

SELECTIVE INSURANCE GROUP INC
Form 10-Q
October 27, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: September 30, 2011

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)

(973) 948-3000
(Registrant's Telephone Number, Including Area Code)

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such report), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

Yes No

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

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

Large accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Accelerated filer

Smaller reporting company

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

Yes No

As of September 30, 2011, there were 54,220,632 shares of common stock, par value \$2.00 per share, outstanding.

SELECTIVE INSURANCE GROUP, INC.
Table of Contents

| | Page No. |
|--|-------------|
| <u>PART I. FINANCIAL INFORMATION</u> | |
| <u>Item 1. Financial Statements</u> | |
| <u>Consolidated Balance Sheets as of September 30, 2011 (Unaudited) and December 31, 2010</u> | <u>1</u> |
| <u>Unaudited Consolidated Statements of Income for the Quarter and Nine Months Ended September 30, 2011 and 2010</u> | <u>2</u> |
| <u>Unaudited Consolidated Statements of Stockholders' Equity for the Nine Months Ended September 30, 2011 and 2010</u> | <u>3</u> |
| <u>Unaudited Consolidated Statements of Cash Flow for the Nine Months Ended September 30, 2011 and 2010</u> | <u>4</u> |
| <u>Notes to Unaudited Interim Consolidated Financial Statements</u> | <u>5</u> |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | |
| <u>Forward-Looking Statements</u> | <u>24</u> |
| <u>Introduction</u> | <u>24</u> |
| <u>Critical Accounting Policies and Estimates</u> | <u>24</u> |
| <u>Financial Highlights of Results for Third Quarter 2011 and Nine Months 2011</u> | <u>25</u> |
| <u>Results of Operations and Related Information by Segment</u> | <u>27</u> |
| <u>Federal Income Taxes</u> | <u>51</u> |
| <u>Financial Condition, Liquidity, Short-term Borrowings, and Capital Resources</u> | <u>51</u> |
| <u>Ratings</u> | <u>53</u> |
| <u>Pending Accounting Pronouncements</u> | <u>54</u> |
| <u>Off-Balance Sheet Arrangements</u> | <u>54</u> |
| <u>Contractual Obligations, Contingent Liabilities, and Commitments</u> | <u>54</u> |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u> | <u>54</u> |
| <u>Item 4. Controls and Procedures</u> | <u>54</u> |

PART II. OTHER INFORMATION

| | | |
|-----------------|--|-----------|
| <u>Item 1.</u> | <u>Legal Proceedings</u> | <u>55</u> |
| <u>Item 1A.</u> | <u>Risk Factors</u> | <u>55</u> |
| <u>Item 2.</u> | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | <u>56</u> |
| <u>Item 6.</u> | <u>Exhibits</u> | <u>57</u> |

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SELECTIVE INSURANCE GROUP, INC.

CONSOLIDATED BALANCE SHEETS

(\$ in thousands, except share amounts)

| | Unaudited September 30, 2011 | December 31, 2010 |
|---|------------------------------------|----------------------|
| ASSETS | | |
| Investments: | | |
| Fixed maturity securities, held-to-maturity – at carrying value (fair value: \$901,385 – 2011; \$1,256,294 – 2010) | \$ 852,843 | 1,214,324 |
| Fixed maturity securities, available-for-sale – at fair value (amortized cost: \$2,649,035 – 2011; \$2,285,988 – 2010) | 2,772,348 | 2,342,742 |
| Equity securities, available-for-sale – at fair value (cost of: \$150,517 – 2011; \$58,039 – 2010) | 139,203 | 69,636 |
| Short-term investments (at cost which approximates fair value) | 162,812 | 161,155 |
| Other investments | 135,560 | 137,865 |
| Total investments | 4,062,766 | 3,925,722 |
| Cash | 287 | 645 |
| Interest and dividends due or accrued | 35,107 | 37,007 |
| Premiums receivable, net of allowance for uncollectible accounts of: \$3,863 – 2011; \$4,691 – 2010 | 477,869 | 414,105 |
| Reinsurance recoverables, net | 631,732 | 318,752 |
| Prepaid reinsurance premiums | 121,560 | 110,327 |
| Current federal income tax | 17,518 | 11,200 |
| Deferred federal income tax | 83,299 | 93,234 |
| Property and equipment – at cost, net of accumulated depreciation and amortization of: \$158,383 – 2011; \$151,704 – 2010 | 39,247 | 41,775 |
| Deferred policy acquisition costs | 220,044 | 209,627 |
| Goodwill | 7,849 | 7,849 |
| Other assets | 51,712 | 61,529 |
| Total assets | \$ 5,748,990 | 5,231,772 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Liabilities: | | |
| Reserve for losses and loss expenses | \$ 3,243,622 | 2,830,058 |
| Unearned premiums | 902,112 | 823,596 |
| Notes payable | 262,353 | 262,333 |
| Accrued salaries and benefits | 98,485 | 100,933 |
| Other liabilities | 155,863 | 143,743 |
| Total liabilities | \$ 4,662,435 | 4,160,663 |
| Stockholders' Equity: | | |
| Preferred stock of \$0 par value per share: Authorized shares: 5,000,000; no shares issued or outstanding | \$ - | - |
| Common stock of \$2 par value per share Authorized shares: 360,000,000 Issued: 97,044,503 – 2011; 96,362,667 – 2010 | 194,089 | 192,725 |
| Additional paid-in capital | 253,939 | 244,613 |
| Retained earnings | 1,158,308 | 1,176,155 |
| Accumulated other comprehensive income | 32,164 | 7,024 |
| Treasury stock – at cost (shares: 42,823,871 – 2011; 42,686,204 – 2010) | (551,945) | (549,408) |

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

| | | |
|--|--------------|-----------|
| Total stockholders' equity | 1,086,555 | 1,071,109 |
| Commitments and contingencies | | |
| Total liabilities and stockholders' equity | \$ 5,748,990 | 5,231,772 |

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

SELECTIVE INSURANCE GROUP, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF
INCOME

| (\$ in thousands, except per share amounts) | Quarter ended September 30, | | Nine Months ended September 30, | |
|--|--------------------------------|----------|------------------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| Revenues: | | | | |
| Net premiums earned | \$358,963 | 354,709 | 1,065,886 | 1,063,101 |
| Net investment income earned | 35,786 | 32,986 | 118,604 | 104,237 |
| Net realized gains (losses): | | | | |
| Net realized investment gains | 498 | 2,864 | 9,203 | 13,960 |
| Other-than-temporary impairments | (2,693) | (4,091) | (3,062) | (16,326) |
| Other-than-temporary impairments on fixed maturity securities recognized in other comprehensive income | 150 | 1,284 | (280) | (905) |
| Total net realized (losses) gains | (2,045) | 57 | 5,861 | (3,271) |
| Other income | 1,365 | 1,950 | 6,744 | 6,465 |
| Total revenues | 394,069 | 389,702 | 1,197,095 | 1,170,532 |
| Expenses: | | | | |
| Losses and loss expenses incurred | 305,958 | 245,019 | 829,719 | 739,142 |
| Policy acquisition costs | 119,456 | 114,042 | 346,729 | 346,143 |
| Interest expense | 4,559 | 4,559 | 13,675 | 14,056 |
| Other expenses | 4,924 | 4,022 | 18,807 | 18,636 |
| Total expenses | 434,897 | 367,642 | 1,208,930 | 1,117,977 |
| (Loss) income from continuing operations, before federal income tax | (40,828) | 22,060 | (11,835) | 52,555 |
| Federal income tax (benefit) expense: | | | | |
| Current | (20,001) | (1,691) | (12,614) | 8,475 |
| Deferred | (1,335) | 4,920 | (3,603) | (1,435) |
| Total federal income tax (benefit) expense | (21,336) | 3,229 | (16,217) | 7,040 |
| Net (loss) income from continuing operations | (19,492) | 18,831 | 4,382 | 45,515 |
| Loss on disposal of discontinued operations, net of tax of \$(350) and \$(880) for Third Quarter 2011 and 2010 and \$(350) and \$(2,019) for Nine Months 2011 and 2010 | (650) | (1,634) | (650) | (3,749) |
| Net (loss) income | \$(20,142) | 17,197 | 3,732 | 41,766 |
| Earnings per share: | | | | |
| Basic net (loss) income from continuing operations | (0.36) | 0.35 | 0.08 | 0.85 |
| Basic net loss from disposal of discontinued operations | (0.01) | (0.03) | (0.01) | (0.07) |
| Basic net (loss) income | \$(0.37) | 0.32 | 0.07 | 0.78 |
| Diluted net (loss) income from continuing operations | (0.36) | 0.35 | 0.08 | 0.84 |
| Diluted net loss from disposal of discontinued operations | (0.01) | (0.03) | (0.01) | (0.07) |
| Diluted net (loss) income | \$(0.37) | 0.32 | 0.07 | 0.77 |

| | | | | |
|---------------------------|--------|------|------|------|
| Dividends to stockholders | \$0.13 | 0.13 | 0.39 | 0.39 |
|---------------------------|--------|------|------|------|

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

SELECTIVE INSURANCE GROUP, INC.
 UNAUDITED CONSOLIDATED STATEMENTS OF
 STOCKHOLDERS' EQUITY

| (\$ in thousands, except per share amounts) | Nine Months ended September 30, | | | |
|--|---------------------------------|---------------|---------------|---------------|
| | 2011 | | 2010 | |
| Common stock: | | | | |
| Beginning of year | \$ 192,725 | | 191,646 | |
| Dividend reinvestment plan (shares: 74,777 – 2011; 81,471 – 2010) | 150 | | 163 | |
| Stock purchase and compensation plans (shares: 607,059 – 2011; 284,793 – 2010) | 1,214 | | 569 | |
| End of period | 194,089 | | 192,378 | |
| Additional paid-in capital: | | | | |
| Beginning of year | 244,613 | | 231,933 | |
| Dividend reinvestment plan | 1,066 | | 1,098 | |
| Stock purchase and compensation plans | 8,260 | | 8,441 | |
| End of period | 253,939 | | 241,472 | |
| Retained earnings: | | | | |
| Beginning of year | 1,176,155 | | 1,138,978 | |
| Net income | 3,732 | 3,732 | 41,766 | 41,766 |
| Dividends to stockholders (\$0.39 per share – 2011 and 2010) | (21,579) | | (21,248) | |
| End of period | 1,158,308 | | 1,159,496 | |
| Accumulated other comprehensive income (loss): | | | | |
| Beginning of year | 7,024 | | (12,460) | |
| Other comprehensive income (loss), increase (decrease) in: | | | | |
| Unrealized gains on investment securities: | | | | |
| Non-credit portion of other-than-temporary impairment losses recognized in other comprehensive income, net of deferred income tax | | | | |
| | 336 | | 3,026 | |
| Other net unrealized gains on investment securities, net of deferred income tax | | | | |
| | 22,617 | | 55,556 | |
| Total unrealized gains on investment securities | 22,953 | 22,953 | 58,582 | 58,582 |
| Defined benefit pension plans, net of deferred income tax | 2,187 | 2,187 | 2,098 | 2,098 |
| End of period | 32,164 | | 48,220 | |
| Comprehensive income | | 28,872 | | 102,446 |
| Treasury stock: | | | | |
| Beginning of year | (549,408) | | (547,722) | |
| Acquisition of treasury stock (shares: 137,667 – 2011; 98,419 – 2010) | (2,537) | | (1,528) | |
| End of period | (551,945) | | (549,250) | |
| Total stockholders' equity | \$ 1,086,555 | | 1,092,316 | |

Selective Insurance Group, Inc. also has authorized, but not issued, 5,000,000 shares of preferred stock, without par value, of which 300,000 shares have been designated Series A junior preferred stock, without par value.

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

SELECTIVE INSURANCE GROUP, INC.

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOW

Nine Months ended
September 30,

(\$ in thousands)

2011 2010

Operating Activities

| | | |
|------------|---------|--------|
| Net Income | \$3,732 | 41,766 |
|------------|---------|--------|

Adjustments to reconcile net income to net cash provided by operating activities:

| | | |
|---|----------|----------|
| Depreciation and amortization | 25,260 | 23,175 |
| Loss on disposal of discontinued operations | 650 | 3,749 |
| Stock-based compensation expense | 6,383 | 6,875 |
| Undistributed income of equity method investments | (1,793) | (6,338) |
| Net realized (gains) losses | (5,861) | 3,271 |

Changes in assets and liabilities:

| | | |
|--|-----------|-----------|
| Increase in reserves for losses and loss expenses, net of reinsurance recoverables | 100,584 | 32,912 |
| Increase in unearned premiums, net of prepaid reinsurance and advance premiums | 67,816 | 25,123 |
| Increase in net federal income tax recoverable | (9,570) | (6,514) |
| Increase in premiums receivable | (63,764) | (13,817) |
| (Increase) decrease in deferred policy acquisition costs | (10,417) | 11 |
| Decrease (increase) in interest and dividends due or accrued | 1,943 | (1,491) |
| (Decrease) increase in accrued salaries and benefits | (2,448) | 150 |
| Decrease in accrued insurance expenses | (6,772) | (6,872) |
| Other-net | 20,817 | 1,284 |
| Net adjustments | 122,828 | 61,518 |
| Net cash provided by operating activities | 126,560 | 103,284 |

Investing Activities

| | | |
|--|-------------|-------------|
| Purchase of fixed maturity securities, available-for-sale | (350,140) | (699,133) |
| Purchase of equity securities, available-for-sale | (148,104) | (47,930) |
| Purchase of other investments | (11,778) | (14,348) |
| Purchase of short-term investments | (1,030,834) | (1,409,971) |
| Sale of subsidiary | 919 | 681 |
| Sale of fixed maturity securities, available-for-sale | 85,773 | 157,823 |
| Sale of short-term investments | 1,029,178 | 1,358,779 |
| Redemption and maturities of fixed maturity securities, held-to-maturity | 138,907 | 238,923 |
| Redemption and maturities of fixed maturity securities, available-for-sale | 95,951 | 251,875 |
| Sale of equity securities, available-for-sale | 59,991 | 76,277 |
| Distributions from other investments | 15,666 | 18,468 |
| Sale of other investments | 16,357 | - |
| Purchase of property, equipment, and other assets | (8,932) | (4,062) |
| Net cash used in investing activities | (107,046) | (72,618) |

Financing Activities

| | | |
|---|-----------|-----------|
| Dividends to stockholders | (19,863) | (19,516) |
| Acquisition of treasury stock | (2,537) | (1,528) |
| Principal payment of notes payable | - | (12,300) |
| Net proceeds from stock purchase and compensation plans | 2,718 | 3,084 |
| Excess tax benefits from share-based payment arrangements | (190) | (795) |

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

| | | |
|---------------------------------------|-----------|-----------|
| Net cash used in financing activities | (19,872) | (31,055) |
| Net decrease in cash | (358) | (389) |
| Cash, beginning of year | 645 | 811 |
| Cash, end of period | \$287 | 422 |

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

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. Organization

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

We classify our business into two operating segments:

- Insurance Operations, which sells property and casualty insurance products and services primarily in 22 states in the Eastern and Midwestern U.S.; and
- Investments.

NOTE 2. Basis of Presentation

These interim unaudited consolidated financial statements (“Financial Statements”) include the accounts of the Parent and its subsidiaries, and have been prepared in conformity with: (i) U.S. generally accepted accounting principles (“GAAP”); and (ii) the rules and regulations of the U.S. Securities and Exchange Commission (“SEC”) regarding interim financial reporting. The preparation of the Financial Statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported financial statement balances, as well as the disclosure of contingent assets and liabilities. Actual results could differ from those estimates. All significant intercompany accounts and transactions between the Parent and its subsidiaries are eliminated in consolidation.

These Financial Statements reflect all adjustments that, in our opinion, are normal, recurring, and necessary for a fair presentation of our results of operations and financial condition. The Financial Statements cover the third quarters ended September 30, 2011 (“Third Quarter 2011”) and September 30, 2010 (“Third Quarter 2010”) and the nine-month periods ended September 30, 2011 (“Nine Months 2011”) and September 30, 2010 (“Nine Months 2010”). The Financial Statements do not include all of the information and disclosures required by GAAP and the SEC for audited financial statements. Results of operations for any interim period are not necessarily indicative of results for a full year. Consequently, the Financial Statements should be read in conjunction with the consolidated financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2010 (“2010 Annual Report”).

NOTE 3. Reclassification

Certain prior year amounts in these Financial Statements and related footnotes have been reclassified to conform to the current year presentation. Such reclassifications had no effect on our net income, stockholders’ equity, or cash flows.

NOTE 4. Adoption of Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements. This guidance requires: (i) separate disclosure of significant transfers between Level 1 and Level 2 of the fair value hierarchy and reasons for the transfers; (ii) disclosure, on a gross basis, of purchases, sales, issuances, and net settlements within Level 3 of the fair value hierarchy; (iii) disclosures by class of assets and liabilities; and (iv) a description of the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. This guidance is effective for reporting periods beginning after December 15, 2009, except for the Level 3 disclosure requirements, which are effective for fiscal years beginning after December 15, 2010 and interim periods within those fiscal years. We have included the disclosures required by this guidance in our notes to the consolidated financial statements, where appropriate.

In December 2010, the FASB issued ASU 2010-28 Intangibles – Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts. This guidance modifies Step 1 of the goodwill impairment test, which assesses whether the carrying amount of a reporting unit exceeds its fair value, for reporting units with zero or negative carrying amounts. It requires that an entity perform Step 2 of the goodwill impairment test, which determines if goodwill has been impaired and measures the amount of impairment, if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider the qualitative factors within existing guidance that would require goodwill of a reporting unit to be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. This guidance is effective for interim and annual periods beginning after December 15, 2010. The adoption of this guidance did not impact our financial condition or results of operations.

In December 2010, the FASB issued ASU 2010-29 Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations. This guidance relates to disclosure of pro forma information for business combinations that have occurred in the current reporting period. It requires that an entity presenting comparative financial statements include revenue and earnings of the combined entity as though the combination had occurred as of the beginning of the comparable prior annual period only. This guidance is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. The adoption of this guidance did not impact our financial condition or results of operations.

Pronouncements to be effective in the future

In October 2010, the FASB issued ASU 2010-26, Financial Services-Insurance (Topic 944): Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts (“ASU 2010-26”). This guidance requires that only costs that are incremental or directly related to the successful acquisition of new or renewal insurance contracts are to be capitalized as a deferred acquisition cost. This would include, among other items, sales commissions paid to agents, premium taxes, and the portion of employee salaries and benefits directly related to time spent on acquired contracts. This guidance is effective, either with a prospective or retrospective application, for interim and annual periods beginning after December 15, 2011, with early adoption permitted. Although we continue to evaluate the impact of this guidance, we anticipate that ASU 2010-26 would have an after-tax impact on our stockholders’ equity of approximately \$55 million, or about \$1 of book value per share. The adoption of this guidance is not expected to have a material impact on our results of operations on either a historical or prospective basis.

In May 2011, the FASB issued ASU 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (“ASU 2011-04”). This guidance changes the wording used to describe the requirements in U.S. GAAP for measuring fair value and disclosing information about fair value measurements to improve consistency in the application and description of fair value between GAAP and International Financial Reporting Standards. ASU 2011-04 clarifies how the concepts of highest and best use and valuation premise in a fair value measurement are relevant only when measuring the fair value of nonfinancial assets, and are not relevant when measuring the fair value of financial assets or liabilities. In addition, ASU 2011-04 expands the disclosures for unobservable inputs for Level 3 fair value measurements, requiring quantitative information to be disclosed related to: (i) the valuation processes used; (ii) the sensitivity of the fair value measurement to changes in unobservable inputs and the interrelationships between those unobservable inputs; and (iii) the use of a nonfinancial asset in a way that differs from the asset’s highest and best use. ASU 2011-04 is effective prospectively for interim and annual periods beginning after December 15, 2011. The adoption of this guidance is not expected to have a material impact on our financial condition, results of operations, or current disclosures.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income (“ASU 2011-05”). ASU 2011-05 requires that all nonowner changes in stockholders’ equity be presented either

in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 also requires financial statement presentation of reclassification adjustments for items that are reclassified from other comprehensive income (“OCI”) to net income. This guidance, which only changes financial statement presentation, is effective, on a retrospective basis, for interim and annual periods beginning after December 15, 2011.

In September 2011, the FASB issued ASU 2011-08, Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment, which simplifies the requirements to test goodwill for impairment. The amendment permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing events and circumstances, an entity determines that it is not more likely than not that the fair value of the reporting unit is less than the carrying amount, then performing the two-step impairment test is unnecessary. However, if the entity concludes otherwise, then it is required to perform the quantitative impairment test. This guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, and early adoption is permitted. The adoption of this guidance is not expected to have a material impact on our financial condition, results of operations, or current disclosures.

