the insurance regulators in the states in which the subsidiaries are organized and file extensive information regarding their business operations and finances.

Provisions in our Amended and Restated Certificate of Incorporation may discourage, delay, or prevent us from being acquired, including:

Supermajority shareholder voting requirements to approve certain business combinations with interested shareholders (as defined in the Amended and Restated Certificate of Incorporation) unless certain other conditions are satisfied; and

Supermajority shareholder voting requirements to amend the foregoing provisions in our Amended and Restated Certificate of Incorporation.

In addition to the requirements in our Amended and Restated Certificate of Incorporation, the New Jersey Shareholders' Protection Act also prohibits us from engaging in certain business combinations with interested stockholders (as defined in the statute), in certain instances for a five year period, and in other instances indefinitely, unless certain conditions are satisfied. These conditions may relate to, among other things, the interested stockholder's acquisition of stock, the approval of the business combination by disinterested members of our Board of Directors and disinterested stockholders, and the price and payment of the consideration proposed in the business combination. Such conditions are in addition to those requirements set forth in our Amended and Restated Certificate of Incorporation.

These provisions of our Amended and Restated Certificate of Incorporation and New Jersey law could have the effect of depriving our stockholders of an opportunity to receive a premium over our common stock's prevailing market price in the event of a hostile takeover and may adversely affect the value of our common stock.



## Risks Related to Our General Operations

Operational risks, including human or systems failures, are inherent in our business.

Operational risks and losses can result from, among other things, fraud, errors, failure to document transactions properly or to obtain proper internal authorization, failure to comply with regulatory requirements, information technology failures, or external events.

We believe that our underwriting, claims, predictive, and catastrophe modeling, as well as our business analytics and our information technology and application systems are critical to our business. We expect our information technology and application systems to remain an important part of our underwriting process and our ability to compete successfully. A major defect or failure in our internal controls or information technology and application systems could: (i) result in management distraction; (ii) harm our reputation; or (iii) increase our expenses. We believe appropriate controls and mitigation procedures are in place to prevent significant risk of a defect in our internal controls around our information technology and application systems, but internal controls provide only a reasonable, not absolute, assurance as to the absence of errors or irregularities and any ineffectiveness of such controls and procedures could have a significant and negative effect on our business.

We are subject to attempted cyber-attacks and other cybersecurity risks.

The nature of our business requires that we store and use significant amounts of personally identifiable information in electronic format that may be targeted in an attempted cybersecurity breach. In addition, our business is heavily reliant on various information technology and application systems that may be impacted by a malicious cyber-attack. These cyber incidents may cause lost revenues or increased expenses stemming from reputational damage and fines related to the breach of personally identifiable information, inability to use certain systems for a period of time, loss of financial assets, remediation and litigation costs, and increased cybersecurity protection costs. We have developed and continue to invest in a variety of controls to prevent, detect and appropriately react to such cyber-attacks, including frequently testing our systems' security and access controls. However, cybersecurity risks continue to become more complex and broad ranging and our internal controls provide only a reasonable, not absolute, assurance that we will be able to protect ourselves from significant cyber-attack incidents. By outsourcing certain business and administrative functions to third parties, we may be exposed to enhanced risk of data security breaches. Any breach of data security could damage our reputation and/or result in monetary damages, which, in turn, could have a material adverse effect on our results of operations, liquidity, financial condition, financial strength, and debt ratings. Although we have not experienced a material cyber-attack, we purchase insurance coverage to specifically address cybersecurity risks. The coverage provides protection up to \$20 million above a deductible of \$250,000 for various cybersecurity risks, including privacy breach related incidents.

If we experience difficulties with outsourcing relationships, our ability to conduct our business might be negatively impacted.

We outsource certain business and administrative functions to third parties for efficiencies and cost savings, and may do so increasingly in the future. If we fail to develop and implement our outsourcing strategies or our third-party providers fail to perform as anticipated, we may experience operational difficulties, increased costs, and a loss of business that may have a material adverse effect on our results of operations or financial condition.

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, a claims fraud model, third party catastrophe models, an enterprise risk management capital model, and modeling tools used by our investment managers, 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, or faulty assumptions used by these financial models, could lead to increased losses. We believe that

statistical models alone do not provide a reliable method of monitoring and controlling risk. Therefore, such models are tools and do not substitute for the experience or judgment of senior management.

30

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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 insurance segments are described in the “Geographic Markets” section of Item 1. “Business.” of this Form 10-K. 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 our Insurance Subsidiaries as either: (i) liability insurers defending or providing indemnity for third-party claims brought against our customers; or (ii) insurers defending first-party coverage claims brought against them. We account for such activity through the establishment of unpaid loss and loss expense reserves. We expect that the ultimate liability, if any, with respect to such ordinary course claims litigation, after consideration of provisions made for potential losses and costs of defense, will not be material to our consolidated financial condition, results of operations, or cash flows.

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

## PART II

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

## (a) Market Information

Our 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 our common stock for each full quarterly period within the two most recent fiscal years:

|                | 2014    |       | 2013  |       |
|----------------|---------|-------|-------|-------|
|                | High    | Low   | High  | Low   |
| First quarter  | \$26.99 | 21.38 | 24.13 | 19.53 |
| Second quarter | 25.42   | 22.14 | 24.75 | 19.58 |
| Third quarter  | 25.46   | 21.97 | 25.95 | 22.61 |
| Fourth quarter | 27.65   | 22.01 | 28.31 | 23.55 |

On February 13, 2015, the closing price of our common stock as reported on the NASDAQ Global Select Market was \$27.36.

## (b) Holders

We had 3,612 stockholders of record as of February 13, 2015 according to the records maintained by our transfer agent.

## (c) Dividends

Dividends on shares of our common stock are declared and paid at the discretion of the Board based on our results of operations, financial condition, capital requirements, contractual restrictions, and other relevant factors. Considering our improving profitability, in the fourth quarter of 2014, our Board of Directors approved an 8% increase in our dividend to \$0.14 per share. The following table provides information on the dividends declared for each quarterly period within our two most recent fiscal years:

| Dividend Per Share | 2014   | 2013 |
|--------------------|--------|------|
| First quarter      | \$0.13 | 0.13 |
| Second quarter     | 0.13   | 0.13 |
| Third quarter      | 0.13   | 0.13 |
| Fourth quarter     | 0.14   | 0.13 |

Our ability to receive dividends, loans, or advances from our Insurance Subsidiaries is subject to the approval or review of the insurance regulators in the respective domiciliary states of our 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 our common stock in the future. For additional information, see Note 20. "Statutory Financial Information, Capital Requirements, and Restrictions on Dividends and Transfers of Funds" in Item 8. "Financial Statements and Supplementary Data." of this Form 10-K.



## (d) Securities Authorized for Issuance under Equity Compensation Plans

The following table provides information about our common stock authorized for issuance under equity compensation plans as of December 31, 2014:

| Plan Category  | (a)<br>Number of securities to be issued upon exercise of outstanding options, warrants and rights | (b)<br>Weighted-average exercise price of outstanding options, warrants and rights | (c)<br>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) |              |
|--|--|--|--|--------------|
| Equity compensation plans approved by security holders | 734,539  | <sup>1</sup> \$19.52   | 6,275,288  | <sup>2</sup> |

<sup>1</sup> Weighted average remaining contractual life of options is 3.42 years.

<sup>2</sup> Includes 764,098 shares available for issuance under the Employee Stock Purchase Plan; 2,019,296 shares available for issuance under the Stock Purchase Plan for Independent Insurance Agencies; and 3,491,894 shares for issuance under the Selective Insurance Group, Inc. 2014 Omnibus Stock Plan ("Stock Plan"). Future grants under the Stock Plan can be made, among other things, as stock options, restricted stock units, or restricted stock.