NOTE 5. Statements of Cash Flow

Cash (received) paid during the period for interest and federal income taxes was as follows:

| (\$ in thousands) | Nine Months ended September 30, | |
|---|---------------------------------|--------|
| | 2011 | 2010 |
| Cash (received) paid during the period for: | | |
| Interest | \$ 11,074 | 11,620 |
| Federal income tax | (6,460) | 14,000 |

NOTE 6. Investments

(a) The following table provides information related to our held-to-maturity (“HTM”) securities:

| September 30, 2011 | | | | | | |
|--|----------------|-------------------------------|----------------|----------------------------|-----------------------------|------------|
| (\$ in thousands) | Amortized Cost | Net Unrealized Gains (Losses) | Carrying Value | Unrecognized Holding Gains | Unrecognized Holding Losses | Fair Value |
| Foreign government | \$5,292 | 311 | 5,603 | - | (106) | 5,497 |
| Obligations of states and political subdivisions | 729,361 | 15,640 | 745,001 | 33,246 | (421) | 777,826 |
| Corporate securities | 67,055 | (2,541) | 64,514 | 7,681 | - | 72,195 |
| Asset-backed securities (“ABS”) | 8,366 | (1,588) | 6,778 | 1,544 | (9) | 8,313 |
| Commercial mortgage-backed securities (“CMBS”) | 36,450 | (5,597) | 30,853 | 6,868 | (275) | 37,446 |
| Residential mortgage-backed securities (“RMBS”) | 132 | (38) | 94 | 14 | - | 108 |
| Total HTM fixed maturity securities | \$846,656 | 6,187 | 852,843 | 49,353 | (811) | 901,385 |
| December 31, 2010 | | | | | | |
| (\$ in thousands) | Amortized Cost | Net Unrealized Gains (Losses) | Carrying Value | Unrecognized Holding Gains | Unrecognized Holding Losses | Fair Value |
| U.S. government and government agencies | \$93,411 | 4,695 | 98,106 | 5,023 | - | 103,129 |
| Foreign government | 5,292 | 368 | 5,660 | - | (30) | 5,630 |
| Obligations of states and political subdivisions | 874,388 | 22,183 | 896,571 | 16,845 | (1,132) | 912,284 |
| Corporate securities | 76,663 | (3,990) | 72,673 | 9,705 | (313) | 82,065 |
| ABS | 12,947 | (2,422) | 10,525 | 1,847 | (444) | 11,928 |

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

| | | | | | | |
|-------------------------------------|-------------|----------|-----------|--------|----------|-----------|
| CMBS1 | 54,909 | (7,354) | 47,555 | 7,483 | (109) | 54,929 |
| RMBS2 | 82,191 | 1,043 | 83,234 | 3,095 | - | 86,329 |
| Total HTM fixed maturity securities | \$1,199,801 | 14,523 | 1,214,324 | 43,998 | (2,028) | 1,256,294 |

1 CMBS includes government guaranteed agency securities with a carrying value \$8.9 million at December 31, 2010.

2 RMBS includes government guaranteed agency securities with a carrying value \$4.0 million at December 31, 2010.

Unrecognized holding gains/losses of HTM securities are not reflected in the consolidated Financial Statements, as they represent fair value fluctuations from the later of: (i) the date a security is designated as HTM; or (ii) the date that an other-than-temporary impairment (“OTTI”) charge is recognized on an HTM security, through the date of the balance sheet. Our HTM securities had an average duration of 3.1 years as of September 30, 2011 and 3.4 years as of December 31, 2010.

During Nine Months 2011, 68 securities, with a carrying value of \$222.2 million in a net unrecognized gain position of \$12.4 million, were reclassified from the HTM category to available-for-sale (“AFS”) due to recent credit rating downgrades by either Moody’s Investors Service, Standard and Poor’s Financial Services, or Fitch Ratings. These unexpected rating downgrades raised significant concerns about the issuers’ credit worthiness, which changed our intention to hold these securities to maturity. In addition to the transfer activity, redemptions and maturities of HTM securities amounted to \$138.9 million in Nine Months 2011.

(b) The following table provides information related to our AFS securities:

September 30, 2011

| (\$ in thousands) | Cost/ Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
|--|----------------------------|---------------------|----------------------|---------------|
| U.S. government and government agencies ¹ | \$ 358,154 | 21,877 | - | 380,031 |
| Foreign government | 31,599 | 1,313 | - | 32,912 |
| Obligations of states and political subdivisions | 524,185 | 37,375 | (45) | 561,515 |
| Corporate securities | 1,085,081 | 46,011 | (5,533) | 1,125,559 |
| ABS | 78,393 | 1,383 | (1,082) | 78,694 |
| CMBS ² | 107,404 | 6,788 | (1,301) | 112,891 |
| RMBS ³ | 464,219 | 17,976 | (1,449) | 480,746 |
| AFS fixed maturity securities | 2,649,035 | 132,723 | (9,410) | 2,772,348 |
| AFS equity securities | 150,517 | 6,690 | (18,004) | 139,203 |
| Total AFS securities | \$ 2,799,552 | 139,413 | (27,414) | 2,911,551 |

December 31, 2010

| (\$ in thousands) | Cost/ Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
|--|----------------------------|---------------------|----------------------|---------------|
| U.S. government and government agencies ¹ | \$ 312,384 | 8,292 | (147) | 320,529 |
| Foreign government | 19,035 | 280 | (349) | 18,966 |
| Obligations of states and political subdivisions | 512,013 | 22,534 | (650) | 533,897 |
| Corporate securities | 973,835 | 28,674 | (8,784) | 993,725 |
| ABS | 48,558 | 514 | (339) | 48,733 |
| CMBS ² | 103,374 | 4,024 | (2,923) | 104,475 |
| RMBS ³ | 316,789 | 7,871 | (2,243) | 322,417 |
| AFS fixed maturity securities | 2,285,988 | 72,189 | (15,435) | 2,342,742 |
| AFS equity securities | 58,039 | 11,597 | - | 69,636 |
| Total AFS securities | \$ 2,344,027 | 83,786 | (15,435) | 2,412,378 |

¹ U.S. government includes corporate securities fully guaranteed by the Federal Deposit Insurance Corporation (“FDIC”) with a fair value of \$96.3 million at September 30, 2011 and \$121.0 million at December 31, 2010.

² CMBS includes government guaranteed agency securities with a fair value of \$78.0 million at September 30, 2011 and \$71.9 million at December 31, 2010.

3 RMBS includes government guaranteed agency securities with a fair value of \$101.3 million at September 30, 2011 and \$91.1 million at December 31, 2010.

Unrealized gains/losses of AFS securities represent fair value fluctuations from the later of: (i) the date a security is designated as AFS; or (ii) the date that an OTTI charge is recognized on an AFS security, through the date of the balance sheet. These unrealized gains and losses are recorded in accumulated other comprehensive income (“AOCI”) on the Consolidated Balance Sheets.

(c) The following tables summarize, for all securities in a net unrealized/unrecognized loss position at September 30, 2011 and December 31, 2010, the fair value and gross pre-tax net unrealized/unrecognized loss by asset class and by length of time those securities have been in a net loss position:

| September 30, 2011 | Less than 12 months | | 12 months or longer | |
|--|---------------------|--------------------------------|---------------------|--------------------------------|
| (\$ in thousands) | Fair Value | Unrealized Losses ¹ | Fair Value | Unrealized Losses ¹ |
| AFS securities | | | | |
| Obligations of states and political subdivisions | \$ 2,127 | (1) | 1,887 | (44) |
| Corporate securities | 182,536 | (4,898) | 6,739 | (636) |
| ABS | 6,202 | (9) | 1,144 | (1,072) |
| CMBS | 6,371 | (60) | 10,050 | (1,240) |
| RMBS | 28,893 | (490) | 11,781 | (960) |
| Total fixed maturity securities | 226,129 | (5,458) | 31,601 | (3,952) |
| Equity securities | 85,918 | (18,004) | - | - |
| Subtotal | \$ 312,047 | (23,462) | 31,601 | (3,952) |

| | Less than 12 months | | | 12 months or longer | | |
|--|---------------------|--------------------------------|---------------------------------|---------------------|--------------------------------|---------------------------------|
| (\$ in thousands) | Fair Value | Unrealized Losses ¹ | Unrecognized Gains ³ | Fair Value | Unrealized Losses ¹ | Unrecognized Gains ³ |
| HTM securities | | | | | | |
| Obligations of states and political subdivisions | \$3,929 | (192) | 178 | 10,072 | (551) | 343 |
| ABS | - | - | - | 2,830 | (1,060) | 762 |
| CMBS | 14,315 | (596) | 575 | 6,529 | (3,348) | 1,016 |
| RMBS | - | - | - | 108 | (38) | 14 |
| Subtotal | \$18,244 | (788) | 753 | 19,539 | (4,997) | 2,135 |
| Total AFS and HTM | \$330,291 | (24,250) | 753 | 51,140 | (8,949) | 2,135 |

| December 31, 2010 | Less than 12 months | | 12 months or longer | |
|--|---------------------|--------------------------------|---------------------|--------------------------------|
| (\$ in thousands) | Fair Value | Unrealized Losses ¹ | Fair Value | Unrealized Losses ¹ |
| AFS securities | | | | |
| U.S. government and government agencies ² | \$ 3,956 | (147) | - | - |
| Foreign government | 10,776 | (349) | - | - |
| Obligations of states and political subdivisions | 40,410 | (650) | - | - |
| Corporate securities | 362,502 | (8,784) | - | - |
| ABS | 30,297 | (273) | 880 | (66) |
| CMBS | 5,453 | (271) | 11,115 | (2,652) |
| RMBS | 70,934 | (1,098) | 20,910 | (1,145) |
| Total fixed maturity securities | 524,328 | (11,572) | 32,905 | (3,863) |
| Equity securities | - | - | - | - |
| Subtotal | \$ 524,328 | (11,572) | 32,905 | (3,863) |

| (\$ in thousands) | Fair Value | Less than 12 months | | | 12 months or longer | | |
|--|------------------|---------------------|---------------------------------|------------------------------------|---------------------|--------------------------------|---------------------------------|
| | | Unrealized (Losses) | Unrecognized Gains ¹ | Unrecognized (Losses) ³ | Fair Value | Unrealized Losses ¹ | Unrecognized Gains ³ |
| HTM securities | | | | | | | |
| Obligations of states and political subdivisions | \$21,036 | (381) | 45 | | 27,855 | (1,969) | 670 |
| Corporate securities | 1,985 | (434) | 420 | | - | - | - |
| ABS | 507 | (546) | (440) | | 2,931 | (1,095) | 747 |
| CMBS | 3,621 | 15 | (17) | | 5,745 | (3,933) | 833 |
| RMBS | - | - | - | | 95 | (38) | 1 |
| Subtotal | \$27,149 | (1,346) | 8 | | 36,626 | (7,035) | 2,251 |
| Total AFS and HTM | \$551,477 | (12,918) | 8 | | 69,531 | (10,898) | 2,251 |

¹Gross unrealized losses include non-OTTI unrealized amounts and OTTI losses recognized in AOCI. In addition, this column includes remaining unrealized gain or loss amounts on securities that were transferred to an HTM designation in the first quarter of 2009 for those securities that are in a net unrealized/unrecognized loss position.

² U.S. government includes corporate securities fully guaranteed by the FDIC.

³Unrecognized holding gains/(losses) represent fair value fluctuations from the later of: (i) the date a security is designated as HTM; or (ii) the date that an OTTI charge is recognized on an HTM security.

The following table provides information regarding securities in an unrealized loss position as of September 30, 2011 and December 31, 2010:

| (\$ in thousands) | | | | | | |
|--------------------|------------------|------------------------------|-------------------|------------------|------------------------------|--|
| September 30, 2011 | | | December 31, 2010 | | | |
| Number of Issues | % of Market/Book | Unrealized Unrecognized Loss | Number of Issues | % of Market/Book | Unrealized Unrecognized Loss | |
| 188 | 80% - 99% | \$ 16,142 | 193 | 80% - 99% | \$ 16,310 | |
| 64 | 60% - 79% | 9,554 | 2 | 60% - 79% | 1,125 | |
| 11 | 40% - 59% | 2,963 | 2 | 40% - 59% | 2,160 | |
| 3 | 20% - 39% | 1,652 | 1 | 20% - 39% | 986 | |
| - | 0% - 19% | - | 1 | 0% - 19% | 976 | |
| | | \$ 30,311 | | | \$ 21,557 | |

We have reviewed the securities in the tables above in accordance with our OTTI policy, as described in Note 2. "Summary of Significant Accounting Policies" in Item 8. "Financial Statements and Supplementary Data." of our 2010 Annual Report.

At September 30, 2011, we had 139 equity securities in an aggregate unrealized loss position of \$18.0 million. These securities, which we purchased as part of our high-dividend yield strategy earlier in the year, have all been in an unrealized loss position for less than six months, generally driven by market volatility in the equity markets over the past two months. Unrealized losses on our fixed maturity portfolio improved by \$9.3 million compared to December

31, 2010, primarily in the less than 12 months category.

At September 30, 2011, unrealized/unrecognized losses on securities that were in a loss position for 12 months or longer amounted to \$6.8 million, primarily driven by \$5.9 million in losses from our structured securities portfolios. Our CMBS portfolio contributed \$3.6 million to these unrealized/unrecognized losses, \$3.2 million of which related to three securities for which we performed discounted cash flow analyses in Third Quarter 2011. These analyses did not indicate further impairment on two of the securities. We recorded an additional other-than-temporary credit impairment of \$0.1 million with a related non-credit impairment in OCI of \$0.6 million on the third security.

For further discussion regarding the credit quality of our investment portfolio, see the “Investments” section of Item 2 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this Form 10-Q.

We do not have the intent to sell any securities in an unrealized/unrecognized loss position nor do we believe we will be required to sell these securities, and therefore we have concluded that they are temporarily impaired as of September 30, 2011. This conclusion reflects our current judgment as to the financial position and future prospects of the entity that issued the investment security and underlying collateral. If our judgment about an individual security changes in the future, we may ultimately record a credit loss after having originally concluded that one did not exist, which could have a material impact on our net income and financial position in future periods.

(d) Fixed maturity securities at September 30, 2011, by contractual maturity, are shown below. Mortgage-backed securities are included in the maturity tables using the estimated average life of each security. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

Listed below are HTM fixed maturity securities at September 30, 2011:

| (\$ in thousands) | Carrying Value | Fair Value |
|---------------------------------------|----------------|------------|
| Due in one year or less | \$ 96,195 | 98,940 |
| Due after one year through five years | 575,181 | 602,982 |
| Due after five years through 10 years | 174,159 | 190,641 |
| Due after 10 years | 7,308 | 8,822 |
| Total HTM fixed maturity securities | \$ 852,843 | 901,385 |

Listed below are AFS fixed maturity securities at September 30, 2011:

| (\$ in thousands) | Fair Value |
|---------------------------------------|--------------|
| Due in one year or less | \$ 231,400 |
| Due after one year through five years | 1,800,407 |
| Due after five years through 10 years | 727,331 |
| Due after 10 years | 13,210 |
| Total AFS fixed maturity securities | \$ 2,772,348 |

(e) The following table outlines a summary of our other investment portfolio by strategy and the remaining commitment amount associated with each strategy:

| Other Investments | Carrying Value | | September 30, 2011 |
|--------------------------------|--------------------|-------------------|----------------------|
| | September 30, 2011 | December 31, 2010 | Remaining Commitment |
| (\$ in thousands) | | | |
| Alternative Investments | | | |
| Energy/power generation | \$ 30,792 | 35,560 | 10,296 |
| Secondary private equity | 29,077 | 26,709 | 11,047 |
| Private equity | 21,067 | 21,601 | 6,637 |
| Distressed debt | 19,285 | 20,432 | 3,169 |
| Real estate | 14,033 | 14,192 | 10,602 |
| Mezzanine financing | 9,993 | 10,230 | 15,910 |
| Venture capital | 7,909 | 6,386 | 900 |
| Total alternative investments | 132,156 | 135,110 | 58,561 |
| Other securities | 3,404 | 2,755 | 2,096 |
| Total other investments | \$ 135,560 | 137,865 | 60,657 |

The carrying value of our other investments decreased by \$2.3 million compared to year end 2010. The carrying value was primarily impacted by distributions of \$37.9 million, partially offset by income of \$24.0 million and additional contributions of \$11.8 million under our commitments.

For a description of our seven alternative investment strategies outlined above, as well as redemption, restrictions, and fund liquidations, refer to Note 5. "Investments" in Item 8. "Financial Statements and Supplementary Data." of our 2010 Annual Report.

The following table sets forth aggregated summarized financial information for the limited partnerships in our alternative investment portfolio. The last line of the table below reflects our share of the aggregate income, which is the portion included in our consolidated Financial Statements. As the majority of these investments report results to us on a quarter lag, the summarized financial statement information for the three and nine-month periods ended June 30 is as follows:

| Income Statement Information (\$ in millions) | Quarter ended, June 30, | | Nine Months ended June 30, | |
|--|----------------------------|-------|-------------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| Net investment income | \$ 136.8 | 119.9 | 423.6 | 394.3 |
| Realized gains (losses) | 710.6 | 75.0 | 873.6 | (411.6) |
| Net change in unrealized appreciation | (194.7) | 129.6 | 1,877.8 | 1,378.3 |
| Net income | \$ 652.7 | 324.5 | 3,175.0 | 1,361.0 |
| Selective's insurance subsidiaries' net income | \$ 4.5 | 2.3 | 24.0 | 11.1 |

(f) At September 30, 2011, we had one fixed maturity security, with a carrying value of \$15.9 million, pledged as collateral for our outstanding borrowing with the Federal Home Loan Bank of Indianapolis ("FHLBI"). This borrowing, which has an outstanding principal balance of \$13.0 million, is included in "Notes payable" on our Consolidated Balance Sheets. In accordance with the terms of our agreement with the FHLBI, we retain all rights regarding this security, which is included in the "U.S. government and government agencies" classification of our AFS fixed maturity securities portfolio.

(g) The components of net investment income earned were as follows:

| (\$ in thousands) | Quarter ended September 30, | | Nine Months ended September 30, | |
|------------------------------|--------------------------------|----------|------------------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| Fixed maturity securities | \$ 31,960 | 31,741 | 97,835 | 97,914 |
| Equity securities | 1,197 | 347 | 2,299 | 1,279 |
| Short-term investments | 28 | 134 | 123 | 367 |
| Other investments | 4,494 | 2,400 | 24,082 | 11,216 |
| Investment expenses | (1,893) | (1,636) | (5,735) | (6,539) |
| Net investment income earned | \$ 35,786 | 32,986 | 118,604 | 104,237 |

Net investment income, before tax, increased by \$2.8 million for Third Quarter 2011 compared to Third Quarter 2010, and increased by \$14.4 million for Nine Months 2011 compared to Nine Months 2010. These increases were primarily driven by income from our alternative investments that are included in our "other investments" portfolio. Our alternative investments, which are accounted for under the equity method, primarily consist of investments in limited partnerships, the majority of which report results to us on a one quarter lag. The following table illustrates income by strategy for these partnerships:

| (\$ in thousands) | Quarter ended September 30, | | Nine Months ended September 30, | |
|--------------------------|-----------------------------|------|---------------------------------|-------|
| | 2011 | 2010 | 2011 | 2010 |
| Energy/power generation | \$ 1,760 | 409 | 7,599 | 3,440 |
| Private equity | 1,640 | 543 | 5,398 | 1,350 |
| Secondary private equity | 1,179 | 240 | 5,895 | 3,924 |
| Distressed debt | (153) | 472 | 1,241 | 1,195 |

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

| | | | | |
|-------------------------------|----------|-------|--------|----------|
| Real estate | 35 | 303 | 1,485 | (2,056) |
| Venture capital | 125 | 15 | 1,448 | 263 |
| Mezzanine financing | (133) | 377 | 928 | 3,006 |
| Other | 41 | 41 | 88 | 94 |
| Total other investment income | \$ 4,494 | 2,400 | 24,082 | 11,216 |

12

(h) The following tables summarize OTTI by asset type for the periods indicated:

| Third Quarter 2011 (\$ in thousands) | Gross | Included in Other Comprehensive Income ("OCI") | Recognized in Earnings |
|---|----------|---|---------------------------|
| Fixed maturity securities | | | |
| ABS | \$ 543 | 493 | 50 |
| CMBS | (184) | (316) | 132 |
| RMBS | 22 | (27) | 49 |
| Total fixed maturities | 381 | 150 | 231 |
| Equity securities | 2,312 | - | 2,312 |
| OTTI losses | \$ 2,693 | 150 | 2,543 |

| Third Quarter 2010 (\$ in thousands) | Gross | Included in OCI | Recognized in Earnings |
|---|----------|-----------------|---------------------------|
| Fixed maturity securities | | | |
| CMBS | \$ 2,116 | 1,245 | 871 |
| RMBS | 150 | 39 | 111 |
| Total fixed maturity securities | 2,266 | 1,284 | 982 |
| Equity securities | 1,825 | - | 1,825 |
| OTTI losses | \$ 4,091 | 1,284 | 2,807 |

| Nine Months 2011 (\$ in thousands) | Gross | Included in OCI | Recognized in Earnings |
|--|----------|-----------------|---------------------------|
| Fixed maturity securities | | | |
| Obligations of states and political subdivisions | \$ 17 | - | 17 |
| Corporate securities | 244 | - | 244 |
| ABS | 543 | 493 | 50 |
| CMBS | (370) | (974) | 604 |
| RMBS | 316 | 201 | 115 |
| Total fixed maturity securities | 750 | (280) | 1,030 |
| Equity securities | 2,312 | - | 2,312 |
| OTTI losses | \$ 3,062 | (280) | 3,342 |

| Nine Months 2010 (\$ in thousands) | Gross | Included in OCI | Recognized in Earnings |
|---------------------------------------|-----------|-----------------|---------------------------|
| Fixed maturity securities | | | |
| ABS | \$ 158 | 127 | 31 |
| CMBS | 5,561 | (807) | 6,368 |
| RMBS | 8,110 | (225) | 8,335 |
| Total fixed maturity securities | 13,829 | (905) | 14,734 |
| Equity securities | 2,497 | - | 2,497 |
| OTTI losses | \$ 16,326 | (905) | 17,231 |

OTTI charges recognized in earnings were \$2.5 million in Third Quarter 2011 and \$3.3 million in Nine Months 2011. These charges were primarily related to certain securities in our high-dividend yield equity strategy that we do not believe will recover in the near term.

The following is a discussion surrounding the OTTI charges that were recognized in earnings in Third Quarter and Nine Months 2010 as outlined in the table above:

- \$0.1 million and \$8.3 million of RMBS credit OTTI charges in Third Quarter and Nine Months 2010, respectively. The Third Quarter 2010 charges related to declines in the related cash flows of the underlying collateral. Based on our analysis, we did not believe it was probable that we would receive all contractual cash flows for these securities. In addition to the Third Quarter 2010 charges, losses in Nine Months 2010 were largely driven by impairments on two securities in the first quarter of 2010 that we intended to sell. We sold these securities in the second quarter of 2010.

- \$0.9 million and \$6.4 million of CMBS credit OTTI charges in Third Quarter and Nine Months 2010, respectively. These charges were related to reductions in the related cash flows of the underlying collateral of these securities. These charges were primarily associated with securities that had been previously impaired but, over time, had shown little, if any, improvement in valuations, poor net operating income performance of the underlying properties, and, in some cases, an increase in over 60-day delinquency rates. For Third Quarter 2010, these securities had, on average, unrealized/unrecognized loss positions of more than 60% of their amortized cost. Based on our analysis, we did not believe it was probable that we would receive all contractual cash flows for these securities.
- \$1.8 million and \$2.5 million of equity OTTI charges in Third Quarter and Nine Months 2010, respectively. These charges were driven primarily by a change in our intent to hold these securities to recovery in the near term as we intended to lower our exposure to equities and pursue a more index-neutral position for this asset class in the near term, providing greater sector and sponsor diversification.

The following tables set forth, for the periods indicated, gross credit loss impairments on fixed maturity securities for which a portion of the OTTI charge was recognized in OCI, and the corresponding changes in such amounts:

| (\$ in thousands) | Quarter ended September 30, | |
|--|-----------------------------|----------|
| | 2011 | 2010 |
| Balance, beginning of period | \$ 14,024 | 20,343 |
| Addition for the amount related to credit loss for which an OTTI was not previously recognized | - | 192 |
| Reductions for securities sold during the period | - | - |
| Reductions for securities for which the amount previously recognized in OCI was recognized in earnings because of intention or potential requirement to sell before recovery of amortized cost | - | - |
| Reductions for securities for which the entire amount previously recognized in OCI was recognized in earnings due to a decrease in cash flows expected | - | (3,254) |
| Additional increases to the amount related to credit loss for which an OTTI was previously recognized | 207 | 530 |
| Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected | - | - |
| Balance, end of period | \$ 14,231 | 17,811 |

| (\$ in thousands) | Nine Months ended September 30, | |
|--|---------------------------------|----------|
| | 2011 | 2010 |
| Balance, beginning of period | \$ 17,723 | 22,189 |
| Addition for the amount related to credit loss for which an OTTI was not previously recognized | - | 2,326 |
| Reductions for securities sold during the period | - | (2,990) |
| Reductions for securities for which the amount previously recognized in OCI was recognized in earnings because of intention or potential requirement to sell before recovery of amortized cost | - | - |
| Reductions for securities for which the entire amount previously recognized in OCI was recognized in earnings due to a decrease in cash flows expected | (3,954) | (7,906) |
| Additional increases to the amount related to credit loss for which an OTTI was previously recognized | 462 | 4,192 |
| | - | - |

Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected

Balance, end of period \$ 14,231 17,811

(i) The components of net realized gains, excluding OTTI charges, were as follows:

| (\$ in thousands) | Quarter ended September 30, | | Nine Months ended September 30, | |
|---|--------------------------------|----------|------------------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| HTM fixed maturity securities | | | | |
| Gains | \$ - | 123 | 9 | 535 |
| Losses | (200) | (296) | (522) | (746) |
| AFS fixed maturity securities | | | | |
| Gains | 698 | 2,961 | 3,052 | 7,743 |
| Losses | (5) | (15) | (12) | (7,604) |
| AFS equity securities | | | | |
| Gains | 5 | 912 | 6,676 | 15,086 |
| Losses | - | (821) | - | (1,054) |
| Total other net realized investment gains | 498 | 2,864 | 9,203 | 13,960 |
| Total OTTI charges recognized in earnings | (2,543) | (2,807) | (3,342) | (17,231) |
| Total net realized gains (losses) | \$ (2,045) | 57 | 5,861 | (3,271) |

Realized gains and losses on the sale of investments are determined on the basis of the cost of the specific investments sold. Proceeds from the sale of AFS securities were \$22.0 million in Third Quarter 2011 and \$145.8 million in Nine Months 2011. In addition to calls, maturities, and certain bond sales, Nine Months 2011 net realized gains, excluding OTTI charges, were driven by the sale of AFS equity securities for proceeds of \$60.0 million and realized gains of \$6.7 million due to a reallocation of the equity portfolio to a high dividend yield strategy.

Proceeds from the sale of AFS securities were \$49.7 million in Third Quarter 2010 and \$234.1 million in Nine Months 2010. In addition to calls and maturities, the net realized gain, excluding OTTI charges, in Third Quarter 2010 was driven by the sale of AFS fixed maturity securities, primarily corporate holdings. In addition, as part of our transition to external investment managers, in Third Quarter 2010, we changed our intent regarding certain equity holdings that we sold to lower our equity exposure at that time and pursue a more index-neutral position for this asset class in the near term, providing greater sector and sponsor diversification. The sale of these equity holdings resulted in gross realized gains of \$0.9 million and gross realized losses of \$0.8 million.

In addition to the Third Quarter 2010 realized gains discussed above, Nine Months 2010 realized gains were driven by: (i) the sale of energy-focused AFS equity securities in the second quarter of 2010 to mitigate portfolio risk and sector exposure; and (ii) sales in the first quarter of 2010 that were predominantly associated with tax planning strategies. These gains were largely offset by realized losses on certain AFS fixed maturity securities in the second quarter of 2010 that our new investment managers, during their initial review of the portfolio, had recommended that we sell. This recommendation was due to ongoing credit concerns of the underlying investments coupled with strategically positioning the portfolio to generate maximum yield while balancing risk objectives.

NOTE 7. Fair Value Measurements

The following table presents the carrying amounts and estimated fair values of our financial instruments as of September 30, 2011 and December 31, 2010:

| (\$ in thousands) | September 30, 2011 | | December 31, 2010 | |
|--|--------------------|------------|-------------------|------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Financial Assets | | | | |
| Fixed maturity securities: | | | | |
| HTM | \$ 852,843 | 901,385 | 1,214,324 | 1,256,294 |
| AFS | 2,772,348 | 2,772,348 | 2,342,742 | 2,342,742 |
| Equity securities, AFS | 139,203 | 139,203 | 69,636 | 69,636 |
| Short-term investments | 162,812 | 162,812 | 161,155 | 161,155 |
| Receivable for proceeds related to sale of Selective | | | | |
| HR Solutions (“Selective HR”) | 3,375 | 3,375 | 5,002 | 5,002 |
| Financial Liabilities | | | | |
| Notes payable: | | | | |
| 7.25% Senior Notes | 49,907 | 58,589 | 49,904 | 55,190 |
| 6.70% Senior Notes | 99,446 | 110,604 | 99,429 | 90,097 |
| 7.50% Junior Notes | 100,000 | 98,664 | 100,000 | 99,840 |
| 2.90% borrowings from FHLBI | 13,000 | 13,780 | 13,000 | 13,389 |
| Total notes payable | \$ 262,353 | 281,637 | 262,333 | 258,516 |

There have been no significant changes to the techniques used to value our financial instruments during Nine Months 2011. For a discussion regarding these techniques, refer to Note 2. “Summary of Significant Accounting Policies” in Item 8. “Financial Statements and Supplementary Data.” in our 2010 Annual Report. For discussion of the sale of

Selective HR, refer to Note 15. “Discontinued Operations” of this Form 10-Q.

The following tables provide quantitative disclosures of our financial assets that were measured at fair value at September 30, 2011 and December 31, 2010:

September 30, 2011

| (\$ in thousands) Description | Fair Value Measurements Using | | | |
|---|--|--|--|---|
| | Assets Measured at Fair Value at 9/30/11 | Active Markets for Identical Assets/ Liabilities (Level 1) | Quoted Prices in Significant Assets/ Liabilities (Level 2) | Other Significant Unobservable Inputs (Level 3) |
| Measured on a recurring basis: | | | | |
| U.S. government and government agencies ¹ | \$ 380,031 | 122,701 | 257,330 | - |
| Foreign government | 32,912 | - | 32,912 | - |
| Obligations of states and political subdivisions | 561,515 | - | 561,515 | - |
| Corporate securities | 1,125,559 | - | 1,125,559 | - |
| ABS | 78,694 | - | 78,694 | - |
| CMBS | 112,891 | - | 112,561 | 330 |
| RMBS | 480,746 | - | 480,746 | - |
| Total AFS fixed maturity securities | 2,772,348 | 122,701 | 2,649,317 | 330 |
| Equity securities | 139,203 | 139,203 | - | - |
| Short-term investments | 162,812 | 162,812 | - | - |
| Receivable for proceeds related to sale of Selective HR | 3,375 | - | - | 3,375 |
| Total financial assets measured on a recurring basis | \$ 3,077,738 | 424,716 | 2,649,317 | 3,705 |

December 31, 2010

| (\$ in thousands) Description | Fair Value Measurements Using | | | |
|---|---|--|--|---|
| | Assets Measured at Fair Value at 12/31/10 | Active Markets for Identical Assets/ Liabilities (Level 1) | Quoted Prices in Significant Assets/ Liabilities (Level 2) | Other Significant Unobservable Inputs (Level 3) |
| Measured on a recurring basis: | | | | |
| U.S. government and government agencies ¹ | \$ 320,529 | 105,317 | 215,212 | - |
| Foreign government | 18,966 | - | 18,966 | - |
| Obligations of states and political subdivisions | 533,897 | - | 533,897 | - |
| Corporate securities | 993,725 | - | 993,725 | - |
| ABS | 48,733 | - | 48,733 | - |
| CMBS | 104,475 | - | 104,290 | 185 |
| RMBS | 322,417 | - | 322,417 | - |
| Total AFS fixed maturity securities | 2,342,742 | 105,317 | 2,237,240 | 185 |
| Equity securities | 69,636 | 69,636 | - | - |
| Short-term investments | 161,155 | 161,155 | - | - |
| Receivable for proceeds related to sale of Selective HR | 5,002 | - | - | 5,002 |
| Total financial assets measured on a recurring basis | \$ 2,578,535 | 336,108 | 2,237,240 | 5,187 |

¹ U.S. government includes corporate securities fully guaranteed by the FDIC.

The following tables provide a summary of the changes in fair value of securities using Level 3 inputs. The transfers of the CMBS, AFS securities in 2010 between levels in the fair value hierarchy were driven primarily by the availability and nature of the broker quotes used at the valuation dates:

| Nine Months 2011 (\$ in thousands) | Receivable for Proceeds Related to Sale | | Total |
|--|---|--------|--------|
| | CMBS, AFS of Selective | HR | |
| Fair value, December 31, 2010 | \$ 185 | 5,002 | 5,187 |
| Total net gains (losses) for the period included in: | | | |
| OCI1 | 425 | - | 425 |
| Net income ^{2, 3} | (269) | (708) | (977) |
| Purchases | - | - | - |
| Sales | - | - | - |
| Issuances | - | - | - |
| Settlements | (11) | (919) | (930) |
| Net transfers in and/or out of Level 3 | - | - | - |
| Fair value, September 30, 2011 | \$ 330 | 3,375 | 3,705 |

| 2010 (\$ in thousands) | Receivable for Proceeds Related to Sale of | | | Total |
|--|--|-----------|--------------|----------|
| | ABS, AFS | CMBS, AFS | Selective HR | |
| Fair Value, December 31, 2009 | \$ - | - | 12,300 | 12,300 |
| Total net (losses) gains for the period included in: | | | | |
| OCI1 | (22) | 1,862 | - | 1,840 |
| Net income ^{2, 3} | - | 41 | (5,460) | (5,419) |
| Purchases, sales, issuances, and settlements (net) | 2,737 | (148) | (1,838) | 751 |
| Net transfers in and/or out of Level 3 | (2,715) | (1,570) | - | (4,285) |
| Fair value, December 31, 2010 | \$ - | 185 | 5,002 | 5,187 |

1 Amounts are reported in “Other net unrealized gains on investment securities, net of deferred income tax” on the Consolidated Statements of Stockholders’ Equity.

2 Amounts are reported in “Net realized investment gains (losses)” for realized gains and losses and “Net investment income earned” for amortization for the CMBS securities on the Consolidated Statements of Income.

3 Amounts are reported in either “Loss on disposal of discontinued operations, net of tax” or “Other income” for the receivable related to sale of Selective HR on the Consolidated Statements of Income. Amounts in “Loss on disposal of discontinued operations, net of tax” relate to charges to reduce the fair value of our receivable and amounts in “Other income” reflect interest accretion on the receivable.

Due to worksite life generation that has not met our expectations, in Third Quarter 2011 we reduced the value of our receivable for the expected proceeds from the sale of Selective HR by \$1.0 million. This charge is reflected in “Loss on disposal of discontinued operations, net of tax” on the Consolidated Statement of Income. We are scheduled to receive the proceeds from the sale of Selective HR over a 10-year period and the fair value of this receivable was determined using a discounted cash flow analysis (Level 3 pricing). Partially offsetting this charge was \$0.3 million

of interest accretion on the receivable, which is reflected in “Other income” on the Consolidated Statement of Income.

NOTE 8. Reinsurance

The following table contains a listing of direct, assumed, and ceded reinsurance amounts for premiums written, premiums earned, and losses and loss expenses incurred. For more information concerning reinsurance, refer to Note 8. "Reinsurance" in Item 8. "Financial Statements and Supplementary Data." in our 2010 Annual Report.

| (\$ in thousands) | Quarter ended September 30, | | Nine Months ended September 30, | |
|---|--------------------------------|-----------|------------------------------------|------------|
| | 2011 | 2010 | 2011 | 2010 |
| Premiums written: | | | | |
| Direct | \$ 453,768 | 431,312 | 1,324,705 | 1,274,061 |
| Assumed | 22,575 | 15,372 | 29,765 | 21,561 |
| Ceded | (79,511) | (79,570) | (221,300) | (206,893) |
| Net | \$ 396,832 | 367,114 | 1,133,170 | 1,088,729 |
| Premiums earned: | | | | |
| Direct | \$ 425,231 | 413,759 | 1,257,087 | 1,238,912 |
| Assumed | 7,626 | 9,158 | 18,866 | 20,858 |
| Ceded | (73,894) | (68,208) | (210,067) | (196,669) |
| Net | \$ 358,963 | 354,709 | 1,065,886 | 1,063,101 |
| Losses and loss expenses incurred: | | | | |
| Direct | \$ 638,219 | 277,111 | 1,204,586 | 834,431 |
| Assumed | 5,977 | 6,612 | 13,549 | 11,535 |
| Ceded | (338,238) | (38,704) | (388,416) | (106,824) |
| Net | \$ 305,958 | 245,019 | 829,719 | 739,142 |

Direct losses and loss expenses increased by \$361.1 million and \$370.2 million, respectively in Third Quarter and Nine Months 2011, respectively, compared to last year. These increases are driven by catastrophe losses incurred this year, including the impact of Hurricane Irene and Tropical Storm Lee in Third Quarter 2011.

Ceded losses and loss expenses increased by \$299.5 million and \$281.6 million in Third Quarter and Nine Months 2011, respectively, reflecting the impact of: (i) Hurricane Irene and Tropical Storm Lee losses in our flood business that are fully ceded to the National Flood Insurance Program ("NFIP"), which are included in the table below; and (ii) Hurricane Irene losses that are anticipated to exceed the first layer of our catastrophe excess of loss treaty.

On a net basis, losses and losses incurred reflect catastrophe losses that increased by \$55.5 million, to \$67.4 million, in the quarter and \$60.2 million, to \$112.4 million, in Nine Months 2011. Hurricane Irene represented the majority of the quarter losses at \$40.4 million (\$48.1 million on a gross basis) with the remainder in Third Quarter 2011 resulting from seven additional events as well as \$10.4 million in prior period storm development.

The ceded premiums and losses related to our involvement with the NFIP are as follows:

| National Flood Insurance Program (\$ in thousands) | Quarter ended September 30, | | Nine Months ended September 30, | |
|---|--------------------------------|-----------|------------------------------------|------------|
| | 2011 | 2010 | 2011 | 2010 |
| Ceded premiums written | \$ (55,198) | (57,838) | (158,777) | (148,296) |
| Ceded premiums earned | (50,256) | (47,240) | (147,111) | (137,220) |
| | (301,725) | (11,227) | (331,604) | (54,303) |

Ceded losses and loss expenses
incurred

NOTE 9. Segment Information

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

- Insurance Operations, which is evaluated based on statutory underwriting results (net premiums earned, incurred losses and loss expenses, policyholders dividends, policy acquisition costs, and other underwriting expenses), and statutory combined ratios; and
 - Investments, which is evaluated based on net investment income and net realized gains and losses.

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

In computing the results of each segment, we do not make adjustments for interest expense, net general corporate expenses, or federal income taxes. We do not maintain separate investment portfolios for the segments and therefore, do not allocate assets to the segments. In addition, we do not aggregate any of our operating segments.

The following summaries present revenue from continuing operations (net investment income and net realized gain (loss) on investments in the case of the Investments segment) and pre-tax income from continuing operations for the individual segments.

Revenue from Continuing Operations by Segment

| (\$ in thousands) | Quarter ended September 30, | | Nine Months ended September 30, | |
|---|--------------------------------|---------|------------------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| Insurance Operations: | | | | |
| Net premiums earned: | | | | |
| Commercial automobile | \$ 70,174 | 73,440 | 209,042 | 220,932 |
| Workers compensation | 63,497 | 63,165 | 189,878 | 189,875 |
| General liability | 87,479 | 83,250 | 255,717 | 252,438 |
| Commercial property | 48,051 | 49,558 | 144,121 | 150,188 |
| Business owners' policies | 16,663 | 16,400 | 49,555 | 48,838 |
| Bonds | 4,727 | 4,884 | 14,219 | 14,315 |
| Other | 1,772 | 2,528 | 6,889 | 7,548 |
| Total commercial lines | 292,363 | 293,225 | 869,421 | 884,134 |
| Personal automobile | 37,371 | 35,927 | 111,522 | 105,490 |
| Homeowners | 25,923 | 22,544 | 75,538 | 64,163 |
| Other | 3,306 | 3,013 | 9,405 | 9,314 |
| Total personal lines | 66,600 | 61,484 | 196,465 | 178,967 |
| Total net premiums earned | 358,963 | 354,709 | 1,065,886 | 1,063,101 |
| Other income | 1,255 | 1,916 | 6,413 | 6,413 |
| Total Insurance Operations revenues | 360,218 | 356,625 | 1,072,299 | 1,069,514 |
| Investments: | | | | |
| Net investment income | 35,786 | 32,986 | 118,604 | 104,237 |
| Net realized (loss) gain on investments | (2,045) | 57 | 5,861 | (3,271) |
| Total investment revenues | 33,741 | 33,043 | 124,465 | 100,966 |
| Total all segments | 393,959 | 389,668 | 1,196,764 | 1,170,480 |
| Other income | 110 | 34 | 331 | 52 |
| Total revenues from continuing operations | \$ 394,069 | 389,702 | 1,197,095 | 1,170,532 |

Income from Continuing Operations, Before Federal Income Tax

| (\$ in thousands) | Quarter ended September 30, | | Nine Months ended September 30, | |
|--|--------------------------------|----------|------------------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| Insurance Operations: | | | | |
| Commercial lines underwriting | \$ (39,332) | (26) | (66,497) | (7,693) |
| Personal lines underwriting | (28,792) | (3,907) | (45,393) | (14,006) |
| Underwriting loss, before federal income tax | (68,124) | (3,933) | (111,890) | (21,699) |
| GAAP combined ratio | 119.0 % | 101.1 | 110.5 % | 102.0 |
| Statutory combined ratio | 116.4 % | 100.3 | 109.6 % | 101.4 |
| Investments: | | | | |
| Net investment income | \$ 35,786 | 32,986 | 118,604 | 104,237 |
| Net realized (loss) gain on investments | (2,045) | 57 | 5,861 | (3,271) |

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

| | | | | |
|---|-------------|----------|-----------|-----------|
| Total investment income, before federal income tax | 33,741 | 33,043 | 124,465 | 100,966 |
| Total all segments | (34,383) | 29,110 | 12,575 | 79,267 |
| Interest expense | (4,559) | (4,559) | (13,675) | (14,056) |
| General corporate and other expenses | (1,886) | (2,491) | (10,735) | (12,656) |
| (Loss) income from continuing operations, before federal income tax | \$ (40,828) | 22,060 | (11,835) | 52,555 |

NOTE 10. Federal Income Taxes

A reconciliation of federal income tax on pre-tax earnings from continuing operations at the corporate rate to the effective tax rate is as follows:

| (\$ in thousands) | Unaudited, Quarter ended September 30, | | Unaudited, Nine Months ended September 30, | |
|--|--|----------|--|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| Tax at statutory rate of 35% | \$ (14,290) | 7,721 | (4,142) | 18,394 |
| Tax-advantaged interest | (4,090) | (4,479) | (12,898) | (14,224) |
| Dividends received deduction | (280) | (67) | (546) | (250) |
| Interim period tax rate adjustment ¹ | (3,250) | (580) | - | 606 |
| Other | 574 | 634 | 1,369 | 2,514 |
| Federal income tax (benefit) expense from continuing operations | \$ (21,336) | 3,229 | (16,217) | 7,040 |

¹During Third Quarter 2011, we recorded year-to-date taxes using the actual effective tax rate as opposed to the estimated full-year effective tax rate that was used in previous quarters.