## (e) Performance Graph

The following chart, produced by Research Data Group, Inc., depicts our performance for the period beginning December 31, 2009 and ending December 31, 2014, as measured by total stockholder return on our 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.

This performance graph is not incorporated into any other filing we have made with the U.S. Securities and Exchange Commission ("SEC") and will not be incorporated into any future filing we may make with the SEC unless we so specifically incorporate it by reference. This performance graph shall not be deemed to be "soliciting material" or to be "filed" with the SEC unless we specifically request so or specifically incorporate it by reference in any filing we make with the SEC.

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

The following table provides information regarding our purchases of our common stock in the fourth quarter of 2014:

| Period                | Total Number of Shares Purchased <sup>1</sup> | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Programs | Maximum Number of Shares that May Yet Be Purchased Under the Announced Programs |
|-----------------------|---|------------------------------|---|---|
| October 1 – 31, 2014  | \$695   | \$23.02                      | —   | —   |
| November 1 – 30, 2014 | 13,077  | 26.66                        | —   | —   |
| December 1 – 31, 2014 | 10,214  | 27.24                        | —   | —   |
| Total                 | \$23,986                                      | \$26.80                      | —   | —   |

<sup>1</sup>During the fourth quarter of 2014, 1,605 shares were purchased from employees in connection with the vesting of restricted stock units and 22,381 shares were purchased from employees in connection with stock option exercises. These repurchases were made to satisfy tax withholding obligations and/or option costs with respect to those employees. These shares were not purchased as part of any publicly announced program. The shares that were purchased in connection with the vesting of restricted stock units were purchased at fair market value as defined in the Selective Insurance Group, Inc. 2005 Omnibus Stock Plan as Amended and Restated Effective as of May 1, 2010. The shares purchased in connection with the option exercises were purchased at the current market prices of our common stock on the dates the options were exercised.

## Item 6. Selected Financial Data.

Five-Year Financial Highlights<sup>1</sup>

(All presentations are in accordance with

GAAP unless noted otherwise,

number of

weighted average shares and dollars

in

thousands, except per share amounts)

|   | 2014        | 2013      | 2012      | 2011       | 2010      |
|---|-------------|-----------|-----------|------------|-----------|
| Net premiums written  | \$1,885,280 | 1,810,159 | 1,666,883 | 1,485,349  | 1,390,541 |
| Net premiums earned   | 1,852,609   | 1,736,072 | 1,584,119 | 1,439,313  | 1,416,598 |
| Net investment income earned  | 138,708     | 134,643   | 131,877   | 147,443    | 145,708   |
| Net realized gains (losses)   | 26,599      | 20,732    | 8,988     | 2,240      | (7,083 )  |
| Total revenues  | 2,034,861   | 1,903,741 | 1,734,102 | 1,597,475  | 1,564,621 |
| Catastrophe losses  | 59,971      | 47,415    | 98,608    | 118,769    | 56,465    |
| Underwriting income (loss)  | 78,143      | 38,766    | (64,007 ) | (103,584 ) | (19,974 ) |
| Net income from continuing operations <sup>2</sup>                    | 141,827     | 107,415   | 37,963    | 22,683     | 70,746    |
| Total discontinued operations, net of tax <sup>2</sup>                | —           | (997 )    | —         | (650 )     | (3,780 )  |
| Net income  | 141,827     | 106,418   | 37,963    | 22,033     | 66,966    |
| Comprehensive income  | 136,764     | 77,229    | 49,709    | 57,303     | 86,450    |
| Total assets  | 6,581,550   | 6,270,170 | 6,794,216 | 5,685,469  | 5,178,704 |
| Notes payable and debentures  | 379,297     | 392,414   | 307,387   | 307,360    | 262,333   |
| Stockholders' equity  | 1,275,586   | 1,153,928 | 1,090,592 | 1,058,328  | 1,018,041 |
| Statutory premiums to surplus ratio                                   | 1.4         | 1.4       | 1.6       | 1.4        | 1.3       |
| Statutory combined ratio  | 95.7        | % 97.5    | 103.5     | 106.7      | 101.6     |
| Impact of catastrophe losses on statutory combined ratio <sup>3</sup> | 3.2         | pts 2.7   | 6.2       | 8.3        | 4.0       |
| GAAP combined ratio   | 95.8        | % 97.8    | 104.0     | 107.2      | 101.4     |
| Invested assets per dollar of stockholders' equity                    | 3.77        | 3.97      | 3.97      | 3.89       | 3.86      |
| Yield on investments, before tax                                      | 3.0         | 3.0       | 3.1       | 3.7        | 3.8       |
| Debt to capitalization ratio  | 22.9        | 25.4      | 22.0      | 22.5       | 20.5      |
| Return on average equity  | 11.7        | 9.5       | 3.5       | 2.1        | 6.8       |

Non-GAAP measures<sup>4</sup>:

|                                    |           |        |        |        |        |
|------------------------------------|-----------|--------|--------|--------|--------|
| Operating income                   | \$124,538 | 93,939 | 32,121 | 21,227 | 75,350 |
| Operating return on average equity | 10.3      | % 8.4  | 3.0    | 2.0    | 7.7    |

## Per share data:

Net income from continuing operations<sup>2</sup>:

|         |        |      |      |      |      |
|---------|--------|------|------|------|------|
| Basic   | \$2.52 | 1.93 | 0.69 | 0.42 | 1.33 |
| Diluted | 2.47   | 1.89 | 0.68 | 0.41 | 1.30 |

|                                    |        |        |        |        |        |
|------------------------------------|--------|--------|--------|--------|--------|
| Net income:                        |        |        |        |        |        |
| Basic                              | \$2.52 | 1.91   | 0.69   | 0.41   | 1.26   |
| Diluted                            | 2.47   | 1.87   | 0.68   | 0.40   | 1.23   |
|                                    |        |        |        |        |        |
| Dividends to stockholders          | \$0.53 | 0.52   | 0.52   | 0.52   | 0.52   |
|                                    |        |        |        |        |        |
| Stockholders' equity               | 22.54  | 20.63  | 19.77  | 19.45  | 18.97  |
|                                    |        |        |        |        |        |
| Price range of common stock:       |        |        |        |        |        |
| High                               | 27.65  | 28.31  | 20.31  | 18.97  | 18.94  |
| Low                                | 21.38  | 19.53  | 16.22  | 12.10  | 14.13  |
| Close                              | 27.17  | 27.06  | 19.27  | 17.73  | 18.15  |
|                                    |        |        |        |        |        |
| Number of weighted average shares: |        |        |        |        |        |
| Basic                              | 56,310 | 55,638 | 54,880 | 54,095 | 53,359 |
| Diluted                            | 57,351 | 56,810 | 55,933 | 55,221 | 54,504 |

<sup>1</sup> Data for 2010 through 2011 has been restated to reflect the implementation of ASU 2010-26, Financial Services-Insurance (Topic 944): Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts, which was adopted on January 1, 2012.

<sup>2</sup> In 2009, we sold our Selective HR Solutions operations. See Note 7. "Fair Value Measurements" and Note 12. "Discontinued Operations" in Item 8. "Financial Statements and Supplementary Data." of this Form 10-K for additional information.

<sup>3</sup> The impact of catastrophe losses on the 2012 statutory combined ratio including flood claims handling fees related to Superstorm Sandy was 5.8 points.

<sup>4</sup> Operating income and operating return on average equity are non-GAAP measures. See the Glossary of Terms attached to this Form 10-K as Exhibit 99.1 for definitions of these items and see the "Financial Highlights of Results for Years Ended December 31, 2014, 2013, and 2012" section in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations." of this Form 10-K for a reconciliation of operating income to net income.