NOTE 11. Retirement Plans

The following tables show the costs of the Retirement Income Plan for Selective Insurance Company of America (“Retirement Income Plan”) and the retirement life insurance component (“Retirement Life Plan”) of the Selective Insurance Company of America Welfare Benefits Plan. For more information concerning these plans, refer to Note 15. “Retirement Plans” in Item 8. “Financial Statements and Supplementary Data.” of our 2010 Annual Report.

| (\$ in thousands) | Retirement Income Plan Quarter ended September 30, | | Retirement Life Plan Quarter ended September 30, | |
|--|---|----------|--|------|
| | 2011 | 2010 | 2011 | 2010 |
| Components of Net Periodic Benefit Cost: | | | | |
| Service cost | \$ 1,894 | 1,842 | - | - |
| Interest cost | 3,087 | 2,950 | 77 | 80 |
| Expected return on plan assets | (3,482) | (2,811) | - | - |
| Amortization of unrecognized prior service cost | 38 | 38 | - | - |
| Amortization of unrecognized net loss | 1,039 | 1,016 | 4 | 1 |
| Net periodic cost | \$ 2,576 | 3,035 | 81 | 81 |

| (\$ in thousands) | Retirement Income Plan Nine Months ended September 30, | | Retirement Life Plan Nine Months ended September 30, | |
|--|---|----------|--|------|
| | 2011 | 2010 | 2011 | 2010 |
| Components of Net Periodic Benefit Cost: | | | | |
| Service cost | \$ 6,241 | 5,784 | - | - |
| Interest cost | 9,397 | 8,965 | 230 | 238 |
| Expected return on plan assets | (10,445) | (8,437) | - | - |
| Amortization of unrecognized prior service cost | 113 | 113 | - | - |
| Amortization of unrecognized net loss | 3,239 | 3,111 | 13 | 4 |
| Net periodic cost | \$ 8,545 | 9,536 | 243 | 242 |

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

| | | | | | | |
|--------------------------------|------|---|------|------|---|------|
| Discount rate | 5.55 | % | 5.93 | 5.55 | % | 5.93 |
| Expected return on plan assets | 8.00 | | 8.00 | - | | - |
| Rate of compensation increase | 4.00 | | 4.00 | - | | - |

We presently anticipate contributing \$8.4 million to the Retirement Income Plan in 2011, \$7.1 million of which has been funded as of September 30, 2011.

NOTE 12. Comprehensive Income

The components of comprehensive income, both gross and net of tax, for Third Quarter 2011 and 2010 are as follows:

Third Quarter 2011

| (\$ in thousands) | Gross | Tax | Net |
|---|--------------|-----------|-----------|
| Net income | \$ (41,828) | (21,686) | (20,142) |
| Components of OCI: | | | |
| Unrealized gains on securities: | | | |
| Unrealized holding gains during the period | 14,712 | 5,148 | 9,564 |
| Portion of OTTI recognized in OCI | (81) | (28) | (53) |
| Amortization of net unrealized gains on HTM securities | (664) | (232) | (432) |
| Reclassification adjustment for losses included in net income | 1,907 | 668 | 1,239 |
| Net unrealized gains | 15,874 | 5,556 | 10,318 |
| Defined benefit pension and post-retirement plans: | | | |
| Reversal of amortization items: | | | |
| Net actuarial loss | 1,043 | 365 | 678 |
| Prior service cost | 38 | 14 | 24 |
| Defined benefit pension and post-retirement plans | 1,081 | 379 | 702 |
| Comprehensive loss | \$ (24,873) | (15,751) | (9,122) |

Third Quarter 2010

| (\$ in thousands) | Gross | Tax | Net |
|---|-----------|--------|--------|
| Net income | \$ 19,546 | 2,349 | 17,197 |
| Components of other comprehensive income: | | | |
| Unrealized gains on securities: | | | |
| Unrealized holding gains during the period | 45,871 | 16,055 | 29,816 |
| Portion of OTTI recognized in OCI | (1,237) | (433) | (804) |
| Amortization of net unrealized gains on HTM securities | (1,383) | (484) | (899) |
| Reclassification adjustment for losses included in net income | 2,454 | 859 | 1,595 |
| Net unrealized gains | 45,705 | 15,997 | 29,708 |
| Defined benefit pension and post-retirement plans: | | | |
| Reversal of amortization items: | | | |
| Net actuarial loss | 1,017 | 355 | 662 |
| Prior service cost | 38 | 14 | 24 |
| Defined benefit pension and post-retirement plans | 1,055 | 369 | 686 |
| Comprehensive income | \$ 66,306 | 18,715 | 47,591 |

The components of comprehensive income, both gross and net of tax, for Nine Months 2011 and 2010 are as follows:

Nine Months 2011

| (\$ in thousands) | Gross | Tax | Net |
|--|--------------|-----------|----------|
| Net income | \$ (12,835) | (16,567) | 3,732 |
| Components of OCI: | | | |
| Unrealized gains on securities: | | | |
| Unrealized holding gains during the period | 43,878 | 15,357 | 28,521 |
| Portion of OTTI recognized in OCI | 517 | 181 | 336 |
| Amortization of net unrealized gains on HTM securities | (3,097) | (1,084) | (2,013) |

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

| | | | |
|--|-----------|----------|----------|
| Reclassification adjustment for gains included in net income | (5,986) | (2,095) | (3,891) |
| Net unrealized gains | 35,312 | 12,359 | 22,953 |
| Defined benefit pension and post-retirement plans: | | | |
| Reversal of amortization items: | | | |
| Net actuarial loss | 3,252 | 1,138 | 2,114 |
| Prior service cost | 113 | 40 | 73 |
| Defined benefit pension and post-retirement plans | 3,365 | 1,178 | 2,187 |
| Comprehensive income | \$ 25,842 | (3,030) | 28,872 |

Nine Months 2010

(\$ in thousands)

| | Gross | Tax | Net |
|---|------------|----------|----------|
| Net income | \$ 46,787 | 5,021 | 41,766 |
| Components of other comprehensive income: | | | |
| Unrealized gains on securities: | | | |
| Unrealized holding gains during the period | 92,569 | 32,399 | 60,170 |
| Portion of OTTI recognized in OCI | 4,655 | 1,629 | 3,026 |
| Amortization of net unrealized gains on HTM securities | (7,938) | (2,778) | (5,160) |
| Reclassification adjustment for losses included in net income | 840 | 294 | 546 |
| Net unrealized gains | 90,126 | 31,544 | 58,582 |
| Defined benefit pension and post-retirement plans: | | | |
| Reversal of amortization items: | | | |
| Net actuarial loss | 3,115 | 1,090 | 2,025 |
| Prior service cost | 113 | 40 | 73 |
| Defined benefit pension and post-retirement plans | 3,228 | 1,130 | 2,098 |
| Comprehensive income | \$ 140,141 | 37,695 | 102,446 |

The balances of, and changes in, each component of AOCI (net of taxes) as of September 30, 2011 are as follows:

September 30, 2011

| (\$ in thousands) | Net Unrealized (Loss) Gain | | | Defined Benefit Pension and Post-Retirement Plans | Total Accumulated OCI |
|------------------------------------|----------------------------|-------------|-----------|---|-----------------------|
| | OTTI Related | HTM Related | All Other | | |
| Balance, December 31, 2010 | \$ (4,593) | 11,144 | 47,316 | (46,843) | 7,024 |
| Changes in component during period | 336 | (5,927) | 28,544 | 2,187 | 25,140 |
| Balance, September 30, 2011 | \$ (4,257) | 5,217 | 75,860 | (44,656) | 32,164 |

NOTE 13. Commitments and Contingencies

At September 30, 2011, we had contractual obligations that expire at various dates through 2022 to invest up to an additional \$60.7 million in alternative and other investments. There is no certainty that such additional investment will be required.

NOTE 14. Litigation

In the ordinary course of conducting business, we are named as defendants in various legal proceedings. Most of these proceedings are claims litigation involving our seven insurance subsidiaries (the "Insurance Subsidiaries") as either: (i) liability insurers defending or providing indemnity for third-party claims brought against insureds; or (ii) insurers defending first-party coverage claims brought against them. We account for such activity through the establishment of unpaid loss and loss adjustment expense reserves. 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 also are involved from time-to-time in other legal actions, some of which assert claims for substantial amounts. These actions include, among others, putative state class actions seeking certification of a state or national class. Such putative class actions have alleged, for example, improper reimbursement of medical providers paid under workers compensation and personal and commercial automobile insurance policies. Our Insurance

Subsidiaries also are 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.

NOTE 15. Discontinued Operations

In 2009, we sold 100% of our interest in Selective HR, which had historically comprised the human resource administration outsourcing segment of our operations. We sold our interest for proceeds scheduled to be received over a 10-year period based on the ability of the purchaser to retain and generate new worksite lives through our independent agency distribution channel. Although the proceeds are contingent upon the future operations of the former Selective HR business, we have no continued involvement relevant to the proceeds. We recorded an after-tax charge of \$0.7 million in both Third Quarter and Nine Months 2011 and after-tax charges of \$1.6 million and \$3.7 million in Third Quarter and Nine Months 2010, respectively. These charges were due to our revaluation of the contingent proceeds, including assumptions regarding worksite life generation and retention. As of September 30, 2011, our estimated sales price was approximately \$5.9 million, of which \$2.5 million has been received to date.

NOTE 16. Business Combinations

In August 2011, one of our Insurance Subsidiaries, Selective Insurance Company of America (“SICA”), purchased the renewal rights to the commercial excess and surplus (“E & S”) lines business written under contract binding authority by Alterra Excess & Surplus Insurance Company (“Alterra”). This business generated gross premiums written of approximately \$77 million in 2010. If all of this business had been written by SICA in 2010, our NPW would have increased by approximately 6%. Considering the size of the book of business, we do not believe it would be meaningful to provide historical proforma financial information regarding this transaction.

To provide a legal entity licensed to write E & S lines of business, in September 2011, the Parent entered into an agreement to purchase Montpelier U.S. Insurance Company (“MUSIC”), a wholly-owned E & S lines subsidiary of Montpelier Re Holdings Ltd. (“Montpelier Re”). Under the terms of the agreement, the Parent agreed to acquire all of the issued and outstanding shares of common stock of MUSIC.

This acquisition provides a nationally-licensed platform that will allow us to write contract binding authority E & S business. Upon closing, which is expected to occur in the fourth quarter of 2011, Montpelier Reinsurance Ltd., a wholly-owned subsidiary of Montpelier Re, and MUSIC will enter into several reinsurance agreements that will indemnify the Parent for any adverse loss development and any other obligations of MUSIC that relate to business written prior to the date of the acquisition. These reinsurance agreements will also provide that the Parent reimburse Montpelier Reinsurance Ltd. for any favorable loss development that is recognized that relates to business written prior to the date of the acquisition. These reinsurance obligations will be collateralized through a trust arrangement. Based on MUSIC’s net asset value at June 30, 2011, the transaction is valued at approximately \$55 million.

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

Forward-Looking Statements

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

Introduction

We offer property and casualty insurance products through our various subsidiaries. We classify our business into two operating segments: (i) Insurance Operations, which consists of commercial lines ("Commercial Lines") and personal lines ("Personal Lines"), including our flood lines of business; and (ii) Investments.

The purpose of the Management's Discussion and Analysis ("MD&A") is to provide an understanding of the consolidated results of operations and financial condition and known trends and uncertainties that may have a material impact in future periods. Consequently, investors should read the MD&A in conjunction with the consolidated financial statements in our annual report on Form 10-K for the year ended December 31, 2010 ("2010 Annual Report").

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

- Critical Accounting Policies and Estimates;
- Financial Highlights of Results for Third Quarter 2011 and Nine Months 2011;
- Results of Operations and Related Information by Segment;
- Federal Income Taxes;
- Financial Condition, Liquidity, Short-term Borrowings, and Capital Resources;
- Ratings;
- Pending Accounting Pronouncements;
- Off-Balance Sheet Arrangements; and
- Contractual Obligations, Contingent Liabilities, and Commitments.

Critical Accounting Policies and Estimates

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

develop. If different estimates and judgments had been applied, materially different amounts might have been reported in the financial statements. For additional information regarding our critical accounting policies, refer to our 2010 Annual Report, pages 44 through 54.

Financial Highlights of Results for Third Quarter 2011 and Nine Months 2011

| (Shares and \$ in thousands, except per share amounts) | Quarter ended September 30, | | Change % or Points | | Nine Months ended September 30, | | Change % or Points | |
|--|--------------------------------|---------|--------------------------|-----|------------------------------------|-----------|--------------------------|--|
| | 2011 | 2010 | | | 2011 | 2010 | | |
| GAAP measures: | | | | | | | | |
| Revenues | \$394,069 | 389,702 | 1 | % | \$1,197,095 | 1,170,532 | 2 | |
| Pre-tax net investment income | 35,786 | 32,986 | 8 | | 118,604 | 104,237 | 14 | |
| Pre-tax net (loss) income | (41,828) | 19,546 | (314) |) | (12,835) | 46,787 | (127) | |
| Net (loss) income | (20,142) | 17,197 | (217) |) | 3,732 | 41,766 | (91) | |
| Diluted net (loss) income per share | (0.37) | 0.32 | (216) |) | 0.07 | 0.77 | (91) | |
| Diluted weighted-average outstanding shares ² | 54,183 | 54,573 | (1) |) | 55,172 | 54,390 | 1 | |
| GAAP combined ratio | 119.0 | % 101.1 | 17.9 | pts | 110.5 | % 102.0 | 8.5 | |
| Statutory combined ratio | 116.4 | % 100.3 | 16.1 | | 109.6 | % 101.4 | 8.2 | |
| Return on average equity | (7.4) |)% 6.4 | (13.8) | | 0.5 | % 5.3 | (4.8) | |
| Non-GAAP measures: | | | | | | | | |
| Operating (loss) income ³ | \$(18,163) | 18,794 | (197) |)% | \$572 | 47,641 | (99) | |
| Diluted operating (loss) income per share ³ | (0.34) |) 0.35 | (197) |) | 0.01 | 0.88 | (99) | |
| Operating return on average equity ³ | (6.6) |)% 7.0 | (13.6) | pts | 0.1 | % 6.1 | (6.0) | |

1 Refer to the Glossary of Terms attached to our 2010 Annual Report as Exhibit 99.1 for definitions of terms used in this Form 10-Q.

2 Diluted weighted average outstanding shares represent weighted-average common shares outstanding adjusted for the impact of dilutive common stock equivalents, if any. Refer to Exhibit 11 of this document for common stock equivalents, if any, that are included in diluted weighted average outstanding shares.

3 Operating (loss) income is used as an important financial measure by us, analysts, and investors, because the realization of investment gains and losses on sales in any given period is largely discretionary as to timing. In addition, these realized investment gains and losses, as well as other-than-temporary impairments ("OTTI") that are charged to earnings and the results of discontinued operations, could distort the analysis of trends. See below for a reconciliation of operating (loss) income to net (loss) income in accordance with U.S. generally accepted accounting principles ("GAAP"). Operating return on average equity is calculated by dividing annualized operating (loss) income by average stockholders' equity.

Our Third Quarter and Nine Months 2011 pre-tax net income decreased compared to the same periods last year primarily due to the historic levels of catastrophe losses we incurred this year. These losses increased by \$55.5 million, to \$67.4 million, in the quarter and \$60.2 million, to \$112.4 million, in Nine Months 2011. Hurricane Irene represented the majority of the quarter losses at \$40.4 million (\$48.1 million on a gross basis) with the remainder in Third Quarter 2011 resulting from seven additional events as well as \$10.4 million in prior period storm development. For the first time since 1989, we anticipate piercing the first layer of our catastrophe excess of loss treaty. As a result of the loss activity, we incurred a \$0.7 million reinstatement premium on the first layer of the treaty.

On a year to date basis, these results were partially offset by a 14% improvement in pre-tax net investment income, which was driven by returns on our alternative investments, which are part of our "other investments" portfolio.

On a net income basis, partially offsetting the pre-tax results above were tax benefits of \$21.7 million in Third Quarter 2011, and \$16.6 million in Nine Months 2011. In Third Quarter and Nine Months 2010, tax expense amounted to \$2.3 million and \$5.0 million, respectively. The variances in both periods are primarily driven by the catastrophe losses noted above.

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

| (\$ in thousands, except per share amounts) | Quarter ended | | Nine Months ended | |
|---|---------------|-----------------------|-------------------|-----------------------|
| | 2011 | September 30, 2010 | 2011 | September 30, 2010 |
| Operating (loss) income | \$ (18,163) | 18,794 | 572 | 47,641 |
| Net realized (losses) gains, after tax | (1,329) | 37 | 3,810 | (2,126) |
| Loss on disposal of discontinued operations, net of tax | (650) | (1,634) | (650) | (3,749) |
| Net (loss) income | \$ (20,142) | 17,197 | 3,732 | 41,766 |
| Diluted operating (loss) income per share | \$ (0.34) | 0.35 | 0.01 | 0.88 |
| Diluted net realized (losses) gains per share | (0.02) | - | 0.07 | (0.04) |
| Diluted net loss from disposal of discontinued operations per share | (0.01) | (0.03) | (0.01) | (0.07) |
| Diluted net (loss) income per share | \$ (0.37) | 0.32 | 0.07 | 0.77 |

The quarter and nine month changes in operating income are reflective of the same results discussed above with respect to net income.

Results of Operations and Related Information by Segment

Insurance Operations

Our Insurance Operations segment writes property and casualty insurance business through seven insurance subsidiaries (the “Insurance Subsidiaries”). Our Insurance Operations segment sells admitted property and casualty insurance products and services primarily in 22 states in the Eastern and Midwestern U.S. through approximately 990 independent insurance agencies. In addition, we recently acquired the rights to a renewal book on an excess and surplus (“E & S”) line of business on a non-admitted basis and are in the process of acquiring a nationally-licensed entity to write E & S business. The combination of these acquisitions will provide us the capability to write E & S business across 50 states plus the District of Columbia through approximately 100 wholesale agents. Our Insurance Operations segment consists of two components: (i) Commercial Lines, which markets primarily to businesses and includes our newly acquired E & S line of business, represents approximately 81% of net premiums written (“NPW”); and (ii) Personal Lines, which markets primarily to individuals and represents approximately 19% of NPW. The underwriting performance of these lines is generally measured by four different statutory ratios: (i) loss and loss expense ratio; (ii) underwriting expense ratio; (iii) dividend ratio; and (iv) combined ratio. For further details regarding these ratios, see the discussion in the “Insurance Operations” section of Item 1. “Business.” of our 2010 Annual Report.