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, as amended, 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 the words such as "may," "will," "could," "would," "should," "expect," "plan," "anticipate," "target," "project," "intend," "believe," "estimate," "pro forma," "seek," "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." of this Form 10-K. 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 classify our business into four reportable segments:

• Standard Commercial Lines - comprised of insurance products and services provided in the standard marketplace to our commercial customers, who are typically businesses, non-profit organizations, and local government agencies.

• Standard Personal Lines - comprised of insurance products and services, including flood insurance coverage, provided primarily to individuals acquiring coverage in the standard marketplace.

• E&S Lines - comprised of insurance products and services provided to customers who have not obtained coverage in the standard marketplace.

• Investments - invests the premiums collected by our Standard Commercial Lines, Standard Personal Lines, and E&S Lines, as well as amounts generated through our capital management strategies, which may include the issuance of debt and equity securities.

This is a change from the segments that we have previously reported of Standard Insurance Operations, E&S Insurance Operations, and Investments. All prior year information contained in this Form 10-K has been restated to reflect our revised segments. For qualitative information behind the change, see Note 11. "Segment Information" in Item 8. "Financial Statements and Supplementary Data." of this Form 10-K.

Our Standard Commercial Lines and Standard Personal Lines products and services are sold through nine subsidiaries that write commercial and personal insurance coverages, some of which write flood business through the National Flood Insurance Program's ("NFIP") Write Your Own ("WYO") program. Our E&S Lines products and services are



sold through one subsidiary, Mesa Underwriters Specialty Insurance Company ("MUSIC"), that provides a nationally-authorized non-admitted platform to write commercial and personal E&S business, of which we currently only write commercial coverages. Our ten insurance subsidiaries are collectively referred to as the "Insurance Subsidiaries".

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, 2014, 2013, and 2012;

• Results of Operations and Related Information by Segment;

• Federal Income Taxes;

• Financial Condition, Liquidity, Short-term Borrowings, and Capital Resources;

• Off-Balance Sheet Arrangements;

• Contractual Obligations, Contingent Liabilities, and Commitments; and

• Ratings.

#### 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 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 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 Financial Statements involved the following: (i) reserves for losses and loss expenses; (ii) pension and post-retirement benefit plan actuarial assumptions; (iii) other-than-temporary-impairment ("OTTI"); and (iv) reinsurance.

#### 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 an estimate of amounts needed to pay reported and unreported net losses and loss expenses. As of December 31, 2014, we had accrued \$3.5 billion of gross loss and loss expense reserves compared to \$3.3 billion at December 31, 2013.

The following tables provide case and incurred but not reported ("IBNR") reserves for losses and loss expenses, and reinsurance recoverable on unpaid losses and loss expenses as of December 31, 2014 and 2013:

As of December 31, 2014

| (\$ in thousands)               | Losses and Loss Expense Reserves |               |           | Reinsurance Recoverable on Unpaid Losses and Loss Expenses | Net Reserves |
|---------------------------------|----------------------------------|---------------|-----------|--|--------------|
|                                 | Case Reserves                    | IBNR Reserves | Total     |  |              |
| General liability               | \$252,294                        | 960,372       | 1,212,666 | 138,366  | 1,074,300    |
| Workers compensation            | 513,069                          | 727,167       | 1,240,236 | 232,676  | 1,007,560    |
| Commercial auto                 | 156,538                          | 221,605       | 378,143   | 19,699   | 358,444      |
| Businessowners' policies        | 42,249                           | 51,918        | 94,167    | 7,990  | 86,177       |
| Commercial property             | 55,519                           | 7,611         | 63,130    | 16,856   | 46,274       |
| Other                           | 5,969                            | 6,484         | 12,453    | 2,007  | 10,446       |
| Total Standard Commercial Lines | 1,025,638                        | 1,975,157     | 3,000,795 | 417,594  | 2,583,201    |
| Personal automobile             | 99,595                           | 84,348        | 183,943   | 68,150   | 115,793      |
| Homeowners                      | 23,195                           | 22,987        | 46,182    | 5,205  | 40,977       |

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|                               |             |           |           |         |           |
|-------------------------------|-------------|-----------|-----------|---------|-----------|
| Other                         | 26,756      | 22,881    | 49,637    | 43,317  | 6,320     |
| Total Standard Personal Lines | 149,546     | 130,216   | 279,762   | 116,672 | 163,090   |
| E&S Lines                     | 31,341      | 165,972   | 197,313   | 37,712  | 159,601   |
| Total                         | \$1,206,525 | 2,271,345 | 3,477,870 | 571,978 | 2,905,892 |

37

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December 31, 2013

| (\$ in thousands)                  | Losses and Loss Expense Reserves |                  |           | Reinsurance<br>Recoverable on<br>Unpaid Losses<br>and Loss<br>Expenses | Net Reserves |
|------------------------------------|----------------------------------|------------------|-----------|--|--------------|
|                                    | Case<br>Reserves                 | IBNR<br>Reserves | Total     |  |              |
| General liability                  | \$227,307                        | 965,095          | 1,192,402 | 137,854  | 1,054,548    |
| Workers compensation               | 532,087                          | 637,738          | 1,169,825 | 197,934  | 971,891      |
| Commercial auto                    | 136,543                          | 225,387          | 361,930   | 18,847   | 343,083      |
| Businessowners' policies           | 32,225                           | 57,636           | 89,861    | 7,915  | 81,946       |
| Commercial property                | 43,831                           | 6,143            | 49,974    | 9,702  | 40,272       |
| Other                              | 6,980                            | 6,115            | 13,095    | 2,975  | 10,120       |
| Total Standard Commercial<br>Lines | 978,973                          | 1,898,114        | 2,877,087 | 375,227  | 2,501,860    |
| Personal automobile                | 106,377                          | 89,596           | 195,973   | 62,663   | 133,310      |
| Homeowners                         | 26,201                           | 27,520           | 53,721    | 7,254  | 46,467       |
| Other                              | 39,155                           | 23,561           | 62,716    | 52,157   | 10,559       |
| Total Standard Personal<br>Lines   | 171,733                          | 140,677          | 312,410   | 122,074  | 190,336      |
| E&S Lines                          | 25,575                           | 134,698          | 160,273   | 43,538   | 116,735      |
| Total                              | \$1,176,281                      | 2,173,489        | 3,349,770 | 540,839  | 2,808,931    |

#### 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 on 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.

Using generally accepted actuarial reserving techniques, we project our estimate of ultimate losses and loss expenses at each reporting date. Our IBNR reserve is the difference between the projected ultimate loss and loss expense incurred and the sum of: (i) case loss and loss expense reserves; and (ii) paid loss and loss expense reserves. 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. In completing this analysis, the actuaries must gather substantially similar data in sufficient volume to ensure statistical credibility of the data, while maintaining appropriate differentiation. This process defines the reserving segments, to which various actuarial projection methods are applied. When applying these methods, the actuaries are required to make numerous assumptions including, for example, the selection of loss and loss expense development factors and the weight to be applied to each individual projection method. These methods include paid and incurred versions for the following: loss and loss expense development, Bornhuetter-Ferguson, Berquist-Sherman, and frequency/severity modeling (chain-ladder approach). The second component of the analysis is the projection of the expected ultimate loss and loss expense 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 and loss expense ratios each quarter. This review includes actual versus

expected pricing changes, loss and loss expense trend assumptions, and updated prior period loss and loss expense ratios from the most recent quarterly reserve analysis.

In addition to the quarterly reserve analysis, a range of possible IBNR reserves is estimated annually and continually considered, among other factors, in establishing IBNR for each reporting period. Loss and loss expense trends are also considered, which include, but are not limited to, large loss activity, asbestos and 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 and loss expense 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 sometime 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 sometime 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. In addition to our internal review, statutory regulation requires us to have a Statement of Actuarial Opinion issued annually on our statutory reserve adequacy. We engage an independent actuary to issue this opinion based on their independent review.