Summary of Insurance Operations

| All Lines (\$ in thousands) | Quarter ended September 30, | | Change % or Points | Nine Months ended September 30, | | Change % or Points |
|---|--------------------------------|----------|--------------------------|------------------------------------|-----------|--------------------------|
| | 2011 | 2010 | | 2011 | 2010 | |
| GAAP Insurance Operations Results: | | | | | | |
| NPW | \$ 396,832 | 367,114 | 8 % | 1,133,170 | 1,088,729 | 4 % |
| Net premiums earned (“NPE”) | 358,963 | 354,709 | 1 | 1,065,886 | 1,063,101 | - |
| Less: | | | | | | |
| Losses and loss expenses incurred | 305,958 | 245,019 | 25 | 829,719 | 739,142 | 12 |
| Net underwriting expenses incurred | 120,073 | 112,895 | 6 | 344,254 | 342,791 | - |
| Dividends to policyholders | 1,056 | 728 | 45 | 3,803 | 2,867 | 33 |
| Underwriting loss | \$ (68,124) | (3,933) | (1,632)% | (111,890) | (21,699) | (416)% |
| GAAP Ratios: | | | | | | |
| Loss and loss expense ratio | 85.2 % | 69.1 | 16.1pts | 77.8 % | 69.5 | 8.3 pts |
| Underwriting expense ratio | 33.5 | 31.8 | 1.7 | 32.3 | 32.2 | 0.1 |
| Dividends to policyholders ratio | 0.3 | 0.2 | 0.1 | 0.4 | 0.3 | 0.1 |
| Combined ratio | 119.0 | 101.1 | 17.9 | 110.5 | 102.0 | 8.5 |
| Statutory Ratios: | | | | | | |
| Loss and loss expense ratio | 85.1 | 68.9 | 16.2 | 77.8 | 69.5 | 8.3 |
| Underwriting expense ratio | 31.0 | 31.2 | (0.2) | 31.4 | 31.6 | (0.2) |

| | | | | | | |
|----------------------------------|---------|-------|---------|---------|-------|---------|
| Dividends to policyholders ratio | 0.3 | 0.2 | 0.1 | 0.4 | 0.3 | 0.1 |
| Combined ratio | 116.4 % | 100.3 | 16.1pts | 109.6 % | 101.4 | 8.2 pts |

- NPW increased in both Third Quarter and Nine Months 2011 compared to the same periods last year. This is the second quarter since the fourth quarter of 2007 that NPW increased compared to the prior year. The increase is driven by improvements in audit and endorsement premiums, coupled with the successful balance between retention and renewal pure price increases. The following provides information on these premium drivers:
 - o Audit and endorsement additional premium was \$4.4 million and \$3.8 million in Third Quarter 2011 and Nine Months 2011, respectively, compared to return premium of \$10.6 million in Third Quarter 2010 and \$41.9 million in Nine Months 2010;
 - o Commercial Lines renewal pure price increases were 2.7% in both Third Quarter and Nine Months 2011, compared to 2.8% and 3.1% in Third Quarter and Nine Months 2010; and
 - o Retention increased by two points, to 84%, in Third Quarter 2011 and one point, to 83%, in Nine Months 2011.
 - o In addition to the drivers above, due to our E & S renewal book acquisition this year, E & S premiums were \$8.4 million in Third Quarter and Nine Months 2011;

NPW increases in Nine Months 2011 were partially offset by reductions in direct new business premiums of \$16.0 million, to \$198.8 million.

- NPE changes in Third Quarter and Nine Months 2011 compared to the same periods last year are consistent with the fluctuation in NPW for the twelve-month period ended September 30, 2011 as compared to the twelve-month period ended September 30, 2010.
- The GAAP loss and loss expense ratio increased by 16.1 points in Third Quarter 2011 and 8.3 points in Nine Months 2011 compared to the prior year periods, reflecting the aforementioned catastrophe losses. In addition to the catastrophe losses, the ratio increased by 2.4 points in both Third Quarter and Nine Months 2011 as a result of elevated non-catastrophe property losses.
- The increase in the GAAP underwriting expense ratio in Third Quarter 2011, compared to the same period last year, was driven by expenses associated with the purchase of the renewal rights E & S business. These expenses, which amounted to \$3.7 million, include \$3.1 million in costs that are directly related to the acquisition and will not impact the on-going results of this operation. NPE on this book of business to date have been minimal due to the timing of the acquisition, and as a result, negatively impacted the expense ratio during the quarter.

Insurance Operations Outlook

A.M. Best Company (“A.M. Best”) notes that industry-wide results for the first half of 2011 deteriorated significantly as a result of unprecedented catastrophe-related losses from tornado activity and wildfires, which added 12.8 points to the industry’s combined ratio of 109.6%. The industry’s performance measures are expected to remain under pressure for the remainder of 2011 as a result of the catastrophe losses that have continued in Third Quarter 2011, ongoing challenging market conditions in the commercial lines sector, a sluggish economic recovery, relatively low investment yields, and volatility in the financial markets. In addition, certain industry analysts believe that results may be unprofitable for the next several years. Our Insurance Operations segment was not immune to catastrophe losses, which is reflected in our statutory combined ratio of 116.4% for Third Quarter 2011 and 109.6% for Nine Months 2011. This includes Commercial Lines statutory combined ratios of 110.7% and 106.6%, for Third Quarter and Nine Months 2011, respectively, and Personal Lines statutory combined ratios of 141.4% and 122.8%, for Third Quarter and Nine Months 2011, respectively.

However, the industry has begun experiencing a modest level of commercial lines renewal price increases, according to the Commercial Lines Insurance Pricing Survey during the second quarter of 2011. We believe these modest increases in a very competitive commercial lines market are not sufficient, and a widespread hardening needs to materialize given: (i) the low interest rate environment that has continued to put pressure on investment yields coupled with significant volatility in the financial markets; (ii) an industry statutory combined ratio for the first half of 2011 of 109.6% as reported by A.M. Best; (iii) higher anticipated reinsurance costs (see the “Reinsurance” section below for more detail); and (iv) declining industry profitability as a result of elevated levels of catastrophe-related losses in Nine Months 2011.

While industry pricing has just begun to improve, we are on our tenth consecutive quarter of Commercial Lines renewal pure price increases with 2.7% in Third Quarter 2011. The price increases that we have obtained demonstrate the overall strength of the relationships that we have with our independent agents, even in difficult economic and competitive times. We believe that once the market as a whole becomes more successful at driving price, we will be able to further capitalize on our relationships with our agents to generate additional renewal price increases through the use of our granular pricing capabilities. The price increases we have been able to obtain, coupled with strong retention, have led to growth in our Commercial Lines NPW for the second consecutive quarter and an increase of 4% in Nine Months 2011.

The personal lines market has been more receptive to price increases and our Personal Lines operations continue to experience NPW growth driven by ongoing rate increases that went into effect in 2010 and 2011. The Personal Lines rate increases we obtained in Nine Months 2011 are expected to generate an additional \$15.5 million in annual

premium. We were able to obtain increased Personal Lines renewal pure price increases of 5.9% in Third Quarter 2011, while retention increased two points, to 87%.

In an effort to write profitable business in the current commercial and personal lines environment, we continue to implement a defined plan of improving risk selection and mitigating higher frequency trends to complement our strong agency relationships and unique field-based model. In addition, we are committed to executing on our strategy to introduce more high-margin products into our portfolio. In Third Quarter 2011, we purchased the renewal rights to an excess and surplus lines book of business written under contract binding authority. To provide a legal entity licensed to write E & S business, in Third Quarter 2011, we announced that we have entered into an agreement to purchase Montpelier U.S. Insurance Company. This acquisition, which is expected to close in the fourth quarter of 2011, provides a nationally-licensed platform for writing this business. The incorporation of E & S lines into our business model allows us a natural expansion of our commercial lines small business and offers a new higher-margin product to agents and customers.

Given the elevated level of catastrophe losses incurred through Nine Months 2011, we expect to generate overall full year statutory and GAAP combined ratios of approximately 108%, which include a catastrophe loss assumption of two points for the fourth quarter of 2011. These combined ratios do not include any assumptions for additional reserve development, favorable or unfavorable. Weighted average shares at year-end 2011 are expected to be approximately 55 million.

Review of Underwriting Results by Line of Business

Commercial Lines

| Commercial Lines (\$ in thousands) | Quarter ended September 30, | | Change % or Points | Nine Months ended September 30, | | Change % or Points |
|---|--------------------------------|---------|--------------------------|------------------------------------|----------|--------------------------|
| | 2011 | 2010 | | 2011 | 2010 | |
| GAAP Insurance Operations Results: | | | | | | |
| NPW | \$ 323,696 | 297,004 | 9 % | 927,335 | 895,795 | 4 % |
| NPE | 292,363 | 293,225 | - | 869,421 | 884,134 | (2) |
| Less: | | | | | | |
| Losses and loss expenses incurred | 229,119 | 197,046 | 16 | 641,504 | 598,123 | 7 |
| Net underwriting expenses incurred | 101,520 | 95,477 | 6 | 290,611 | 290,837 | - |
| Dividends to policyholders | 1,056 | 728 | 45 | 3,803 | 2,867 | 33 |
| Underwriting loss | \$ (39,332) | (26) | n/m % | (66,497) | (7,693) | (764)% |
| GAAP Ratios: | | | | | | |
| Loss and loss expense ratio | 78.4 % | 67.2 | 11.2pts | 73.8 % | 67.7 | 6.1pts |
| Underwriting expense ratio | 34.7 | 32.6 | 2.1 | 33.4 | 32.9 | 0.5 |
| Dividends to policyholders ratio | 0.4 | 0.2 | 0.2 | 0.4 | 0.3 | 0.1 |
| Combined ratio | 113.5 | 100.0 | 13.5 | 107.6 | 100.9 | 6.7 |
| Statutory Ratios: | | | | | | |
| Loss and loss expense ratio | 78.2 | 67.1 | 11.1 | 73.8 | 67.5 | 6.3 |
| Underwriting expense ratio | 32.1 | 32.4 | (0.3) | 32.4 | 32.7 | (0.3) |
| Dividends to policyholders ratio | 0.4 | 0.3 | 0.1 | 0.4 | 0.3 | 0.1 |
| Combined ratio | 110.7 % | 99.8 | 10.9pts | 106.6 % | 100.5 | 6.1pts |

- NPW increased in both Third Quarter and Nine Months 2011 compared to the same periods last year. This is the second quarter since the fourth quarter of 2007 that NPW increased compared to the prior year. This increase is driven by improvements in audit and endorsement premium, coupled with the successful balance between retention and renewal pure price increases. The following provides information on these premium drivers:
 - o Audit and endorsement additional premium of \$4.4 million and \$3.5 million in Third Quarter and Nine Months 2011, respectively, compared to audit and endorsement return premium of \$10.8 million and \$42.5 million in Third Quarter and Nine Months 2010, respectively;
 - o Commercial Lines renewal pure price increases were 2.7% in both Third Quarter and Nine Months 2011, compared to 2.8% and 3.1% in Third Quarter and Nine Months 2010;
 - o Retention increased by two points, to 82%, in Third Quarter 2011 and one point, to 80%, in Nine Months 2011; and
 - o In addition to the drivers above, due to our E & S renewal book acquisition this year, E & S premiums were \$8.4 million in Third Quarter and Nine Months 2011.

NPW increases in Nine Months 2011 were partially offset by reductions in net renewals of \$12.6 million, to \$788.2 million, and reductions in direct new business premiums of \$7.9 million, to \$160.1 million.

- NPE changes in Third Quarter and Nine Months 2011 compared to the Third Quarter and Nine Months 2010 are consistent with the fluctuation in NPW for the twelve-month period ended September 30, 2011 as compared to the

twelve-month period ended September 30, 2010.

The 11.2-point increase in the GAAP loss and loss expense ratio in Third Quarter 2011 compared to Third Quarter 2010 reflects an increase in catastrophe losses of \$32.6 million, or 11.1 points, to \$39.6 million in Third Quarter 2011. Catastrophe losses in Third Quarter 2011 included \$18.9 million, or 6.5 points, related to Hurricane Irene.

The 6.1-point increase in the GAAP loss and loss expense ratio in Nine Months 2011 compared to Nine Months 2010 reflects:

- o An increase in catastrophe losses of \$34.6 million, or 4.1 points, in Nine Months 2011 of which 2.2 points was related to Hurricane Irene; and
- o Approximately \$19 million, or 2.2 points, of favorable casualty prior year development in Nine Months 2011 compared to approximately \$33 million, or 3.8 points, in Nine Months 2010. For further detail regarding the development in Third Quarter and Nine Months 2011 and 2010 see the following lines of business discussions.
- The increase in the GAAP underwriting expense ratio in Third Quarter 2011, compared to the same period last year, was driven by expenses associated with the purchase of the renewal rights E & S business. These expenses, which amounted to \$3.7 million, include \$3.1 million in costs that are directly related to the acquisition and will not impact the ongoing results of this operation. NPE to date have been minimal due to the timing of the acquisition and as a result negatively impacted the expense ratio during the quarter.

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

General Liability

| (\$ in thousands) | Quarter ended | | Change % or Points | Nine Months ended | | Change % or Points |
|-------------------------------------|-----------------------|-----------------------|--------------------------|-----------------------|-----------------------|--------------------------|
| | September 30, 2011 | September 30, 2010 | | September 30, 2011 | September 30, 2010 | |
| Statutory NPW | \$ 95,187 | 84,141 | 13 % | 274,422 | 257,188 | 7 % |
| Statutory NPE | 87,478 | 83,249 | 5 | 255,717 | 252,438 | 1 |
| Statutory combined ratio | 95.9 % | 99.1 | (3.2) pts | 99.7 % | 95.1 | 4.6pts |
| % of total statutory commercial NPW | 29 % | 29 | | 30 % | 29 | |

We continue to see improvements in pricing in this line as our renewal pure price increase was 3.3% and 3.7% in Third Quarter and Nine Months 2011, respectively. NPW increased in both Third Quarter and Nine Months 2011 driven by improvements in audit and endorsement premiums. Additional audit and endorsement premiums amounted to \$2.8 million in Third Quarter 2011 compared to return premium of \$5.3 million in Third Quarter 2010. On a year-to-date basis, audit and endorsement additional premium amounted to \$0.6 million in Nine Months 2011, compared to return premium of \$21.4 million in Nine Months 2010.

As of September 30, 2011, approximately 53% of our premium in this line is subject to audit. At the end of the policy period, actual exposure units (usually sales or payroll) on policies with premium subject to audit are compared to beginning of period estimates and a return premium or additional premium transaction occurs.

The 3.2-point improvement in the statutory combined ratio for this line in Third Quarter 2011 compared to last year is primarily due to NPW increases that have more than outpaced increases in underwriting expenses. While fixed underwriting expenses have remained relatively flat quarter on quarter, the improvement in audit and endorsement premiums have driven NPW higher in 2011, thus having a favorable impact on the combined ratio. In addition, favorable prior year casualty development was \$6 million in Third Quarter 2011 compared to \$5 million in Third Quarter 2010.

The 4.6-point deterioration in the combined ratio for this line in Nine Months 2011 is driven by lower favorable development this year compared to last. Prior year favorable development in Nine Months 2011 and 2010 was as follows:

- 2011: \$9 million, or 3.7 points, driven by the 2005 through 2009 accident years partially offset by adverse development in the 2010 accident year;

- 2010: \$24 million, or 9.6 points, driven by 2008 and prior accident years.

The decrease in the favorable development is partially offset by an increase in NPW during Nine Months 2011.

Workers Compensation

| (\$ in thousands) | Quarter ended September 30, | | Change % or Points | Nine Months ended September 30, | | Change % or Points |
|-------------------------------------|--------------------------------|--------|--------------------------|------------------------------------|---------|--------------------------|
| | 2011 | 2010 | | 2011 | 2010 | |
| Statutory NPW | \$64,269 | 57,997 | 11 % | 198,742 | 187,540 | 6 % |
| Statutory NPE | 63,497 | 61,179 | 4 | 189,878 | 187,889 | 1 |
| Statutory combined ratio | 114.2 % | 130.2 | (16.0) pts | 117.7 % | 124.4 | (6.7) pts |
| % of total statutory commercial NPW | 20 % | 20 | | 21 % | 21 | |

In Third Quarter and Nine Months 2011, we experienced NPW increases, with renewal pure price increases of 3.6% and 3.4% for Third Quarter and Nine Months 2011, respectively. The NPW increase included audit and endorsement additional premiums of \$1.6 million and \$3.5 million in Third Quarter and Nine Months 2011 compared to return premium of \$4.9 million and \$18.5 million in Third Quarter and Nine Months 2010, respectively. In Nine Months 2011, these premium improvements were partially offset by net renewals that decreased 6%, or \$10.0 million.

The 16.0-point improvement in the statutory combined ratio for this line in the quarter compared to last year reflects no casualty development in Third Quarter 2011 as compared to \$13 million, or 21.6 points, of adverse casualty development in Third Quarter 2010 of which \$10 million, or 16.7 points, was attributable to the current accident year.

Partially offsetting these improvements are increased loss costs in Third Quarter 2011 compared to Third Quarter 2010.

The 6.7-point improvement in the statutory combined ratio for this line in Nine Months 2011 compared to last year is attributable to reductions in adverse prior year development as follows:

- 2011: Adverse development of \$7 million, or 3.7 points, driven by the 2010 accident year.
- 2010: Adverse development of \$17 million, or 9.0 points, primarily associated with increased severity in the 2008 and 2009 accident years.

Commercial Automobile

| (\$ in thousands) | Quarter ended September 30, | | Change % or Points | Nine Months ended September 30, | | Change % or Points |
|-------------------------------------|--------------------------------|--------|--------------------------|------------------------------------|---------|--------------------------|
| | 2011 | 2010 | | 2011 | 2010 | |
| Statutory NPW | \$76,031 | 75,425 | 1 % | 220,500 | 223,680 | (1) % |
| Statutory NPE | 70,173 | 73,440 | (4) | 209,042 | 220,932 | (5) |
| Statutory combined ratio | 95.9 % | 83.3 | 12.6pts | 93.5 % | 87.4 | 6.1pts |
| % of total statutory commercial NPW | 23 % | 26 | | 24 % | 25 | |

Statutory NPW were relatively flat in Third Quarter and Nine Months 2011 compared to last year, while NPE for the same periods decreased by 4% and 5%, respectively. The NPE decreases reflect the economic factors that continued to put pressure on NPW as exposure levels declined in 2010.

The increase in the statutory combined ratio for this line was primarily driven by lower favorable casualty prior year development in Third Quarter and Nine Months 2011 compared to Third Quarter and Nine Months 2010. Prior year favorable casualty development was as follows:

o

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

2011: \$2 million, or 2.9 points, in Third Quarter driven by the 2009 accident year and \$10 million, or 4.8 points, in Nine Months driven by accident years 2006 through 2010; and
o 2010: \$11 million, or 14.3 points, in Third Quarter due to lower than anticipated severity primarily in the 2008 and 2009 accident years and \$27 million, or 12.2 points, in Nine Months, due to lower than anticipated severity primarily in the 2005 through 2009 accident years.

Commercial Property

| (\$ in thousands) | Quarter ended September 30, | | Change % or Points | Nine Months ended September 30, | | Change % or Points | | |
|--|--------------------------------|--------|--------------------------|------------------------------------|---------|--------------------------|---------|---|
| | 2011 | 2010 | | 2011 | 2010 | | | |
| Statutory NPW | \$55,725 | 53,764 | 4 | % | 153,105 | 153,405 | - | % |
| Statutory NPE | 48,051 | 49,558 | (3 |) | 144,121 | 150,188 | (4 |) |
| Statutory combined ratio % of total statutory commercial NPW | 148.1 | % 90.2 | 57.9pts | | 121.8 | % 96.3 | 25.5pts | |
| | 17 | % 18 | | | 17 | % 17 | | |

NPW for this line of business increased in Third Quarter 2011 due to the following:

- o An increase in new business of 18%, or \$1.7 million, to \$11.0 million; and
- o An increase in net renewals of 3%, or \$1.8 million, to \$55.1 million.

The increase in the statutory combined ratio for this line was driven by the following:

- o An increase in catastrophe losses of \$26.6 million, or 55.6 points, to \$32.1 million in Third Quarter 2011 and \$27.6 million, or 20.0 points, to \$57.0 million in Nine Months 2011; and
- o An increase in non-catastrophe property losses of \$4.9 million, or 4.9 points, to \$57.7 million in Nine Months 2011.