#### Range of reasonable reserves

We have estimated a range of reasonably possible reserves for net loss and loss expense claims to be \$2,645 million to \$3,061 million at December 31, 2014, which compares to \$2,574 million to \$2,966 million at December 31, 2013. These ranges reflect low and high reasonable reserve estimates, which were selected 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 these ranges reflect likely scenarios, it is possible that the final outcomes may fall above or below these amounts. The ranges do not include a provision for potential increases or decreases associated with asbestos, environmental, and other continuous exposure claims, as traditional actuarial techniques cannot be effectively applied to these exposures.

Our loss and loss expense reserve development over the preceding 10 years is shown on the following table, which has five parts:

Section I shows the estimated liability recorded at the end of each indicated year 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 unpaid claims, including IBNR reserves. In accordance with GAAP, the liability for unpaid loss and loss expenses is recorded gross of the effects of reinsurance. An estimate of reinsurance recoverables is reported separately as an asset. The net balance represents the estimated amount of unpaid loss and loss expenses outstanding reduced by estimates of amounts recoverable under reinsurance contracts.

Section II shows the re-estimated amount of the previously recorded net liability as of the end of each succeeding year. Estimates of the liability of 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 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 shows the re-estimated gross liability and re-estimated reinsurance recoverables through December 31, 2014.

Section V shows the cumulative gross and net (deficiency)/redundancy representing the aggregate change in the liability from the original balance sheet dates and the re-estimated liability through December 31, 2014.

This table does not present accident or policy year development data. Conditions and trends that have affected past reserve development may not necessarily occur in the future. As a result, extrapolating redundancies or deficiencies based on this table is inherently uncertain.

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| (\$ in millions)   | 2004     | 2005     | 2006     | 2007     | 2008     | 2009     | 2010     | 2011     | 2012      | 2013     | 2014     |
|--|----------|----------|----------|----------|----------|----------|----------|----------|-----------|----------|----------|
| I. Gross reserves for unpaid losses and loss expenses at December 31       | 1,835.2  | 2,084.0  | 2,288.8  | 2,542.5  | 2,641.0  | 2,745.8  | 2,830.1  | 3,144.9  | 4,068.9   | 3,349.8  | 3,477.9  |
| Reinsurance recoverables on unpaid losses and loss expenses at December 31 | (218.8 ) | (218.2 ) | (199.7 ) | (227.8 ) | (224.2 ) | (271.6 ) | (313.7 ) | (549.5 ) | (1,409.7) | (540.9 ) | (572.0 ) |
| Net reserves for unpaid losses and loss expenses at December 31            | 1,616.4  | 1,865.8  | 2,089.1  | 2,314.7  | 2,416.8  | 2,474.2  | 2,516.4  | 2,595.4  | 2,659.2   | 2,808.9  | 2,905.9  |
| II. Net reserves estimate as of:   |          |          |          |          |          |          |          |          |           |          |          |
| One year later   | 1,621.5  | 1,858.5  | 2,070.2  | 2,295.4  | 2,387.4  | 2,430.6  | 2,477.6  | 2,569.8  | 2,633.7   | 2,749.6  |          |
| Two years later  | 1,637.3  | 1,845.1  | 2,024.0  | 2,237.8  | 2,324.6  | 2,368.1  | 2,428.6  | 2,531.4  | 2,554.9   |          |          |
| Three years later  | 1,643.7  | 1,825.2  | 1,982.4  | 2,169.7  | 2,286.0  | 2,315.0  | 2,388.8  | 2,502.2  |           |          |          |
| Four years later   | 1,649.8  | 1,808.9  | 1,931.1  | 2,155.8  | 2,264.9  | 2,295.3  | 2,363.3  |          |           |          |          |
| Five years later   | 1,653.6  | 1,780.7  | 1,916.0  | 2,151.5  | 2,258.1  | 2,282.3  |          |          |           |          |          |
| Six years later  | 1,639.5  | 1,777.3  | 1,924.4  | 2,154.6  | 2,243.6  |          |          |          |           |          |          |
| Seven years later  | 1,638.7  | 1,789.3  | 1,939.5  | 2,147.7  |          |          |          |          |           |          |          |
| Eight years later  | 1,648.0  | 1,810.9  | 1,936.5  |          |          |          |          |          |           |          |          |
| Nine years later   | 1,671.7  | 1,806.4  |          |          |          |          |          |          |           |          |          |
| Ten years later  | 1,669.4  |          |          |          |          |          |          |          |           |          |          |



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|  |          |          |          |          |          |          |          |          |            |          |
|--|----------|----------|----------|----------|----------|----------|----------|----------|------------|----------|
| Cumulative net redundancy (deficiency)               | (53.0 )  | 59.4     | 152.6    | 167.0    | 173.2    | 191.9    | 153.1    | 93.2     | 104.3      | 59.3     |
| III. Cumulative amount of net reserves paid through: |          |          |          |          |          |          |          |          |            |          |
| One year later                                       | 422.4    | 468.6    | 469.4    | 579.4    | 584.5    | 561.3    | 569.9    | 632.7    | 572.4      | 592.1    |
| Two years later                                      | 729.5    | 775.0    | 841.3    | 945.5    | 966.8    | 936.7    | 990.8    | 1,003.8  | 964.0      |          |
| Three years later                                    | 942.4    | 1,026.9  | 1,080.0  | 1,201.6  | 1,238.3  | 1,235.8  | 1,248.2  | 1,293.6  |            |          |
| Four years later                                     | 1,101.0  | 1,174.2  | 1,235.2  | 1,388.7  | 1,439.5  | 1,409.5  | 1,443.4  |          |            |          |
| Five years later                                     | 1,189.2  | 1,267.1  | 1,347.0  | 1,513.0  | 1,550.3  | 1,533.4  |          |          |            |          |
| Six years later                                      | 1,245.4  | 1,341.8  | 1,426.8  | 1,587.7  | 1,631.7  |          |          |          |            |          |
| Seven years later                                    | 1,294.2  | 1,399.6  | 1,481.9  | 1,648.1  |          |          |          |          |            |          |
| Eight years later                                    | 1,333.8  | 1,438.2  | 1,525.5  |          |          |          |          |          |            |          |
| Nine years later                                     | 1,361.7  | 1,469.4  |          |          |          |          |          |          |            |          |
| Ten years later                                      | 1,387.1  |          |          |          |          |          |          |          |            |          |
| IV.  |          |          |          |          |          |          |          |          |            |          |
| Re-estimated gross liability                         | 2,038.8  | 2,190.4  | 2,273.9  | 2,483.2  | 2,598.7  | 2,652.4  | 2,760.2  | 3,110.4  | 4,207.2    | 3,349.5  |
| Re-estimated reinsurance recoverables                | (369.4 ) | (384.0 ) | (337.4 ) | (335.5 ) | (355.1 ) | (370.1 ) | (396.9 ) | (608.2 ) | (1,652.3 ) | (599.9 ) |
| Re-estimated net liability                           | 1,669.4  | 1,806.4  | 1,936.5  | 2,147.7  | 2,243.6  | 2,282.3  | 2,363.3  | 2,502.2  | 2,554.9    | 2,749.6  |
| V.   |          |          |          |          |          |          |          |          |            |          |
| Cumulative gross redundancy (deficiency)             | (203.6 ) | (106.4 ) | 14.9     | 59.3     | 42.3     | 93.4     | 69.9     | 34.5     | (138.3 )   | 0.3      |
| Cumulative net redundancy (deficiency)               | (53.0 )  | 59.4     | 152.6    | 167.0    | 173.2    | 191.9    | 153.1    | 93.2     | 104.3      | 59.3     |

Note: Some amounts may not foot due to rounding.