Personal Lines

| Personal Lines (\$ in thousands) | Quarter ended September 30, | | Change % or Points | Nine Months ended September 30, | | Change % or Points |
|-------------------------------------|--------------------------------|----------|--------------------------|------------------------------------|-----------|--------------------------|
| | 2011 | 2010 | | 2011 | 2010 | |
| GAAP Insurance Operations | | | | | | |
| Results: | | | | | | |
| NPW | \$ 73,136 | 70,110 | 4 % | 205,835 | 192,934 | 7 % |
| NPE | 66,600 | 61,484 | 8 | 196,465 | 178,967 | 10 |
| Less: | | | | | | |
| Losses and loss expenses | | | | | | |
| incurred | 76,839 | 47,973 | 60 | 188,215 | 141,019 | 33 |
| Net underwriting expenses | | | | | | |
| incurred | 18,553 | 17,418 | 7 | 53,643 | 51,954 | 3 |
| Underwriting loss | \$ (28,792) | (3,907) | (637)% | (45,393) | (14,006) | (224)% |
| GAAP Ratios: | | | | | | |
| Loss and loss expense ratio | 115.4 % | 78.0 | 37.4pts | 95.8 % | 78.8 | 17.0pts |
| Underwriting expense ratio | 27.8 | 28.4 | (0.6) | 27.3 | 29.0 | (1.7) |
| Combined ratio | 143.2 | 106.4 | 36.8 | 123.1 | 107.8 | 15.3 |
| Statutory Ratios: | | | | | | |
| Loss and loss expense ratio | 115.2 | 78.0 | 37.2 | 95.7 | 78.8 | 16.9 |
| Underwriting expense ratio | 26.2 | 25.2 | 1.0 | 27.1 | 27.1 | - |
| Combined ratio | 141.4 % | 103.2 | 38.2pts | 122.8 % | 105.9 | 16.9pts |

- NPW increased in Third Quarter and Nine Months 2011 compared to Third Quarter and Nine Months 2010 primarily due to increases in net renewal direct premium written (“DPW”) of \$7.5 million, or 14%, to \$62.4 million, in Third Quarter 2011 and \$22.3 million, or 15%, to \$172.5 million in Nine Months 2011, which were driven by:
 - o Rate increases, 26 of which are 5% or more, that went into effect across our Personal Lines footprint during Nine Months 2011; and
 - o Increases in policy retention of two points in Third Quarter 2011, to 87%, and one point in Nine Months 2011, to 86%.

These increases were partially offset by reductions in new business premiums of \$3.7 million, or 22%, to \$12.8 million in Third Quarter 2011 and \$8.1 million, or 17%, to \$38.8 million in Nine Months 2011.

- NPE increases in Third Quarter and Nine Months 2011, compared to the same periods last year, are consistent with the fluctuation in NPW for the 12-month period ended September 30, 2011 as compared to the 12-month period ended September 30, 2010.
- The 37.4-point increase in the GAAP loss and loss expense ratio in Third Quarter 2011 compared to Third Quarter 2010 was primarily attributable to increases in both catastrophe and non-catastrophe property losses. Catastrophe losses increased by \$22.9 million, or 33.8 points, to \$27.9 million, and non-catastrophe property losses increased \$7.9 million, or 9.5 points, to \$26.9 million. Hurricane Irene accounted for \$21.5 million, or 32.2 points, of the Third Quarter 2011 catastrophe losses. Partially offsetting these losses were claims handling fees earned on our flood book of business that increased \$4.2 million, or 6.2 points, to \$4.9 million in Third Quarter 2011. These claims handling fees reflect the significant flooding activity during the quarter throughout the Northeast and Mid-Atlantic states.

The 17.0-point increase in the GAAP loss and loss expense ratio in Nine Months 2011 compared to Nine Months 2010 was primarily attributable to an increase in property losses of \$44.5 million, or 19.2 points, which included an increase in catastrophe losses of \$25.6 million, or 12.2 points. During Nine Months 2011, 62 large non-catastrophe property claims (more than \$100,000) amounted to \$19.3 million, compared to \$10.2 million from 35 large non-catastrophe property claims for Nine Months 2010. Partially offsetting these losses were claims handling fees earned on our flood book of business that increased \$4.1 million, or 2.0 points, to \$6.4 million in Nine Months 2011 compared to the same period last year.

- The decrease in the GAAP underwriting expense ratio in Third Quarter and Nine Months 2011 reflects the impact of premiums outpacing expenses last year. On a statutory basis, the impact of this trend is recognized immediately in the expense ratio while, on a GAAP basis, the impact is recognized over a longer period.

Given the substantial growth in our Personal Lines operations, as of September 30, 2011, 49% of our business was two years old or less. Policies in this age category have traditionally run at a higher loss ratio than the overall book of business. As the book matures, we expect to experience an improvement in loss ratios in this book of business. In addition, we continue to work on improving the profitability of our Personal Lines operations and are doing so through a multi-faceted approach consisting of the following:

- Continuing to achieve rate increases across our footprint states. The rate increases we anticipate obtaining in 2011 are expected to generate approximately \$18 million in annual premium, of which \$15.5 million results from the rate increases achieved in Nine Months 2011. Renewal pure price increases of 5.9% and 6.3% were obtained in Third Quarter and Nine Months 2011, respectively;
- Continuing to balance rate increases with retention. Despite the increases we have been able to achieve to our rates over the past several years, policy retention continues to be positive at 87%; and
- Improving the quality of our Personal Lines core book of business by focusing on low-frequency and high retention accounts. In addition, we will continue to review our underwriting guidelines and coverage options to improve the quality of our homeowners book of business and implement changes when appropriate, including, but not limited to, higher deductibles to achieve better cost sharing with the property owners.

Reinsurance

On February 28, 2011, Risk Management Solutions, Inc. (“RMS”), one of the leaders in catastrophe modeling, launched a new version of its US Hurricane Model. The RMS v. 11.0 model incorporates increased vulnerability of construction assumptions and increases to wind hazards further inland. Reinsurance brokers indicate that the RMS version change created significant increases in modeled losses across portfolios with different geographic and business mix attributes. The modeled results of our portfolio indicate increases in modeled losses of between 70%-100% of the RMS v. 9 model results. Below is a summary of the largest 4 actual hurricane losses that we experienced in the past 20 years:

| Hurricane Name | Actual Loss (\$ in millions) | Accident Year |
|------------------|---------------------------------|---------------|
| Hurricane Irene | \$ 48.1 | 2011 |
| Hurricane Hugo | 26.0 | 1989 |
| Hurricane Floyd | 14.5 | 1999 |
| Hurricane Isabel | 13.4 | 2003 |

¹ This amount represents reported and unreported gross losses estimated as of September 30, 2011.

We view catastrophe modeling as an important tool in our management of aggregation risk. The significant shift of the results created by the latest update to the RMS model, as well as the differences in the modeled losses for the same portfolio between RMS and AIR Worldwide (“AIR”) hurricane models, demonstrates the limitations of available models. We therefore use these models to gauge the general direction of change in our risk profile rather than a precise risk indicator. Modeling results are an important part of the determination of the amount of reinsurance we seek to purchase to transfer some of our catastrophic risk. As a result of our blended view of RMS’s v. 11.0 and AIR v. 12, on April 22, 2011 we purchased an additional \$75 million layer of catastrophe coverage. This brings our catastrophe excess of loss program to \$435 million in excess of a \$40 million retention.

The following table presents modeled hurricane losses on a near-term basis from: (i) RMS’s v. 9.0; (ii) RMS’s v. 11.0; and (iii) AIR v. 12. These projections are based on the Insurance Subsidiaries’ property book of business as of July 2010:

| Occurrence Probability | RMS v. 9.0 | | RMS v. 11.0 | | | AIR v. 12 | | | |
|----------------------------|--------------------------|---|---------------------------|---|-------------------------|---|-------------------------|---|---|
| | Gross Losses v.9.0 | Net Losses as a Percent of Equity ² | Gross Losses v.11.0 | Net Losses as a Percent of Equity ² | Gross Losses v.12 | Net Losses as a Percent of Equity ² | Gross Losses v.12 | Net Losses as a Percent of Equity ² | Net Losses as a Percent of Equity ² |
| 4.0% (1 in 25 year event) | \$ 58,201 | 27,675 3 % | \$ 113,995 | 33,038 3 % | \$ 97,588 | 31,300 3 % | | | |
| 2.0% (1 in 50 year event) | 121,799 | 33,883 3 | 230,242 | 43,926 4 | 168,590 | 38,951 4 | | | |
| 1.0% (1 in 100 year event) | 228,213 | 43,820 4 | 412,597 | 54,642 5 | 284,973 | 46,771 4 | | | |
| 0.4% (1 in 250 year event) | 457,873 | 61,438 6 | 784,332 | 265,074 24 | 573,510 | 128,041 12 | | | |

¹ Losses are after tax, based on total reinsurance program of \$435 million in excess of \$40 million retention and includes applicable reinstatement premium.

² Equity as of September 30, 2011.

3 Current catastrophe excess of loss program exhausts at 1 in 153 year event with corresponding net losses to equity of 6% based on blended model results. The blended model results for a 1 in 250 year event corresponds to net losses equal to 18% of equity.

We successfully completed negotiations of our July 1, 2011 excess of loss treaties with highlights as follows:

Property Excess of Loss

The property excess of loss treaty (“Property Treaty”) was renewed with the same terms as the expiring treaty providing for per risk coverage of \$28.0 million in excess of a \$2.0 million retention.

- The per occurrence cap on the total program is \$64.0 million.
- The first layer continues to have unlimited reinstatements. The annual aggregate limit for the second, \$20.0 million in excess of \$10.0 million, layer remains at \$80.0 million.
- Consistent with the prior year treaty, the Property Treaty excludes nuclear, biological, chemical, and radiological terrorism losses.

Casualty Excess of Loss

The casualty excess of loss treaty (“Casualty Treaty”) was renewed with substantially the same terms as the expiring treaty providing the following per occurrence coverage:

- The first layer now provides coverage for 100% of up to \$3.0 million in excess of a \$2.0 million retention, compared to 85% coverage in the expiring treaty.
 - The next five layers provide coverage for 100% of up to \$85.0 million in excess of a \$5.0 million retention.
- Consistent with the prior year, the Casualty Treaty excludes nuclear, biological, chemical, and radiological terrorism losses. Annual aggregate terrorism limits increased to \$201.0 million, from \$198.8 million, due to the increased participation on the first layer.

Investments

Our investment philosophy includes certain return and risk objectives for the fixed maturity, equity, and other investment portfolios. The primary return objective of the fixed maturity portfolio is to maximize after-tax investment yield and income while balancing risk. A secondary objective is to meet or exceed a weighted-average benchmark of public fixed income indices. Within the equity portfolio, the dividend yield strategy is designed to generate consistent dividend income while maintaining a minimal tracking error to the S&P 500 Index. Additional equity strategies are focused on meeting or exceeding strategy specific benchmarks of public equity indices. Although yield and income generation remain the key drivers to our investment strategy, our overall philosophy is to invest with a long-term horizon along with a “buy-and-hold” principle. The return objective for other investments, which includes alternative investments, is to meet or exceed the S&P 500 Index.

Total Invested Assets

| (\$ in thousands) | September 30, 2011 | December 31, 2010 | Change | |
|------------------------------|-----------------------|----------------------|--------|---|
| Total invested assets | \$ 4,062,766 | 3,925,722 | 3 | % |
| Unrealized gain – before tax | 118,185 | 82,874 | 43 | |
| Unrealized gain – after tax | 76,820 | 53,867 | 43 | |

Our investment portfolio totaled \$4.1 billion at September 30, 2011, an increase of 3% compared to December 31, 2010. This increase was driven primarily by: (i) cash flows generated from our Insurance Operations; and (ii) increased valuations on securities in our available-for-sale (“AFS”) portfolio. The unrealized gain position on the AFS portfolio increased by \$43.6 million on a pre-tax basis, from December 31, 2010 to \$112.0 million, as of September 30, 2011.

The breakdown of our investment portfolio, which generally remained unchanged from December 31, 2010, is as follows:

| | September 30, 2011 | | December 31, 2010 | |
|------------------------------------|-----------------------|---|----------------------|---|
| U.S. government obligations | 9 | % | 11 | % |
| Foreign government obligations | 1 | | 1 | |
| State and municipal obligations | 32 | | 36 | |
| Corporate securities | 29 | | 27 | |
| Mortgage-backed securities (“MBS”) | 16 | | 14 | |
| Asset-backed securities (“ABS”) | 2 | | 2 | |
| Total fixed maturity securities | 89 | | 91 | |
| Equity securities | 4 | | 2 | |
| Short-term investments | 4 | | 4 | |
| Other investments | 3 | | 3 | |
| Total | 100 | % | 100 | % |

We structure our portfolio conservatively with a focus on: (i) asset diversification; (ii) investment quality; (iii) liquidity, particularly to meet the cash obligations of our Insurance Operations segment; (iv) consideration of taxes; and (v) preservation of capital. We believe that we have a high quality and liquid investment portfolio. The average duration of the fixed maturity securities portfolio as of September 30, 2011, including short-term investments, was 3.2 years compared to the Insurance Subsidiaries' liability duration of approximately 3.8 years. The current duration of the fixed maturity securities portfolio is within our historical range, and is monitored and managed to maximize yield and limit interest rate risk. We manage liquidity with a laddered maturity structure and an appropriate level of short-term investments to avoid liquidation of AFS fixed maturities in the ordinary course of business. We typically have a long investment time horizon and every purchase or sale is made with the intent of improving future investment returns while balancing capital preservation.

The weighted average credit rating on our fixed maturity portfolio migrated to AA- as of September 30, 2011, from AA last quarter. This slight rating deterioration is the result of the S&P downgrade of U.S. sovereign debt in August 2011. In addition, general economic conditions and our recent heavier allocation to investment-grade corporate bonds affected our portfolio's rating. The following table presents the credit ratings of our fixed maturity securities portfolio:

| Fixed Maturity Security Rating | September | | December | |
|-----------------------------------|-------------|---|-------------|---|
| | 30, 2011 | | 31, 2010 | |
| Aaa/AAA | 16 | % | 42 | % |
| Aa/AA | 53 | | 28 | |
| A/A | 22 | | 21 | |
| Baa/BBB | 8 | | 8 | |
| Ba/BB or below | 1 | | 1 | |
| Total | 100 | % | 100 | % |

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

The following table summarizes the fair value, unrealized gain (loss) balances, and the weighted average credit qualities of our AFS fixed maturity securities at September 30, 2011 and December 31, 2010:

| (\$ in millions) | September 30, 2011 | | | December 31, 2010 | | |
|---|--------------------|------------------------|------------------------|-------------------|------------------------|------------------------|
| | Fair Value | Unrealized Gain (Loss) | Average Credit Quality | Fair Value | Unrealized Gain (Loss) | Average Credit Quality |
| AFS Fixed Maturity Portfolio: | | | | | | |
| U.S. government obligations ¹ | \$ 380.0 | 21.9 | AA+ | 320.5 | 8.1 | AAA |
| Foreign government obligations | 32.9 | 1.3 | AA | 19.0 | - | AA |
| State and municipal obligations | 561.5 | 37.3 | AA+ | 533.9 | 21.9 | AA+ |
| Corporate securities | 1,125.6 | 40.5 | A | 993.7 | 19.9 | A |
| MBS | 593.6 | 22.0 | AA | 426.9 | 6.7 | AA+ |
| ABS | 78.7 | 0.3 | AAA | 48.7 | 0.2 | AAA |
| Total AFS fixed maturity portfolio | \$ 2,772.3 | 123.3 | AA- | 2,342.7 | 56.8 | AA |
| State and Municipal Obligations: | | | | | | |
| General obligations | \$ 296.8 | 21.3 | AA+ | 289.6 | 11.1 | AA+ |
| Special revenue obligations | 264.7 | 16.0 | AA | 244.3 | 10.8 | AA |
| Total state and municipal obligations | \$ 561.5 | 37.3 | AA+ | 533.9 | 21.9 | AA+ |
| Corporate Securities: | | | | | | |
| Financial | \$ 349.0 | 3.7 | A+ | 289.9 | 4.5 | A+ |
| Industrials | 82.0 | 5.7 | A- | 77.0 | 3.6 | A- |
| Utilities | 68.9 | 2.7 | BBB+ | 56.5 | 0.2 | BBB+ |
| Consumer discretion | 98.0 | 3.7 | A- | 98.9 | 1.1 | A- |
| Consumer staples | 125.6 | 6.2 | A | 101.6 | 2.1 | A- |
| Healthcare | 149.0 | 9.7 | AA- | 138.0 | 4.1 | AA- |
| Materials | 52.7 | 1.2 | A- | 57.0 | 0.8 | A- |
| Energy | 64.5 | 2.8 | A- | 49.5 | 1.2 | A |
| Information technology | 74.0 | 2.2 | A+ | 51.5 | 0.4 | A+ |
| Telecommunications services | 46.3 | 1.1 | BBB+ | 50.5 | 0.2 | A- |
| Other | 15.6 | 1.5 | AA+ | 23.3 | 1.7 | AA+ |
| Total corporate securities | \$ 1,125.6 | 40.5 | A | 993.7 | 19.9 | A |
| MBS: | | | | | | |
| Government guaranteed agency commercial MBS ("CMBS") | \$ 78.0 | 5.8 | AA+ | 71.9 | 3.3 | AAA |
| Non-agency CMBS | 34.9 | (0.3) | A | 32.6 | (2.1) | A- |
| Government guaranteed agency residential MBS ("RMBS") | 101.3 | 5.5 | AA+ | 91.1 | 3.0 | AAA |

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

| | | | | | | |
|------------------------------|----------|--------|------|-------|--------|-----|
| Other agency RMBS | 336.8 | 11.6 | AA+ | 183.6 | 3.8 | AAA |
| Non-agency RMBS | 34.6 | (0.6) | BBB- | 38.3 | (1.0) | BBB |
| Alternative-A (“Alt-A”) RMBS | 8.0 | - | AA+ | 9.4 | (0.3) | AAA |
| Total MBS | \$ 593.6 | 22.0 | AA | 426.9 | 6.7 | AA+ |
| ABS: | | | | | | |
| ABS | \$ 77.6 | 1.3 | AAA | 47.8 | 0.2 | AAA |
| Alt-A ABS3 | 0.4 | (1.0) | D | - | - | - |
| Sub-prime ABS2, 3 | 0.7 | - | D | 0.9 | - | D |
| Total ABS | \$ 78.7 | 0.3 | AAA | 48.7 | 0.2 | AAA |

1 U.S. government includes corporate securities fully guaranteed by the Federal Deposit Insurance Corporation (“FDIC”).

2 We define sub-prime exposure as exposure to direct and indirect investments in non-agency residential mortgages with average FICO® scores below 650.

3 Alt-A ABS and subprime ABS each consist of one security that is currently expected by rating agencies to default on its obligations.

The following tables provide information regarding our held-to-maturity (“HTM”) fixed maturity securities and their credit qualities at September 30, 2011 and December 31, 2010:

September 30, 2011

| (\$ in millions) | Fair Value | Carry Value | Unrecognized Holding Gain (Loss) | Unrealized Gain (Loss) AOCI | Total Unrealized/Unrecognized Gain (Loss) | Average Credit Quality |
|--|-----------------|--------------|----------------------------------|-----------------------------|---|------------------------|
| HTM Portfolio: | | | | | | |
| Foreign government obligations | \$ 5.5 | 5.6 | (0.1) | 0.3 | 0.2 | AA+ |
| State and municipal obligations | 777.8 | 745.0 | 32.8 | 15.7 | 48.5 | AA |
| Corporate securities | 72.2 | 64.5 | 7.7 | (2.6) | 5.1 | A |
| MBS | 37.6 | 30.9 | 6.7 | (5.6) | 1.1 | AA |
| ABS | 8.3 | 6.8 | 1.5 | (1.6) | (0.1) | A |
| Total HTM portfolio | \$ 901.4 | 852.8 | 48.6 | 6.2 | 54.8 | AA |
| State and Municipal Obligations: | | | | | | |
| General obligations | \$ 235.4 | 226.0 | 9.4 | 7.4 | 16.8 | AA |
| Special revenue obligations | 542.4 | 519.0 | 23.4 | 8.3 | 31.7 | AA |
| Total state and municipal obligations | \$ 777.8 | 745.0 | 32.8 | 15.7 | 48.5 | AA |
| Corporate Securities: | | | | | | |
| Financial | \$ 20.8 | 18.3 | 2.5 | (1.7) | 0.8 | A- |
| Industrials | 20.5 | 17.7 | 2.8 | (0.8) | 2.0 | A |
| Utilities | 17.8 | 15.9 | 1.9 | (0.1) | 1.8 | A |
| Consumer discretion | 5.8 | 5.7 | 0.1 | 0.1 | 0.2 | AA- |
| Consumer staples | 5.2 | 5.0 | 0.2 | - | 0.2 | A |
| Materials | 2.1 | 1.9 | 0.2 | (0.1) | 0.1 | BBB |
| Total corporate securities | \$ 72.2 | 64.5 | 7.7 | (2.6) | 5.1 | A |
| MBS: | | | | | | |
| Non-agency CMBS | \$ 37.5 | 30.8 | 6.7 | (5.6) | 1.1 | AA |
| Non-agency RMBS | 0.1 | 0.1 | - | - | - | BBB |
| Total MBS | \$ 37.6 | 30.9 | 6.7 | (5.6) | 1.1 | AA |
| ABS: | | | | | | |
| ABS | \$ 6.0 | 5.2 | 0.8 | (0.6) | 0.2 | BBB+ |
| Alt-A ABS | 2.3 | 1.6 | 0.7 | (1.0) | (0.3) | AAA |
| Total ABS | \$ 8.3 | 6.8 | 1.5 | (1.6) | (0.1) | A |