In 2014, we experienced overall favorable loss development of approximately \$59.3 million, compared to \$25.5 million in both 2013 and 2012. The following table summarizes prior year development by line of business:

(Favorable)/Unfavorable Prior Year Loss and Loss Expense Development

| (\$ in millions)         | 2014    | 2013    | 2012    |
|--------------------------|---------|---------|---------|
| General Liability        | (43.9 ) | (20.0 ) | 2.5     |
| Commercial Automobile    | (4.1 )  | (4.5 )  | (8.5 )  |
| Workers Compensation     | —       | 23.5    | 2.5     |
| Businessowners' Policies | 1.9     | (9.5 )  | (9.0 )  |
| Commercial Property      | (2.1 )  | (7.5 )  | (3.5 )  |
| Homeowners               | (4.0 )  | (2.5 )  | (9.0 )  |
| Personal Automobile      | (10.8 ) | (3.0 )  | 0.5     |
| E&S                      | 3.7     | (2.0 )  | —       |
| Other                    | —       | —       | (1.0 )  |
| Total                    | (59.3 ) | (25.5 ) | (25.5 ) |

#### Major developments related to loss and loss expense reserve estimates and 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. As market conditions change, certain developments may occur that increase or decrease the amount of uncertainty. These developments include impacts within our own paid and reported loss and loss expense experience, as well as other internal and external factors that have not yet manifested within our data, but may do so in the future. All of these developments are considered when establishing loss and loss expense reserves, and in estimating the range of reasonable reserves.

For the past nine years, the Insurance Subsidiaries have experienced favorable prior accident year loss and loss expense development. Over the past three years, contributions to the favorable emergence have come from virtually all lines of business, with the exceptions of workers compensation and E&S Lines. The greater contributions have generally come from the longer tailed casualty lines, primarily due to their associated volume of reserves and the inherent uncertainty of the longer claims settlement process.

A more detailed discussion of recent developments, by line of business, follows.

#### Standard Market General Liability Line of Business

At December 31, 2014, our general liability line of business had recorded reserves, net of reinsurance, of \$1.1 billion, which represented 37% of our total net reserves. In 2014, this line experienced favorable development of \$43.9 million, which was partially driven by lower severities in the 2010 through 2012 accident years, within both the premises and operations and products liability coverages. In addition, accident years 2011 and 2012 continue to show lower than expected claim counts.

During 2013, this line experienced favorable development due to lower severities in accident years 2010 and prior. This was partially offset by unfavorable development in accident years 2011 and 2012, which showed higher average severities in the premises and operations coverage. During 2012, this line of business showed modestly unfavorable development due to increased severities in the 2010 and 2011 accident years. The broad nature of this line of business, and the longer average time for the claims settlement process, makes it more susceptible to changes in litigation and the tort environment. This line of business includes excess policies that provide additional limits above underlying automobile and general liability coverages, which is subject to catastrophic losses, and therefore influenced by the factors noted above to a greater degree.



#### Standard Market Workers Compensation Line of Business

At December 31, 2014, our workers compensation line of business recorded reserves, net of reinsurance, of \$1.0 billion, which represented 35% of our total net reserves. During 2014, this line experienced no development on prior accident years. This represents a significant change compared to 2013, during which this line experienced unfavorable development of approximately \$23.5 million driven mainly by assisted living facility claims. Unfavorable development in 2012 was approximately \$2.5 million. During 2014, this line showed a significant reduction in reported claim counts and associated paid and reported amounts. We believe this to be reflective of both our proactive underwriting actions in recent years, as well as various claims initiatives that we implemented, including the centralization of our workers compensation claim handling in Charlotte, North Carolina. Jurisdictionally trained and aligned medical only and lost-time adjusters manage non-complex workers compensation claims within our footprint. Claims with high exposure and/or significant escalation risk are referred to the workers compensation strategic case management unit.

While we believe these changes are already contributing to our improved loss experience, there is always risk associated with change. Most notably, these changes in operations may inherently change paid and reported development patterns. While our reserve analyses incorporate methods that adjust for these changes, there nevertheless remains a greater risk in the estimated 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 the following:

Unexpected changes in medical cost inflation - Variability in our historical workers compensation medical costs, along with uncertainty regarding future medical inflation, creates the potential for additional volatility in our reserves;

Changes in statutory workers compensation benefits - Benefit changes may be enacted that affect all outstanding claims, regardless of having occurred in the past. Depending upon the social and political climate, these changes may either increase or decrease associated claim costs;

Changes in utilization of the workers compensation system - These changes may be driven by economic, legislative, or other changes. For example, higher levels of unemployment could ultimately impact both the severity and frequency of workers compensation claims. In particular, during more difficult economic times, workers may be more likely to use the system, and less likely to return to work. Another example is the potential impact of federal healthcare reform, for which there are opposing views regarding the impact on workers compensation costs.

In addition, changes in the economy could impact reserves in other ways. For example, in 2014, audit and endorsement activity resulted in additional premium of \$15.7 million, and in 2013, audit and endorsement activity resulted in additional premium of \$7.4 million. As premiums earned are used as a basis for setting initial reserves on the current accident year, our reserves could be impacted. While audit and endorsement premiums are modeled within our annual budgeting process, they remain uncertain, and therefore provide additional variability to the resulting loss and loss expense ratio estimates.

#### Standard Market Commercial Automobile Line of Business

At December 31, 2014, our commercial automobile line of business had recorded reserves, net of reinsurance, of \$358 million, which represented 12% of our total net reserves. During the past three years, this line experienced favorable reserve development. In 2014, the favorable development was \$4.1 million, driven by bodily injury liability for accident years 2012 and prior. For accident years 2011 and prior, this reflects a continued trend of better than expected reported emergence in these years. Accident year 2012 experienced favorable development due to a reduction in estimated severity, after experiencing unfavorable development during 2013 due to higher than expected claim

frequency. The favorable development for accident years 2012 and prior was partially offset by unfavorable development in the 2013 accident year due to higher than expected claim frequency.

#### Standard Market Personal Automobile Line of Business

At December 31, 2014, our personal automobile line of business had recorded reserves, net of reinsurance, of \$116 million, which represented 4% of our total net reserves. In 2014, this line experienced favorable development of \$10.8 million, which was driven by the liability coverages for accident years 2012 and prior. Our mix of business continues to shift away from New Jersey towards other targeted states within our footprint. We continue to recalibrate our predictive models to improve the accuracy of our rating plans. While we believe these changes will ultimately lead to improved profitability and greater stability, they may impact paid and reported development patterns, thereby increasing the uncertainty in the reserves in the near-term.

#### E&S Lines

At December 31, 2014, our E&S Lines had recorded reserves, net of reinsurance, of \$160 million, which represented 6% of our total net reserves. In 2014, these lines experienced unfavorable development of \$3.7 million, associated with accident years 2011 through 2013. As we have limited historical loss experience in this segment, our reserve estimates are partially based on development patterns of companies that have similar operations. Therefore, these estimates are subject to somewhat greater uncertainty than the comparable traditional lines of business. As our own experience matures, we will continue to place greater weight upon it, and less weight upon the surrogate patterns.

#### Other Lines of Business

At December 31, 2014, no other individual line of business had recorded reserves of more than \$87 million, net of reinsurance. We have not identified any recent trends that would create additional significant reserve uncertainty for these other lines of business.

#### Other impacts creating additional loss and loss expense reserve uncertainty

##### Claims Initiative Impacts

In addition to the line of business specific issues mentioned above, our lines of business have been impacted by a number of initiatives undertaken by our claims department that have resulted in variability, or shifts, in the average level of case reserves. Some of these initiatives have also impacted claims settlement rates. These changes affect the data upon which the ultimate loss and loss expense projections are made. While these changes in case reserve levels and settlement rates increase the uncertainty in the short run, we expect the longer-term benefit will be a more refined management of the claims process.

Some of the specific actions implemented over the past several years are as follows:

- Increased focus on reducing workers compensation medical costs through more favorable Preferred Provider Organizations ("PPO") contracts and greater PPO penetration.
- The introduction of a Complex Claims Unit to which all significant and complex liability claims are assigned. This unit has been staffed with personnel that have significant experience in handling and settling these types of claims.
- Increased activity in the areas of fraud investigation and salvage/subrogation recoveries. These efforts have been supported by the introduction of predictive models that allow us to better focus our efforts.
- The centralization of workers compensation claims handling discussed above.

Our internal reserve analyses incorporate actuarial projection methods, which make adjustments for changes in case reserve adequacy and claims settlement rates. These methods adjust our historical loss experience to the current level of case adequacy or settlement rate, which provides a more consistent basis for projecting future development patterns. These methods have their own assumptions and judgments associated with them, so as with any projection method, they are not definitive in and of themselves. Furthermore, given that the expected benefits from our claims initiatives take time to fully manifest, we do not take full credit for the anticipated benefit in establishing our loss and loss expense reserves. These initiatives may prove more or less beneficial than currently reflected, which will affect development in future years. Our various projection methods provide an indication of these potential future impacts. These impacts would be greatest within our larger reserve lines of workers compensation, general liability, and commercial automobile liability, within the more recent accident years.

##### Economic Inflationary Impacts

Although inflationary volatility is expected to be low in the near term, current United States monetary policy and global economic conditions bring additional uncertainty in the long-term given the length of time required for claim settlement and the impact of medical cost trends relating to longer-tail liability and workers compensation claims. Uncertainty regarding future inflation or deflation creates the potential for additional volatility in our reserves for

these lines of business.

Sensitivity analysis: Potential impact on reserve uncertainty 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 and loss expense development factors;
- The weight to be applied to each individual actuarial projection method;
- Projected future loss trends; and
- Expected ultimate loss and loss expense 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 are sensitivity tests which highlight potential impacts to loss and loss expense reserves under different scenarios, for the major casualty lines of business. These tests consider each assumption and line of business individually, without any consideration of correlation between lines of business and accident years, and therefore, does not constitute an actuarial range. While the figures represent possible impacts from variations in key assumptions as identified by management, there is no assurance that the future emergence of our loss and loss expense experience will be consistent with either our current or alternative sets of assumptions.

While the sources of variability discussed above are generated by different underlying trends and operational changes, they ultimately manifest themselves as changes in the expected loss and loss expense development patterns. These patterns are a key assumption in the reserving process. In addition to the expected development patterns, the expected loss and loss expense ratios are another key assumption in the reserving process. These expected ratios are developed via a rigorous process of projecting recent accident years' experience to an ultimate settlement basis, and then adjusting it to the current accident year's pricing and loss cost levels. Impact from changes in the underwriting portfolio and changes in claims handling practices are also quantified and reflected, where appropriate. As is the case with all estimates, the ultimate loss and loss expense ratios may differ from those currently estimated.

The sensitivities of loss and loss expense reserves to these key assumptions are illustrated below for the major casualty lines. The first table shows the estimated impacts from changes in expected reported loss and loss expense development patterns. It shows reserve impacts by line of business if the actual calendar year incurred amounts are greater or less than current expectations by the selected percentages. The second table shows the estimated impacts from changes to the expected loss and loss expense ratios for the current accident year. It shows reserve impacts by line of business if the expected loss and loss expense ratios for the current accident year are greater or less than current expectations by the selected percentages. While the selected percentages by line are judgmentally based, they reflect the relative contribution of the specific line of business to the overall reserve range. Therefore, the smaller reserve lines reflect greater percentages due to their greater relative variability.

#### Reserve Impacts of Changes to Prior Years Expected Loss and Loss Expense Reporting Patterns

| (\$ in millions)                | Percentage<br>Decrease/Increase | (Decrease) to Future<br>Calendar Year<br>Reported | Increase to Future<br>Calendar Year<br>Reported |
|---------------------------------|---------------------------------|---|---|
| General liability               | 7 %                             | \$(75)  | ) \$75  |
| Workers compensation            | 10 %                            | (60)  | ) 60  |
| Commercial automobile liability | 10 %                            | (30)  | ) 30  |
| Personal automobile liability   | 15 %                            | (10)  | ) 10  |
| E&S lines                       | 15 %                            | (20)  | ) 20  |

#### Reserve Impacts of Changes to Current Year Expected Ultimate Loss and Loss Expense Ratios

| (\$ in millions)                | Percentage<br>Decrease/Increase | (Decrease) to Current<br>Accident Year<br>Expected Loss and<br>Loss Expense Ratio | Increase to Current<br>Accident Year<br>Expected Loss and<br>Loss Expense Ratio |
|---------------------------------|---------------------------------|---|---|
| General liability               | 7 %                             | \$(31)  | ) \$31  |
| Workers compensation            | 10 %                            | (27)  | ) 27  |
| Commercial automobile liability | 7 %                             | (18)  | ) 18  |
| Personal automobile liability   | 7 %                             | (7)   | ) 7   |

E&S lines 10 % (10 ) 10

Note that there is some overlap between the impacts in the two tables. For example, increases in the calendar year development would ultimately impact our view of the current accident year's loss and loss expense ratios. Nevertheless, these tables provide perspective into the sensitivity of each of these key assumptions.

#### Asbestos and Environmental Reserves

Our general liability, excess liability, and homeowners reserves include exposure to asbestos and environmental claims. Our exposure to environmental liability is primarily due to: (i) landfill exposures from policies written prior to the absolute pollution endorsement in the mid 1980s; and (ii) underground storage tank leaks mainly from New Jersey homeowners policies. These environmental claims stem primarily from insured exposures in municipal government, small non-manufacturing commercial risks, and homeowners policies.

The total carried net losses and loss expense reserves for these claims was \$23.0 million as of December 31, 2014 and \$25.2 million as of December 31, 2013. The emergence of these claims is slow and highly unpredictable. For example, within our Standard Commercial Lines book, 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 has the authority to re-open previously closed sites and return them to the NPL. We currently have reserves for eight customers related to four sites on the NPL.

“Asbestos claims” are claims for bodily injury alleged to have occurred from exposure to asbestos-containing products. Our primary exposure arises from insuring various distributors of asbestos-containing products, such as electrical and plumbing materials. At December 31, 2014, asbestos claims constituted 32% of our \$23.0 million net asbestos and environmental reserves, compared to 30% of our \$25.2 million net asbestos and environmental reserves at December 31, 2013.

“Environmental claims” are claims alleging bodily injury or property damage from pollution or other environmental contaminants other than asbestos. These claims include landfills and leaking underground storage tanks. Our landfill exposure lies largely in policies written for municipal governments, in their operation or maintenance of certain public lands. In addition to landfill exposures, in recent years, we have experienced a relatively consistent level of reported losses in the homeowners line of business related to claims for groundwater contamination from leaking underground heating oil storage tanks in New Jersey. In 2007, we instituted a fuel oil system exclusion on our New Jersey homeowners policies that limits our exposure to leaking underground storage tanks for certain customers. At that time, existing customers were offered a one-time opportunity to buy back oil tank liability coverage. The exclusion applies to all new homeowners policies in New Jersey. These customers are eligible for the buy-back option only if the tank meets specific eligibility criteria.

Our asbestos and environmental claims are handled in our centralized and specialized asbestos and environmental claim unit. Case reserves for these exposures are evaluated on a claim-by-claim basis. The ability to assess potential exposure often improves as a claim develops, including judicial determinations of coverage issues. As a result, reserves are adjusted accordingly.