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

December 31, 2010

| (\$ in millions) | Fair Value | Carry Value | Unrealized | | Total Unrealized/ | Average Credit Quality |
|--|-------------------|----------------|---------------------------|----------------------------------|--------------------------|------------------------|
| | | | Unrecognized Holding Gain | Unrecognized Gain (Loss) in AOCI | Unrecognized Gain (Loss) | |
| HTM Portfolio: | | | | | | |
| U.S. government obligations ¹ | \$ 103.1 | 98.1 | 5.0 | 4.7 | 9.7 | AAA |
| Foreign government obligations | 5.6 | 5.6 | - | 0.3 | 0.3 | AA+ |
| State and municipal obligations | 912.3 | 896.6 | 15.7 | 22.2 | 37.9 | AA |
| Corporate securities | 82.1 | 72.7 | 9.4 | (4.0) | 5.4 | A- |
| MBS | 141.3 | 130.8 | 10.5 | (6.3) | 4.2 | AAA |
| ABS | 11.9 | 10.5 | 1.4 | (2.4) | (1.0) | A |
| Total HTM portfolio | \$ 1,256.3 | 1,214.3 | 42.0 | 14.5 | 56.5 | AA |
| State and Municipal Obligations: | | | | | | |
| General obligations | \$ 240.3 | 236.8 | 3.5 | 9.7 | 13.2 | AA |
| Special revenue obligations | 672.0 | 659.8 | 12.2 | 12.5 | 24.7 | AA |
| Total state and municipal obligations | \$ 912.3 | 896.6 | 15.7 | 22.2 | 37.9 | AA |
| Corporate Securities: | | | | | | |
| Financial | \$ 23.5 | 20.0 | 3.5 | (2.5) | 1.0 | A- |
| Industrials | 22.8 | 19.4 | 3.4 | (1.2) | 2.2 | A |
| Utilities | 16.9 | 16.1 | 0.8 | (0.1) | 0.7 | BBB |
| Consumer discretion | 7.7 | 7.1 | 0.6 | 0.2 | 0.8 | AA- |
| Consumer staples | 5.4 | 4.9 | 0.5 | (0.1) | 0.4 | A |
| Materials | 2.1 | 1.9 | 0.2 | (0.1) | 0.1 | BBB- |
| Energy | 3.7 | 3.3 | 0.4 | (0.2) | 0.2 | BB+ |
| Total corporate securities | \$ 82.1 | 72.7 | 9.4 | (4.0) | 5.4 | A- |
| MBS | | | | | | |
| Government guaranteed agency | | | | | | |
| CMBS | \$ 9.2 | 8.9 | 0.3 | - | 0.3 | AAA |
| Other agency CMBS | 3.6 | 3.6 | - | - | - | AAA |
| Non-agency CMBS | 42.1 | 35.0 | 7.1 | (7.4) | (0.3) | AA+ |
| Government guaranteed agency | | | | | | |
| RMBS | 4.5 | 4.0 | 0.5 | (0.1) | 0.4 | AAA |
| Other agency RMBS | 81.8 | 79.2 | 2.6 | 1.2 | 3.8 | AAA |
| Non-agency RMBS | 0.1 | 0.1 | - | - | - | BBB |
| Total MBS | \$ 141.3 | 130.8 | 10.5 | (6.3) | 4.2 | AAA |
| ABS: | | | | | | |
| ABS | \$ 9.1 | 8.0 | 1.1 | (0.9) | 0.2 | A- |
| Alt-A ABS | 2.8 | 2.5 | 0.3 | (1.5) | (1.2) | AA- |
| Total ABS | \$ 11.9 | 10.5 | 1.4 | (2.4) | (1.0) | A |

1 U.S. government includes corporate securities fully guaranteed by the FDIC.

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

A portion of our AFS and HTM municipal bonds contain insurance enhancements. The following table provides information regarding these insurance-enhanced securities as of September 30, 2011:

| Insurers of Municipal Bond Securities | | Ratings with Insurance | Ratings without Insurance |
|---|-------------------|------------------------------|---------------------------------|
| (\$ in thousands) | Fair Value | | |
| National Public Finance Guarantee Corporation, a subsidiary of MBIA, Inc. | \$ 345,014 | AA- | A+ |
| Assured Guaranty | 228,633 | AA+ | A |
| Ambac Financial Group, Inc. | 91,727 | AA- | AA- |
| Other | 20,716 | AA | A |
| Total | \$ 686,090 | AA | A+ |

The following table details the top 10 state exposures of the municipal bond portion of our fixed maturity securities portfolio at September 30, 2011:

| State Exposures of Municipal Bonds (\$ in thousands) | General Obligation | | Special Revenue | Fair Value | Average Credit Quality |
|---|--------------------|---------|-----------------|------------|------------------------|
| | Local | State | | | |
| Texas | \$ 85,274 | 1,090 | 59,322 | 145,686 | AA+ |
| Washington | 46,120 | - | 38,468 | 84,588 | AA |
| Arizona | 6,984 | - | 66,671 | 73,655 | AA |
| North Carolina | 24,328 | 22,846 | 23,975 | 71,149 | AA+ |
| New York | - | - | 68,107 | 68,107 | AA+ |
| Florida | - | - | 58,817 | 58,817 | AA- |
| Ohio | 13,699 | 7,327 | 32,973 | 53,999 | AA+ |
| Minnesota | 5,097 | 41,540 | 6,435 | 53,072 | AA+ |
| Illinois | 20,310 | - | 28,414 | 48,724 | AA- |
| Colorado | 29,005 | 1,830 | 17,191 | 48,026 | AA- |
| Other | 120,598 | 76,921 | 367,017 | 564,536 | AA |
| | 351,415 | 151,554 | 767,390 | 1,270,359 | AA |
| Advanced refunded/escrowed to maturity bonds | 23,988 | 5,338 | 39,656 | 68,982 | AA+ |
| Total | \$ 375,403 | 156,892 | 807,046 | 1,339,341 | AA |

There has recently been widespread concern regarding the stress on state and local governments emanating from declining revenues, large unfunded liabilities, and entrenched cost structures. This has led to speculation about potential fallout on the municipal bond market. Overall, we are comfortable with the quality, composition, and diversification of our \$1.3 billion municipal bond portfolio, but we closely monitor our exposure, particularly in light of the changing landscape for municipalities. In addition, we have not reinvested proceeds of maturities and calls into this sector. As a result, municipal bonds as a percentage of invested assets have declined to 32% from 38% a year ago. Our municipal bond portfolio is very high quality with an average AA rating and is well laddered with 38% maturing within three years and another 36% maturing between three and five years. The weightings of the municipal bond portfolio are: 60% of high-quality revenue bonds that have dedicated revenue streams, 28% of local general obligation bonds, and 12% of state general obligation bonds. In addition, approximately 5% of the municipal bond portfolio has been refunded in advance. Our largest state exposure is to Texas, at 11% excluding the impact of advanced refunded bonds. Of the \$85 million in local Texas general obligation bonds, \$41 million represents investments in Texas Permanent School Fund bonds, which are considered to be lower risk.

The sector composition and credit quality of our special revenue bonds did not significantly change from December 31, 2010. For details regarding our special revenue bond sectors and additional information regarding credit risk associated with our portfolio, see Item 7A. "Quantitative and Qualitative Disclosures About Market Risk." of our 2010 Annual Report.

As of September 30, 2011, alternative investments represented 3% of our total invested assets. The following table outlines a summary of our other investment portfolio by strategy and the remaining commitment amount associated with each strategy:

| Other Investments (\$ in thousands) | Carrying Value | | September 30, 2011 |
|--|--------------------|-------------------|----------------------|
| | September 30, 2011 | December 31, 2010 | Remaining Commitment |
| Alternative Investments: | | | |
| Energy/power generation | \$ 30,792 | 35,560 | 10,296 |
| Secondary private equity | 29,077 | 26,709 | 11,047 |
| Private equity | 21,067 | 21,601 | 6,637 |
| Distressed debt | 19,285 | 20,432 | 3,169 |
| Real estate | 14,033 | 14,192 | 10,602 |
| Mezzanine financing | 9,993 | 10,230 | 15,910 |
| Venture capital | 7,909 | 6,386 | 900 |
| Total alternative investments | 132,156 | 135,110 | 58,561 |
| Other securities | 3,404 | 2,755 | 2,096 |
| Total other investments | \$ 135,560 | 137,865 | 60,657 |

In addition to the capital that we have already invested to date, we are contractually obligated to invest up to an additional \$60.7 million in these alternative and other investments through commitments that currently expire at various dates through 2022. For a description of our seven alternative investment strategies outlined above, as well as redemption, restrictions, and fund liquidations, refer to Note 5. "Investments" in Item 8. "Financial Statements and Supplementary Data." of our 2010 Annual Report.

Net Investment Income

The components of net investment income earned were as follows:

| (\$ in thousands) | Quarter ended | | Nine Months ended | |
|---|---------------|----------|-------------------|----------|
| | September 30, | | September 30, | |
| | 2011 | 2010 | 2011 | 2010 |
| Fixed maturity securities | \$ 31,960 | 31,741 | 97,835 | 97,914 |
| Equity securities | 1,197 | 347 | 2,299 | 1,279 |
| Short-term investments | 28 | 134 | 123 | 367 |
| Other investments | 4,494 | 2,400 | 24,082 | 11,216 |
| Investment expenses | (1,893) | (1,636) | (5,735) | (6,539) |
| Net investment income earned – before tax | 35,786 | 32,986 | 118,604 | 104,237 |
| Net investment income tax expense | 8,810 | 7,681 | 30,083 | 24,179 |
| Net investment income earned – after tax | \$ 26,976 | 25,305 | 88,521 | 80,058 |
| Effective tax rate on net investment income | 24.6 % | 23.3 | 25.4 % | 23.2 |
| Annual after-tax yield on fixed maturity securities | | | 2.7 | 2.8 |
| Annual after-tax yield on investment portfolio | | | 3.0 | 2.8 |

Net investment income, before tax, increased by \$2.8 million for Third Quarter 2011 and \$14.4 million for Nine Months 2011 compared to the prior year periods. These increases were primarily driven by income from our alternative investments within our investment portfolio. Our alternative investments, which are accounted for under the equity method, primarily consist of investments in limited partnerships, the majority of which report results to us on a one quarter lag. The following table illustrates income by strategy for these partnerships:

| (\$ in thousands) | Quarter ended September 30, | | Nine Months ended September 30, | |
|-------------------------------|--------------------------------|-------|------------------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| Energy/power generation | \$ 1,760 | 409 | 7,599 | 3,440 |
| Private equity | 1,640 | 543 | 5,398 | 1,350 |
| Secondary private equity | 1,179 | 240 | 5,895 | 3,924 |
| Distressed debt | (153) | 472 | 1,241 | 1,195 |
| Real estate | 35 | 303 | 1,485 | (2,056) |
| Venture capital | 125 | 15 | 1,448 | 263 |
| Mezzanine financing | (133) | 377 | 928 | 3,006 |
| Other | 41 | 41 | 88 | 94 |
| Total other investment income | \$ 4,494 | 2,400 | 24,082 | 11,216 |

Realized Gains and Losses

Realized Gains and Losses (excluding OTTI)

Realized gains and losses, by type of security excluding OTTI charges, are determined on the basis of the cost of specific investments sold and are credited or charged to income. The components of net realized gains were as follows:

| (\$ in thousands) | Quarter ended September 30, | | Nine Months ended September 30, | |
|---|--------------------------------|----------|------------------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| HTM fixed maturity securities | | | | |
| Gains | \$ - | 123 | 9 | 535 |
| Losses | (200) | (296) | (522) | (746) |
| AFS fixed maturity securities | | | | |
| Gains | 698 | 2,961 | 3,052 | 7,743 |
| Losses | (5) | (15) | (12) | (7,604) |
| AFS equity securities | | | | |
| Gains | 5 | 912 | 6,676 | 15,086 |
| Losses | - | (821) | - | (1,054) |
| Total other net realized investment gains | 498 | 2,864 | 9,203 | 13,960 |
| Total OTTI charges recognized in earnings | (2,543) | (2,807) | (3,342) | (17,231) |
| Total net realized gains (losses) | \$ (2,045) | 57 | 5,861 | (3,271) |

For a discussion of realized gains and losses, see Note 6. "Investments" in Item 1. "Financial Statements" of this Form 10-Q.

There were no securities sold at a loss during Third Quarter 2011 and Nine Months 2011. The following tables present the period of time that securities sold at a loss in Third Quarter 2010 and Nine Months 2010 were continuously in an unrealized loss position prior to sale:

| Period of Time in an Unrealized Loss Position | Quarter ended September 30, 2010 | |
|--|---|------------------|
| | Fair Value on Sale Date | Realized Loss |
| (\$ in thousands) | | |
| Equities: | | |
| 0 – 6 months | \$ 6,326 | 332 |
| 7 – 12 months | 3,173 | 489 |
| Total equity securities | 9,499 | 821 |
| Total | \$ 9,499 | 821 |
| | | |
| Period of Time in an Unrealized Loss Position | Nine Months ended September 30, 2010 | |
| | Fair Value on Sale Date | Realized Loss |
| (\$ in thousands) | | |
| Fixed maturities: | | |
| 0 – 6 months | \$ 11,462 | 463 |
| 7 – 12 months | - | - |
| Greater than 12 months | 10,257 | 7,098 |
| Total fixed maturities | 21,719 | 7,561 |
| Equities: | | |
| 0 – 6 months | 10,454 | 565 |
| 7 – 12 months | 3,173 | 489 |
| Total equity securities | 13,627 | 1,054 |
| Total other investments | - | - |
| Total | \$ 35,346 | 8,615 |

Our general philosophy for sales of securities is to reduce our exposure to securities and sectors based on economic evaluations and when the fundamentals for that security or sector have deteriorated. We typically have a long investment time horizon and every purchase or sale is made with the intent of improving future investment returns while balancing capital preservation. From time to time, this may involve initiating sales programs to rebalance the overall portfolio allocation.

Other-than-Temporary Impairments

The following table provides information regarding our OTTI charges recognized in earnings:

| (\$ in thousands) | Quarter ended September 30, | | Nine Months ended September 30, | |
|--|--------------------------------|--------------|------------------------------------|---------------|
| | 2011 | 2010 | 2011 | 2010 |
| HTM securities | | | | |
| ABS | \$ - | - | - | 31 |
| CMBS | - | 90 | - | 4,215 |
| RMBS | - | 102 | - | 419 |
| Total HTM securities | - | 192 | - | 4,665 |
| AFS securities | | | | |
| Obligations of state and political subdivisions | - | - | 17 | - |
| Corporate securities | - | - | 244 | - |
| ABS | 50 | - | 50 | - |
| CMBS | 132 | 781 | 604 | 2,153 |
| RMBS | 49 | 9 | 115 | 7,916 |
| Total fixed maturity AFS securities | 231 | 790 | 1,030 | 10,069 |
| Equity securities | 2,312 | 1,825 | 2,312 | 2,497 |
| Total AFS securities | 2,543 | 2,615 | 3,342 | 12,566 |
| Total OTTI charges recognized in earnings | \$ 2,543 | 2,807 | 3,342 | 17,231 |

We regularly review our entire investment portfolio for declines in fair value. If we believe that a decline in the value of a particular investment is other than temporary, we record it as an OTTI, through realized losses in earnings for the credit-related portion and through unrealized losses in OCI for the non-credit related portion. If there is a decline in fair value of an equity security 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 to fair value and record the charge through earnings as a component of realized losses.

For discussion of our OTTI methodology, see Note 2. "Summary of Significant Accounting Policies" in Item 8. "Financial Statements and Supplementary Data." of our 2010 Annual Report. In addition, for qualitative information regarding these charges, see Note 6. "Investments," included in Item 1. "Financial Statements" of this Form 10-Q.

Unrealized/Unrecognized Gains and Losses

The following table summarizes the aggregate fair value and gross pre-tax unrealized/unrecognized losses recorded, by asset class and by length of time, for all securities that have continuously been in an unrealized/unrecognized loss position at September 30, 2011 and December 31, 2010:

| September 30, 2011 (\$ in thousands) | Less than 12 months | | 12 months or longer | |
|--|---------------------|--------------------------------|---------------------|--------------------------------|
| | Fair Value | Unrealized Losses ¹ | Fair Value | Unrealized Losses ¹ |
| AFS securities | | | | |
| Obligations of states and political subdivisions | 2,127 | (1) | 1,887 | (44) |
| Corporate securities | 182,536 | (4,898) | 6,739 | (636) |
| ABS | 6,202 | (9) | 1,144 | (1,072) |
| CMBS | 6,371 | (60) | 10,050 | (1,240) |
| RMBS | 28,893 | (490) | 11,781 | (960) |
| Total fixed maturity securities | 226,129 | (5,458) | 31,601 | (3,952) |
| Equity securities | 85,918 | (18,004) | - | - |
| Subtotal | \$ 312,047 | (23,462) | 31,601 | (3,952) |

| (\$ in thousands) | Less than 12 months | | | 12 months or longer | | |
|--|---------------------|--------------------------------|--|---------------------|--------------------------------|--|
| | Fair Value | Unrealized Losses ¹ | Unrecognized Gains (Losses) ³ | Fair Value | Unrealized Losses ¹ | Unrecognized Gains (Losses) ³ |
| HTM securities | | | | | | |
| Obligations of states and political subdivisions | \$3,929 | (192) | 178 | 10,072 | (551) | 343 |
| ABS | - | - | - | 2,830 | (1,060) | 762 |
| CMBS | 14,315 | (596) | 575 | 6,529 | (3,348) | 1,016 |
| RMBS | - | - | - | 108 | (38) | 14 |
| Subtotal | \$18,244 | (788) | 753 | 19,539 | (4,997) | 2,135 |
| Total AFS and HTM | \$330,291 | (24,250) | 753 | 51,140 | (8,949) | 2,135 |

| December 31, 2010 (\$ in thousands) | Less than 12 months | | 12 months or longer | |
|--|---------------------|--------------------------------|---------------------|--------------------------------|
| | Fair Value | Unrealized Losses ¹ | Fair Value | Unrealized Losses ¹ |
| AFS securities | | | | |
| U.S. government and government agencies ² | \$ 3,956 | (147) | - | - |
| Foreign government | 10,776 | (349) | - | - |
| Obligations of states and political subdivisions | 40,410 | (650) | - | - |
| Corporate securities | 362,502 | (8,784) | - | - |
| ABS | 30,297 | (273) | 880 | (66) |
| CMBS | 5,453 | (271) | 11,115 | (2,652) |
| RMBS | 70,934 | (1,098) | 20,910 | (1,145) |
| Total fixed maturity securities | 524,328 | (11,572) | 32,905 | (3,863) |
| Equity securities | - | - | - | - |

| | | | | |
|----------|------------|-----------|--------|----------|
| Subtotal | \$ 524,328 | (11,572) | 32,905 | (3,863) |
|----------|------------|-----------|--------|----------|

| (\$ in thousands) | Less than 12 months | | | 12 months or longer | | |
|--|---------------------|--|--|---------------------|--------------------------------|---------------------------------|
| | Fair Value | Unrealized (Losses) Gains ¹ | Unrecognized Gains (Losses) ³ | Fair Value | Unrealized Losses ¹ | Unrecognized Gains ³ |
| HTM securities | | | | | | |
| Obligations of states and political subdivisions | \$ 21,036 | (381) | 45 | 27,855 | (1,969) | 670 |
| Corporate securities | 1,985 | (434) | 420 | - | - | - |
| ABS | 507 | (546) | (440) | 2,931 | (1,095) | 747 |
| CMBS | 3,621 | 15 | (17) | 5,745 | (3,933) | 833 |
| RMBS | - | - | - | 95 | (38) | 1 |
| Subtotal | \$ 27,149 | (1,346) | 8 | 36,626 | (7,035) | 2,251 |
| Total AFS and HTM | \$ 551,477 | (12,918) | 8 | 69,531 | (10,898) | 2,251 |

¹ Gross unrealized losses include non-OTTI unrealized amounts and OTTI losses recognized in AOCI. In addition, this column includes remaining unrealized gain or loss amounts on securities that were transferred to an HTM designation in the first quarter of 2009 for those securities that are in a net unrealized/unrecognized loss position.

² U.S. government includes corporate securities fully guaranteed by the FDIC.

³ Unrecognized holding gains/(losses) represent fair value fluctuations from the later of: (i) the date a security is designated as HTM; or (ii) the date that an OTTI charge is recognized on an HTM security.

At September 30, 2011 we had 139 equity securities in an aggregate unrealized loss position of \$18.0 million. These securities, which we purchased as part of our high-dividend yield equities strategy earlier in the year, have all been in an unrealized loss position for less than six months, generally driven by market volatility in the equity markets over the past two months. Unrealized losses on our fixed maturity portfolio improved by \$9.3 million, primarily in the less than 12 months category, compared to December 31, 2010.