Estimating IBNR reserves for asbestos and environmental claims is difficult because of the delayed and inconsistent reporting patterns associated with these claims. In addition, there are significant uncertainties associated with estimating critical assumptions, such as average clean-up costs, third-party costs, potentially responsible party shares, allocation of damages, litigation and coverage costs, and potential state and federal legislative changes. Normal historically-based actuarial approaches cannot be applied to asbestos and environmental claims because past loss history is not indicative of future potential loss emergence. In addition, while certain alternative models can be applied, such models can produce significantly different results with small changes in assumptions. As a result, we do not calculate an asbestos and environmental loss range. Historically, our asbestos and environmental claims have been significantly lower in volume, with less volatility and uncertainty than many of our competitors in the commercial lines industry. Prior to the introduction of the absolute pollution exclusion endorsement in the mid-1980's, we were primarily a personal lines carrier and therefore do not have broad exposure to asbestos and environmental claims.

Additionally, we are the primary insurance carrier on the majority of these exposures, which provides more certainty in our reserve position compared to others in the insurance marketplace.

#### Pension and Post-retirement Benefit Plan Actuarial Assumptions

Our pension and post-retirement benefit obligations and related costs are calculated using actuarial methods, within the framework of U.S. GAAP. 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. In the fourth quarter of 2014, the Society of Actuaries issued their updated mortality table (RP-2014), which reflects increasing life expectancies in the United States. We adopted these mortality tables in the fourth quarter of 2014.

The discount rate enables us to state expected future cash flows at their present value on the measurement date. The purpose of the discount rate is to determine the interest rates inherent in the price at which pension benefits could be effectively settled. Our discount rate selection is based on high-quality, long-term corporate bonds. A higher discount rate reduces the present value of benefit obligations and reduces pension expense. Conversely, a lower discount rate increases the present value of benefit obligations and increases pension expense. We decreased our discount rate for the Retirement Income Plan for Selective Insurance Company of America and the Supplemental Excess Retirement Plan (jointly referred to as the "Retirement Income Plan" or the "Plan") to 4.29% for 2014, from 5.16% for 2013, reflecting lower market interest rates. We also decreased our discount rate for the life insurance benefit provided to eligible Selective Insurance Company of America ("SICA") employees (referred to as the "Retirement Life Plan") to 4.08% for 2014 from 4.85% for 2013.

The expected long-term rate of return on the plan assets is determined by considering 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 the plan assets was lowered 65 basis points to 6.27% in 2014 as compared to 6.92% in 2013. This expected return is within a reasonable range considering the lower interest rate environment, as well as our actual 8.3% annualized return since the plan inception for all the plan assets.

At December 31, 2014, our pension and post-retirement benefit plan obligation was \$337.4 million compared to \$262.6 million at December 31, 2013. Volatility in the marketplace, changes in the discount rate assumption, and further changes in mortality assumptions could materially impact our pension and post-retirement life valuation in the future. For additional information regarding our pension and post-retirement benefit plan obligations, see Note 15. "Retirement Plans" in Item 8. "Financial Statements and Supplementary Data." of this Form 10-K.

#### Other-Than-Temporary Investment Impairments

When the fair value of any investment is lower than its cost/amortized cost, an assessment is made to determine if the decline is 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 an available-for-sale ("AFS") security is temporary, we record the decline as an unrealized loss in Accumulated Other Comprehensive Income ("AOCI"). Temporary declines in the value of a held-to-maturity ("HTM") security are not recognized in the Financial Statements. 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, as well as a review of the security's underlying collateral for fixed income investments. Broad changes in the overall market or interest rate environment generally will not lead to a write-down.

#### Fixed Income Securities and Short-Term Investments

Our evaluation for OTTI of a fixed income security or a short-term investment may include, 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 the issuer is current or in arrears in making principal and interest payments on the fixed income security;
- The issuer's current financial condition and ability to make future scheduled principal and interest payments on a timely basis;
- Evaluation of projected cash flows;
- Buy/hold/sell recommendations published by outside investment advisors and analysts; and
- Relevant rating history, analysis, and guidance provided by rating agencies and analysts.

OTTI charges are recognized as a realized loss to the extent that they are credit related, unless we have the intent to sell the security or it is more likely than not that we will be required to sell the security. In those circumstances, the

security is written down to fair value with the entire amount of the writedown charged to earnings as a component of realized losses.

To determine if an impairment is other than temporary, we compare the present value of cash flows expected to be collected with the amortized cost of fixed income securities meeting certain criteria. In addition, this analysis is performed on all previously-impaired debt securities that continue to be held by us and all structured securities that were not of high-credit quality at the date of purchase. These impairment assessments may include, but are not limited to, discounted cash flow analyses ("DCF's").

For structured securities, including CMBS, RMBS, ABS, and CDOs, we also consider variables such as expected default, severity, and prepayment assumptions based on security type and vintage, taking into consideration information from credit agencies, historical performance, and other relevant economic and performance factors.

In making our assessment, we perform a DCF to determine the present value of future cash flows to be generated by the underlying collateral of the security. Any shortfall in the expected present value of the future cash flows, based on the DCF, from the amortized cost basis of a security is considered a “credit impairment,” with the remaining decline in fair value of a security considered as a “non-credit impairment.” As mentioned above, credit impairments are charged to earnings as a component of realized losses, while non-credit impairments are recorded to Other Comprehensive Income (“OCI”) as a component of unrealized losses.

#### Discounted Cash Flow Assumptions

The discount rate we use in a DCF is the effective interest rate implicit in the security at the date of acquisition for those structured securities that were not of high-credit quality at acquisition. For all other securities, we use a discount rate that equals the current yield, excluding the impact of previous OTTI charges, used to accrete the beneficial interest.

If applicable, we use a conditional default rate assumption in the DCF to estimate future defaults. The conditional default rate is the proportion of all loans outstanding in a security at the beginning of a time period that are expected to default during that period. Our assumption of this rate takes into consideration the uncertainty of future defaults as well as whether or not these securities have experienced significant cumulative losses or delinquencies to date.

If applicable, conditional default rate assumptions apply at the total collateral pool level held in the securitization trust. Generally, collateral conditional default rates will “ramp-up” over time as the collateral seasons, because the performance begins to weaken and losses begin to surface. As time passes, depending on the collateral type and vintage, losses will peak and performance will begin to improve as weaker borrowers are removed from the pool through delinquency resolutions. In the later years of a collateral pool’s life, performance is generally materially better as the resulting favorable selection of the portfolio improves the overall quality and performance.

For CMBS, we also consider the net operating income (“NOI”) generated by the underlying properties. Our assumptions of the properties’ ultimate cash flows take into consideration both an immediate reduction to the reported NOIs and decreases to projected NOIs.

If applicable, we use a loan loss severity assumption in our DCF that is applied at the loan level of the collateral pool. The loan loss severity assumptions represent the estimated percentage loss on the loan-to-value exposure for a particular security. For CMBS, the loan loss severities applied are based on property type. Losses generated from the evaluations are then applied to the entire underlying deal structure in accordance with the original service agreements.

#### Equity Securities

Evaluation for OTTI of an equity security may include, but is not limited to, an 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, coupled with our intention to hold the securities in the near term;
  - 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;
  - Buy/hold/sell recommendations or price projections published by outside investment advisors;
  - Rating agency announcements;
  - The length of time and the extent to which the fair value has been, or is expected to be, less than cost in the near term;
- and

Our expectation of when the cost of the security will be recovered.

If there is a decline in the fair value on an equity security that we do not intend to hold, or if we determine the decline is other-than-temporary, including declines driven by market volatility for which we cannot assert will recover in the near term, we will write down the carrying value of the investment and record the charge through earnings as a component of realized losses.



#### Other Investments

Our evaluation for OTTI of an other investment (i.e., an alternative investment) may include, 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.

If there is a decline in the equity method value of an other investment that we do not intend to hold, or if we determine the decline is other than temporary, we write down the cost of the investment and record the charge through earnings as a component of realized losses.

#### 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 recovered from reinsurers are recognized as assets at the same time and in a manner consistent with the paid and unpaid losses associated with the reinsured 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 \$6.9 million at December 31, 2014 and \$5.1 million at December 31, 2013. We continually monitor developments that may impact recoverability from our reinsurers and have available to us contractually provided remedies if necessary. For further information regarding reinsurance, see the “Reinsurance” section below and Note 8. “Reinsurance” in Item 8. “Financial Statements and Supplementary Data.” of this Form 10-K.

Financial Highlights of Results for Years Ended December 31, 2014, 2013, and 2012<sup>1</sup>

| (\$ in thousands, except per share amounts) | 2014        | 2013        | 2014 vs.<br>2013 | 2012      | 2013 vs.<br>2012 |
|---|-------------|-------------|------------------|-----------|------------------|
| GAAP measures:                              |             |             |                  |           |                  |
| Revenues                                    | \$2,034,861 | \$1,903,741 | 7 %              | 1,734,102 | 10 %             |
| Pre-tax net investment income               | 138,708     | 134,643     | 3                | 131,877   | 2                |
| Pre-tax net income                          | 197,131     | 142,267     | 39               | 37,635    | 278              |
| Net income                                  | 141,827     | 106,418     | 33               | 37,963    | 180              |
| Diluted net income per share                | 2.47        | 1.87        | 32               | 0.68      | 175              |
| Diluted weighted-average outstanding shares | 57,351      | 56,810      | 1                | 55,933    | 2                |
| GAAP combined ratio                         | 95.8        | % 97.8      | (2.0 ) pts       | 104.0     | (6.2 ) pts       |
| Statutory combined ratio                    | 95.7        | % 97.5      | (1.8 )           | 103.5     | (6.0 )           |
| Return on average equity ("ROE")            | 11.7        | % 9.5       | 2.2              | 3.5       | 6.0              |
| Non-GAAP measures:                          |             |             |                  |           |                  |
| Operating income                            | \$124,538   | \$93,939    | 33 %             | 32,121    | 192 %            |
| Diluted operating income per share          | 2.17        | 1.65        | 32               | 0.58      | 184              |
| Operating ROE                               | 10.3        | % 8.4       | 1.9 pts          | 3.0       | 5.4 pts          |

<sup>1</sup>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.

The following table reconciles operating income and net income for the periods presented above:

| (\$ in thousands, except per share amounts)           | 2014      | 2013    | 2012   |
|---|-----------|---------|--------|
| Operating income                                      | \$124,538 | 93,939  | 32,121 |
| Net realized gains, net of tax                        | 17,289    | 13,476  | 5,842  |
| Loss on discontinued operations, net of tax           | —         | (997 )  | —      |
| Net income  | \$141,827 | 106,418 | 37,963 |
| Diluted operating income per share                    | \$2.17    | 1.65    | 0.58   |
| Diluted net realized gains per share                  | 0.30      | 0.24    | 0.10   |
| Diluted net loss on discontinued operations per share | —         | (0.02 ) | —      |
| Diluted net income per share                          | \$2.47    | 1.87    | 0.68   |

We are currently targeting an ROE that is three points higher than our cost of capital, or 12%, excluding the impact of realized gains and losses, which is referred to as operating return on equity. Our operating ROE and contribution by component for the following years are as follows:

| Operating Return on Average Equity | 2014    | 2013    | 2012    |
|------------------------------------|---------|---------|---------|
| Insurance Segments                 | 4.2 %   | 2.3 %   | (3.9 )% |
| Investment Segment                 | 8.6 %   | 9.0 %   | 9.3 %   |
| Other                              | (2.5 )% | (2.9 )% | (2.4 )% |
| Total                              | 10.3 %  | 8.4 %   | 3.0 %   |



## Insurance Segments

The key metric in understanding our insurance segments' contribution to operating ROE is the GAAP combined ratio. The following table provides a quantitative foundation for analyzing this ratio:

| All Lines<br>(\$ in thousands)            | 2014      | 2013      | 2014<br>vs. 2013 | 2012        | 2013<br>vs. 2012 |       |  |
|---|-----------|-----------|------------------|-------------|------------------|-------|--|
| <b>GAAP Insurance Operations Results:</b> |           |           |                  |             |                  |       |  |
| Net Premiums Written ("NPW")              | 1,885,280 | 1,810,159 | 4                | % 1,666,883 | 9                | %     |  |
| Net Premiums Earned ("NPE")               | 1,852,609 | 1,736,072 | 7                | 1,584,119   | 10               |       |  |
| <b>Less:</b>                              |           |           |                  |             |                  |       |  |
| Losses and loss expenses incurred         | 1,157,501 | 1,121,738 | 3                | 1,120,990   | —                |       |  |
| Net underwriting expenses incurred        | 610,783   | 571,294   | 7                | 523,688     | 9                |       |  |
| Dividends to policyholders                | 6,182     | 4,274     | 45               | 3,448       | 24               |       |  |
| Underwriting income (loss)                | 78,143    | 38,766    | 102              | % (64,007   | ) 161            | %     |  |
| <b>GAAP Ratios:</b>                       |           |           |                  |             |                  |       |  |
| Loss and loss expense ratio               | 62.5      | % 64.6    | (2.1             | ) pts 70.8  | (6.2             | ) pts |  |
| Underwriting expense ratio                | 33.0      | 33.0      | —                | 33.0        | —                |       |  |
| Dividends to policyholders ratio          | 0.3       | 0.2       | 0.1              | 0.2         | —                |       |  |
| Combined ratio                            | 95.8      | 97.8      | (2.0             | ) 104.0     | (6.2             | )     |  |
| <b>Statutory Ratios:</b>                  |           |           |                  |             |                  |       |  |
| Loss and loss expense ratio               | 62.4      | 64.5      | (2.1             | ) 70.7      | (6.2             | )     |  |
| Underwriting expense ratio                | 33.0      | 32.8      | 0.2              | 32.6        | 0.2              |       |  |
| Dividends to policyholders ratio          | 0.3       | 0.2       | 0.1              | 0.2         | —                |       |  |
| Combined ratio                            | 95.7      | % 97.5    | (1.8             | ) pts 103.5 | (6.0             | ) pts |  |

Fluctuations in our GAAP combined ratio were driven by the following:

Earned rate in excess of expected claims inflation in both 2014 and 2013. Renewal pure price increases of 5.6% in 2014, 7.6% in 2013, and 6.3% in 2012 have earned in at 6.6% in 2014 and 7.1% in 2013, both of which are above loss inflation trends of approximately 3%. After taking into account the incremental expenses associated with the additional premium, the net benefit to the combined ratio is approximately 2.5 points in both years.

Favorable prior year casualty reserve development, the details of which are below:

## (Favorable)/Unfavorable Prior Year Casualty Reserve

## Development

| (\$ in millions)                | 2014    | 2013    | 2012    |
|---------------------------------|---------|---------|---------|
| General liability               | \$(43.9 | ) (20.0 | ) 2.5   |
| Commercial automobile           | (4.0    | ) (5.0  | ) (7.5  |
| Workers compensation            | —       | 23.5    | 2.5     |
| Businessowners' policies        | 2.5     | (9.5    | ) (8.0  |
| Other                           | —       | —       | (1.0    |
| Total Standard Commercial Lines | (45.4   | ) (11.0 | ) (11.5 |
| Homeowners                      | (0.7    | )       |         |