The following table provides information regarding securities in an unrealized loss position as of September 30, 2011 and December 31, 2010:

| (\$ in thousands) | | | | | |
|--------------------|------------------|------------------------------|-------------------|------------------|------------------------------|
| September 30, 2011 | | | December 31, 2010 | | |
| Number of Issues | % of Market/Book | Unrealized Unrecognized Loss | Number of Issues | % of Market/Book | Unrealized Unrecognized Loss |
| 188 | 80% - 99% | \$ 16,142 | 193 | 80% - 99% | \$ 16,310 |
| 64 | 60% - 79% | 9,554 | 2 | 60% - 79% | 1,125 |
| 11 | 40% - 59% | 2,963 | 2 | 40% - 59% | 2,160 |
| 3 | 20% - 39% | 1,652 | 1 | 20% - 39% | 986 |
| - | 0% - 19% | - | 1 | 0% - 19% | 976 |
| | | \$ 30,311 | | | \$ 21,557 |

We have reviewed the securities in the tables above in accordance with our OTTI policy, which is discussed in Note 2. "Summary of Significant Accounting Policies" in Item 8. "Financial Statements and Supplementary Data." of our 2010 Annual Report. For qualitative information regarding our conclusion as to why these impairments are deemed temporary, see Note 6. "Investments," in Item 1. "Financial Statements" of this Form 10-Q.

Contractual Maturities

The following table presents amortized cost and fair value regarding our AFS fixed maturities that were in an unrealized loss position at September 30, 2011 by contractual maturity:

| Contractual Maturities (\$ in thousands) | Amortized Cost | Fair Value |
|---|-------------------|----------------|
| One year or less | \$ 21,337 | 20,651 |
| Due after one year through five years | 174,867 | 169,973 |
| Due after five years through ten years | 63,035 | 60,965 |
| Due after ten years | 7,902 | 6,141 |
| Total | \$ 267,141 | 257,730 |

The following table presents information regarding our HTM fixed maturities that were in an unrealized/unrecognized loss position at September 30, 2011 by contractual maturity:

| Contractual Maturities (\$ in thousands) | Amortized Cost | Fair Value |
|---|-------------------|---------------|
| One year or less | \$ 19,899 | 19,515 |
| Due after one year through five years | 17,938 | 15,631 |
| Due after five years through ten years | 2,524 | 2,343 |
| Due after ten years | 319 | 294 |
| Total | \$ 40,680 | 37,783 |

Investments Outlook

The slow pace of economic recovery in 2011 continues with second quarter real Gross Domestic Product (“GDP”) revised to 1.3% year over year. The sluggish labor market was reflected in the Bureau of Labor Statistics report that the September 2011 unemployment rate was 9.1%, with 7 of the first 9 months of the year at 9% or greater. We continue to be concerned about the European sovereign debt crisis, slowing global growth, commodity prices, domestic housing market overhang, and inflation expectations. Volatility in the equity and bond markets reflects these concerns. The Federal Reserve continues to maintain an accommodative monetary policy and the Federal Open Market Committee’s recent implementation of “Operation Twist” is intended to keep long-term interest rates at historically low levels. Yields have continued to decline over the past few months and remain a challenge for the fixed income portfolio as the yield on maturing securities is higher than the yield available on new investments with similar credit quality. If current conditions persist, the overall yield on our bond portfolio is expected to continue its decline.

Our fixed income strategy remains focused on maintaining sufficient liquidity while maximizing yield within acceptable risk tolerances. We will continue to invest in high-quality instruments, including additions to investment grade corporate bonds with diversified maturities to manage incremental interest rate risk, and may opportunistically invest in below investment grade fixed income securities to take advantage of risk adjusted return opportunities.

As mentioned previously, we have allocated assets to a high dividend yield equities strategy, which is expected to improve diversification of our equity portfolio and provide additional yield while maintaining our allocation to the domestic equities market. This strategy is relatively sector-neutral and provides attractive current income yields.

Our current outlook for alternative investments remains positive and private markets continue to offer attractive risk adjusted returns.

Federal Income Taxes

The following table provides information regarding federal income taxes from continuing operations:

| (\$ in millions) | Quarter ended September 30, | | Nine Months ended September 30, | |
|---|--------------------------------|------|------------------------------------|------|
| | 2011 | 2010 | 2011 | 2010 |
| Federal income (benefit) expense from continuing operations | \$ (21.3) | 3.2 | (16.2) | 7.0 |
| Effective tax rate | 52 % | 15 | 137 | 13 |

The decreases in Third Quarter and Nine Months 2011 were primarily due to an increase in underwriting losses as compared to the prior year, partially offset by increases in net investment income. For a reconciliation of the federal corporate tax rate to our effective tax rate, see Note 10. "Federal Income Taxes" in Item 1. "Financial Statements" of this Form 10-Q.

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

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

Liquidity

We manage liquidity with a focus on generating sufficient cash flows to meet both the short-term and long-term cash requirements of our business operations. Our cash and short-term investment position was \$163 million at September 30, 2011, primarily comprised of \$54 million at Selective Insurance Group, Inc. (the "Parent") and \$109 million at the Insurance Subsidiaries. As we continually evaluate our liquidity levels, our cash and short-term position increased in the quarter, by \$20 million, to provide the additional liquidity that we anticipate will be needed to pay claims in the fourth quarter of 2011 related to the historic levels of catastrophe losses that we incurred during Third Quarter 2011. Short-term investments are maintained in AAA rated money market funds approved by the National Association of Insurance Commissioners.

Sources of cash for the Parent have historically consisted of dividends from the Insurance Subsidiaries, borrowings under its line of credit, loan agreements with our Indiana-domiciled Insurance Subsidiaries ("Indiana Subsidiaries"), and the issuance of stock and debt securities. We continue to monitor these sources, giving consideration to our long-term liquidity and capital preservation strategies. The Parent had no private or public issuances of stock or debt during 2011 and there were no borrowings under its \$30 million line of credit ("Line of Credit").

We currently anticipate the Insurance Subsidiaries paying approximately \$63 million of dividends to the Parent in 2011, of which \$46 million was paid through Third Quarter 2011, compared to our allowable ordinary maximum dividend amount of approximately \$110 million. Any dividends to the Parent continue to be subject to the approval and/or review of the insurance regulators in the respective domiciliary states under insurance holding company acts, and are generally payable only from earned surplus as reported in the statutory annual statements of those subsidiaries as of the preceding December 31. Although past dividends have historically been met with regulatory approval, there is no assurance that future dividends that may be declared will be approved. For additional information regarding dividend restrictions, refer to Note 6. "Stockholders' Equity and Other Comprehensive Income (Loss)" in Item 8. "Financial Statements and Supplementary Data." of our 2010 Annual Report.

The Indiana Subsidiaries are members in the Federal Home Loan Bank of Indianapolis ("FHLBI"), which provides these companies with access to additional liquidity. The Indiana Subsidiaries' aggregate investment of \$0.8 million provides them with the ability to borrow up to 20 times the total amount of the FHLBI common stock purchased, at comparatively low borrowing rates. The Parent's Line of Credit agreement permits collateralized borrowings by the

Indiana Subsidiaries from the FHLBI so long as the aggregate amount borrowed does not exceed 10% of the respective Indiana Subsidiary's admitted assets from the preceding calendar year. For additional information regarding the Parent's Line of Credit, refer to the section below entitled "Short-term Borrowings." All borrowings from FHLBI are required to be secured by certain investments. The Indiana Department of Insurance has approved lending agreements from the Indiana Subsidiaries to the Parent. At September 30, 2011, the outstanding borrowings of the Indiana Subsidiaries from the FHLBI were \$13 million in fixed rate borrowings after pledging the required collateral. These funds have been loaned to the Parent under the approved lending agreements. For additional information regarding the required collateral, refer to Note 6. "Investments" of this Form 10-Q.

The Insurance Subsidiaries also generate liquidity through insurance float, which is created by collecting premiums and earning investment income before losses are paid. The period of the float can extend over many years. Our investment portfolio consists of maturity dates that are well-laddered to continually provide a source of cash flows for claims payments in the ordinary course of business. The duration of the fixed maturity securities portfolio, including short-term investments, was 3.2 years as of September 30, 2011, while the liabilities of the Insurance Subsidiaries have a duration of approximately 3.8 years. In addition, the Insurance Subsidiaries purchase reinsurance coverage for protection against any significantly large claims or catastrophes that may occur during the year.

The liquidity generated from the sources discussed above is used, among other things, to pay dividends to our stockholders. Dividends on shares of the Parent's common stock are declared and paid at the discretion of the Board of Directors based on our operating results, financial condition, capital requirements, contractual restrictions, and other relevant factors.

Our ability to meet our interest and principal repayment obligations on our debt, as well as our ability to continue to pay dividends to our stockholders is dependent on liquidity at the Parent coupled with the ability of the Insurance Subsidiaries to pay dividends, if necessary, and/or the availability of other sources of liquidity to the Parent. Our next principal repayment of \$13 million is due in 2014, with the next principal repayment occurring beyond that in 2034. Restrictions on the ability of the Insurance Subsidiaries to declare and pay dividends, without alternative liquidity options, could materially affect the Parent's ability to service its debt and pay dividends on common stock.

Short-term Borrowings

Our Line of Credit with Wells Fargo Bank, National Association, as administrative agent, and Branch Banking and Trust Company (BB&T), was renewed effective June 13, 2011 with a borrowing capacity of \$30 million, which can be increased to \$50 million with the approval of both lending parties. This Line of Credit, which is not used in our daily cash management, provides the Parent an additional source of short-term liquidity, if needed. The interest rate on our Line of Credit varies and is based on the Parent's debt ratings. The Line of Credit expires on June 13, 2014. There were no balances outstanding under this credit facility as of September 30, 2011 or at any time during 2011.

The Line of Credit agreement contains representations, warranties, and covenants that are customary for credit facilities of this type, including, without limitation, financial covenants under which we are obligated to maintain a minimum consolidated net worth, minimum combined statutory surplus, and maximum ratio of consolidated debt to total capitalization, as well as covenants limiting our ability to: (i) merge or liquidate; (ii) incur debt or liens; (iii) dispose of assets; (iv) make investments and acquisitions; and (v) engage in transactions with affiliates.

The table below outlines information regarding certain of the covenants in the Line of Credit:

| | Required as of September 30, 2011 | Actual as of September 30, 2011 |
|---|--------------------------------------|------------------------------------|
| Consolidated net worth | \$0.8 billion | \$1.1 billion |
| Statutory surplus | Not less than \$750 million | \$1.0 billion |
| Debt-to-capitalization ratio ¹ | Not to exceed 35% | 17.9 % |
| A.M. Best financial strength rating | Minimum of A- | A+ |

¹ Calculated in accordance with Line of Credit agreement.

Capital Resources

Capital resources provide protection for policyholders, furnish the financial strength to support the business of underwriting insurance risks, and facilitate continued business growth. At September 30, 2011, we had statutory

surplus of approximately \$1.0 billion and GAAP stockholders' equity of approximately \$1.1 billion. We had total debt of \$262 million at September 30, 2011, which equates to a debt-to-capital ratio of approximately 19.4%.

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

We continually monitor our cash requirements and the amount of capital resources that we maintain at the holding company and operating subsidiary levels. As part of our long-term capital strategy, we strive to maintain capital metrics, relative to the macroeconomic environment, that support an “A+” (Superior) financial strength A.M. Best rating for the Insurance Subsidiaries. Based on our analysis and market conditions, we may take a variety of actions, including, but not limited to, contributing capital to the Insurance Subsidiaries, issuing additional debt and/or equity securities, repurchasing shares of the Parent’s common stock, and increasing stockholders’ dividends.

Our capital management strategy is intended to protect the interests of the policyholders of the Insurance Subsidiaries and our stockholders, while enhancing our financial strength and underwriting capacity.

Book value per share increased to \$20.04 as of September 30, 2011, from \$19.95 as of December 31, 2010, primarily driven by: (i) an increase in unrealized gains on our investment portfolio, which led to an increase in book value of \$0.42; and (ii) net income, which led to an increase in book value per share of \$0.07. Partially offsetting this increase was the impact of dividends paid to our stockholders, which resulted in a decrease in book value per share of \$0.39.

Ratings

We are rated by major rating agencies that issue opinions on our financial strength, operating performance, strategic position, and ability to meet policyholder obligations. We believe that our ability to write insurance business is most influenced by our rating from A.M. Best, which was reaffirmed in Second Quarter 2011 as “A+ (Superior),” their second highest of 15 ratings, with a “negative” outlook. They cited our strong capitalization, solid level of operating profitability, and established presence within our targeted regional markets. We have been rated “A” or higher by A.M. Best for the past 81 years, with our current rating of “A+ (Superior)” being in place for the last 50 consecutive years. The financial strength reflected by our A.M. Best rating is a competitive advantage in the marketplace and influences where independent insurance agents place their business. A downgrade from A.M. Best to a rating below “A-” could: (i) affect our ability to write new business with customers and/or agents, some of whom are required (under various third-party agreements) to maintain insurance with a carrier that maintains a specified A.M. Best minimum rating; or (ii) be an event of default under our Line of Credit.

Our ratings by other major rating agencies are as follows:

- Standard & Poor’s (“S&P”) Insurance Rating Services – S&P cites our strong competitive position in Mid-Atlantic markets, effective use of well-developed predictive modeling and agency interface technology, strong financial flexibility, and strong capital adequacy in support of our “A” financial strength rating and outlook of stable.
- Moody’s Investor Service – Our financial strength rating of “A2” and outlook of stable was reaffirmed in the first quarter of 2011. Moody’s cited our strong regional franchise with established independent agency support, along with good risk adjusted capitalization and moderate financial leverage. Their outlook reflects the expectation that we will continue to employ our technologically-based risk management process to identify and manage underperforming segments, while maintaining pricing discipline and reserve adequacy.
- Fitch Ratings – Our “A+” rating and outlook of stable was reaffirmed in the second quarter of 2011, citing our disciplined underwriting culture, conservative balance sheet with very good capitalization and reserve strength, strong independent agency relationships, and improved diversification through our continued efforts to reduce our concentration in New Jersey.

Our S&P and Moody’s financial strength ratings affect our ability to access capital markets. There can be no assurance that our ratings will continue for any given period of time or that they will not be changed. It is possible that positive or negative ratings actions by one or more of the rating agencies may occur in the future.

Pending Accounting Pronouncements

In October 2010, the FASB issued ASU 2010-26, Financial Services-Insurance (Topic 944): Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts (“ASU 2010-26”). This guidance requires that only costs that are incremental or directly related to the successful acquisition of new or renewal insurance contracts are to be capitalized as a deferred acquisition cost. This would include, among other items, sales commissions paid to agents, premium taxes, and the portion of employee salaries and benefits directly related to time spent on acquired contracts. This guidance is effective, either with a prospective or retrospective application, for interim and annual periods beginning after December 15, 2011, with early adoption permitted. Although we continue to evaluate the impact of this guidance, we anticipate that ASU 2010-26 would have an after-tax impact on our stockholders’ equity of approximately \$55 million, or about \$1 of book value per share. The adoption of this guidance is not expected to have a material impact on our results of operations on both a historical and prospective basis.

Off-Balance Sheet Arrangements

At September 30, 2011 and December 31, 2010, we did not have any relationships with unconsolidated entities or financial partnerships, such entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or for other contractually narrow or limited purposes. As such, we are not exposed to any financing, liquidity, market, or credit risk that could arise if we had engaged in such relationships.

Contractual Obligations, Contingent Liabilities, and Commitments

Our future cash payments associated with loss and loss expense reserves, contractual obligations pursuant to operating leases for office space and equipment, and notes payable have not materially changed since December 31, 2010. We expect to have the capacity to repay and/or refinance these obligations as they come due.

At September 30, 2011, we had contractual obligations that expire at various dates through 2022 that may require us to invest up to an additional \$60.7 million in alternative investments. There is no certainty that such additional investment will be required. We have issued no material guarantees on behalf of others and have no trading activities involving non-exchange traded contracts accounted for at fair value. We have no material transactions with related parties other than those disclosed in Note 17. “Related Party Transactions” included in Item 8. “Financial Statements and Supplementary Data.” of our 2010 Annual Report.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in the information about market risk set forth in our 2010 Annual Report.

ITEM 4. CONTROLS AND PROCEDURES

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (“Exchange Act”)), as of the end of the period covered by this report. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, our disclosure controls and procedures are: (i) effective in recording, processing, summarizing, and reporting information on a timely basis that we are required to disclose in the reports that we file or submit under the Exchange Act; and (ii) effective in ensuring that information that we are required to disclose in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. No changes in our internal control over financial reporting (as such term is defined in Rule 13a-15(f) of the Exchange Act) occurred during Third Quarter or Nine Months 2011 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

Our Insurance Subsidiaries also are involved from time-to-time in other legal actions, some of which assert claims for substantial amounts. These actions include, among others, putative state class actions seeking certification of a state or national class. Such putative class actions have alleged, for example, improper reimbursement of medical providers paid under workers compensation and personal and commercial automobile insurance policies. Our Insurance Subsidiaries also are 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.

ITEM 1A. RISK FACTORS

Certain risk factors exist that can have a significant impact on our business, liquidity, capital resources, results of operations, and financial condition. The impact of these risk factors could also impact certain actions that we take as part of our long-term capital strategy including, but not limited to, contributing capital to our subsidiaries in our Insurance Operations, issuing additional debt and/or equity securities, repurchasing shares of our common stock, or changing stockholders' dividends. We operate in a continually changing business environment and new risk factors emerge from time-to-time. Consequently, we can neither predict such new risk factors nor assess the impact, if any, they might have on our business in the future. The following is in addition to the risk factors disclosed in Item 1A. "Risk Factors." in our 2010 Annual Report:

The recent credit downgrade of United States long-term sovereign debt by S&P, in addition to a potential downgrade of the United States credit rating, could have a material adverse effect on our business, financial condition, and results of operations.

On August 5, 2011, S&P reduced its long-term assessment of the United States sovereign debt to AA+, which marked the first time in nearly 70 years that the credit rating was not AAA. Moody's and Fitch have not yet made any reductions on their ratings of the United States long-term sovereign debt, but continue to include it on their watchlists. The downgrade has triggered significant volatility in the financial markets in the final two months of Third Quarter 2011. We cannot estimate the ultimate impact of the downgrade of the sovereign debt or any further credit downgrades of the United States Treasury. A further downgrade or the failure of the United States Treasury to maintain its AAA rating with S&P could have a material adverse effect on financial markets and economic conditions in the United States and throughout the world. In addition, lenders and/or regulators may require future changes in capital requirements. In turn, this could have a material adverse effect on our business, financial condition, and results of operations. In particular, these events could have a material adverse effect on the value and liquidity of financial assets, including assets in our investment portfolio. Our investment portfolio, which is described in Note 6. "Investments" of Item 1. "Financial Statements" of this Form 10-Q, was comprised of non-fixed income securities with a

carrying value of \$437.6 million and fixed income securities with a carrying value of \$3.6 billion at September 30, 2011. Our fixed income securities portfolio included \$380.0 million of U.S. Treasury securities and obligations of U.S. government and government agencies and authorities, and \$1.3 billion of obligations of states, municipalities, and political subdivisions as of September 30, 2011.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table provides information regarding our purchases of the Parent's common stock in Third Quarter 2011:

| Period | Total Number of Shares Purchased ¹ | 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 Programs |
|------------------------|---|------------------------------|---|---|
| July 1– 31, 2011 | - | \$ - | - | - |
| August 1 – 31, 2011 | - | - | - | - |
| September 1 – 30, 2011 | 763 | 14.28 | - | - |
| Total | 763 | \$ 14.28 | - | - |

¹ During Third Quarter 2011, 763 shares were purchased from employees in connection with the vesting of restricted stock units. These repurchases were made to satisfy tax withholding obligations 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 Parent's 2005 Omnibus Stock Plan.

ITEM 6.

EXHIBITS

(a) Exhibits:

Exhibit No.

- * 10.1 Employment Agreement between Selective Insurance Company of America and Amy Carver, dated as of October 24, 2011
- * 10.2 Selective Insurance Company of America Deferred Compensation Plan (2005) As Amended and Restated Effective as of January 1, 2010.
- * 10.2a Amendment No. 1 to Selective Insurance Company of America Deferred Compensation Plan (2005) As Amended and Restated Effective as of January 1, 2010, dated September 16, 2011.
- * 11 Statement Re: Computation of Per Share Earnings.
- * 31.1 Rule 13a-14(a) Certification of the Chief Executive Officer of Selective Insurance Group, Inc. (Section 302 of the Sarbanes-Oxley Act of 2002).
- * 31.2 Rule 13a-14(a) Certification of the Chief Financial Officer of Selective Insurance Group, Inc. (Section 302 of the Sarbanes-Oxley Act of 2002).
- * 32.1 Certification of Chief Executive Officer of Selective Insurance Group, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- * 32.2 Certification of Chief Financial Officer of Selective Insurance Group, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- ** 101.INS XBRL Instance Document.
- ** 101.SCH XBRL Taxonomy Extension Schema Document.
- ** 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.
- ** 101.LAB XBRL Taxonomy Extension Label Linkbase Document.
- ** 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.
- ** 101.DEF XBRL Taxonomy Extension Definition Linkbase Document.

* Filed herewith

** Furnished and not filed herewith

SIGNATURES

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

SELECTIVE INSURANCE GROUP, INC.

Registrant

By: /s/ Gregory E. Murphy
Gregory E. Murphy
Chairman of the Board, President and Chief Executive Officer

October 27, 2011

By: /s/ Dale A. Thatcher
Dale A. Thatcher
Executive Vice President and Chief Financial Officer
(principal accounting officer and principal financial officer)

October 27, 2011

