SELECTIVE INSURANCE GROUP INC
Form 10-K
February 22, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K
(Mark One)

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

For the fiscal year ended: December 31, 2016
or

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

For the transition period from_______________________to_______________________

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

New Jersey	22-2168890
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
40 Wantage Avenue, Branchville, New Jersey	07890
(Address of Principal Executive Offices)	(Zip Code)
Registrant’s telephone number, including area code:	(973) 948-3000

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $2 per share	NASDAQ Global Select Market
5.875% Senior Notes due February 9, 2043	New York Stock Exchange

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
ý Yes ¨ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
¨ Yes ý No

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

ý Yes ¨ No

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

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

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

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company ¨
(Do not check if a smaller reporting company)	

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).
¨ Yes ý No

The aggregate market value of the voting company common stock held by non-affiliates of the registrant, based on the closing price on the NASDAQ Global Select Market, was $2,154,552,276 on June 30, 2016. As of February 14, 2017, the registrant had outstanding 58,204,352 shares of common stock.

DOCUMENTS INCORPORATED BY REFERENCE
Portions of the registrant's definitive Proxy Statement for the 2017 Annual Meeting of Stockholders to be held on April 26, 2017 are incorporated by reference into Part III of this report.

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PART I

Item 1. Business.

Overview

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

In 2016 we celebrated our 90th year in business. Over the years, we have transformed ourselves into a super-regional property and casualty insurance company with the customer service capabilities, product offering, and technical know-how of a national carrier.

In 2016, we were ranked as the 41st largest property and casualty group in the United States based on 2015 net premiums written (“NPW”) in A.M. Best Company’s (“A.M. Best”) annual list of “Top 200 U.S. Property/Casualty Writers.”

The property and casualty insurance market is highly competitive, with fragmented market share and three main distribution methods: (i) sales through independent insurance agents; (ii) direct sales to personal and commercial customers; and (iii) a combination of independent agent and direct sales. In this highly competitive and regulated industry, we think we have three principal strategic advantages. The first is the true franchise value we have with our independent distribution partners, who collectively have significant market share in the states in which we operate and from whom we expect to gain increasing percentages of the business they write. The second is our unique field model, in which our underwriting, claims, and safety management personnel are located in the same communities as our distribution partners and customers supported by sophisticated analytics, technology, and regional and home office support. The third is our focus on customer service and providing an exceptional and personalized omni-channel 24/7 customer experience, which is less common in the marketplace for commercial customers and more so for personal customers.

Based on these three principal strategic advantages, we have a financial goal to achieve an operating return on equity that is at least three percentage points higher than our weighted-average cost of capital over time. For further details regarding our 2016 performance as it relates to return on equity, refer to "Financial Highlights of Results for Years Ended December 31, 2016, 2015, and 2014" in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations." of this Form 10-K.

Furthermore, Financial Strength Ratings play a significant role in insurance purchasing recommendations by our distribution partners and in decision-making by our customers. Distribution partners generally recommend higher rated carriers to limit their liability for error and omission claims, and customers often have minimum insurer rating requirements in loan and other banking covenants securing real and personal property. Our Insurance Subsidiaries’ ratings by major rating agency are as follows:

Rating Agency	Financial Strength Rating	Outlook
A.M. Best	A	Stable

Standard & Poor's Global Ratings ("S&P")	A	Stable
Moody's Investors Services ("Moody's")	A2	Stable
Fitch Ratings ("Fitch")	A+	Stable

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

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

Segments

We classify our business into four reportable segments, which are as follows:

- Standard Commercial Lines, which is comprised of insurance products and services provided in the standard marketplace to commercial enterprises, which are typically businesses, non-profit organizations, and local government agencies. This business represents 78% of our total insurance segments' NPW and is sold in 22 Eastern and Midwestern states and the District of Columbia.

- Standard Personal Lines, which is comprised of insurance products and services provided primarily to individuals acquiring coverage in the standard marketplace. This business represents 13% of our total insurance segments' NPW and is primarily sold in 13 Eastern and Midwestern states and the District of Columbia. Standard Personal Lines includes flood insurance coverage. We are the sixth largest writer of this coverage through the National Flood Insurance Program ("NFIP") and write flood business in all 50 states and the District of Columbia.

- E&S Lines, which is comprised of insurance products and services provided to customers who have not obtained coverage in the standard marketplace. We currently only write commercial lines E&S coverages and this business represents 9% of our total insurance segments' NPW and is sold in all 50 states and the District of Columbia.

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

We derive substantially all of our income in three ways:

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

- Net investment income from the investment segment. We generate income from investing insurance premiums and amounts generated through our capital management strategies. Net investment income consists primarily of: (i) interest earned on fixed income investments and preferred stocks; (ii) dividends earned on equity securities; and (iii) other income primarily generated from our alternative investment portfolio.

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

Our income is partially offset by: (i) expenses at the Parent that include general corporate expenses, as well as interest on our debt obligations; and (ii) federal income taxes.

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

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

Our operations are heavily regulated by the state insurance regulators in the states in which our Insurance Subsidiaries are organized and licensed or authorized to do business. In these states, the Insurance Subsidiaries are required to file financial statements prepared in accordance with SAP, which are promulgated by the National Association of Insurance Commissioners ("NAIC") and adopted by the various states. Because of these state insurance regulatory requirements, we use SAP to manage our insurance operations. The purpose of these state insurance regulations is to protect policyholders, so SAP focuses on solvency and liquidation value unlike GAAP, which focuses on shareholder returns as a going concern. Consequently, significant differences exist between GAAP and SAP as discussed below:

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

- With regard to income or expense recognition:

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

- Deferred taxes are recognized as either a deferred tax expense or a deferred tax benefit in income under GAAP; whereas they are recorded directly to surplus under SAP.

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

- With regard to loss and loss expense reserves:

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

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

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

($ in thousands)	2016	2015
GAAP losses and loss expense reserves – net	$3,691,719	3,517,728
Statutory reinsurance recoverable on unpaid losses and loss expenses	(616,700)	(556,719)
Structured settlements	(12,127)	(9,104)
Statutory losses and loss expense reserves	$3,062,892	2,951,905

The following table reconciles reinsurance recoverables under GAAP and SAP at December 31:

($ in thousands)	2016	2015
GAAP reinsurance recoverable – net	$621,537	561,968
Reinsurance recoverable on paid losses and loss expenses	(10,337)	(10,949)
GAAP reinsurance recoverable on unpaid losses and loss expenses	611,200	551,019
Provision for uncollectible reinsurance	5,500	5,700

Statutory reinsurance recoverable on unpaid losses and loss expenses	$616,700	556,719

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

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

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- Regarding unrealized gains and losses on fixed income securities:

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

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

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

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

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

	Years ended December 31,			
($ in thousands)	2016		2015	2014
Combined Insurance Segments Results				
NPW	$2,237,288		2,069,904	1,885,280
NPE	$2,149,572		1,989,909	1,852,609
Losses and loss expenses incurred	1,234,797		1,148,541	1,157,501
Net underwriting expenses incurred	759,194		686,120	610,783
Policyholder dividends	3,648		6,219	6,182
Underwriting income	$151,933		149,029	78,143
Ratios:				
Loss and loss expense ratio	57.4	%	57.7	62.5
Underwriting expense ratio	35.3		34.5	33.0
Policyholder dividends ratio	0.2		0.3	0.3
GAAP combined ratio	92.9	%	92.5	95.8
Statutory combined ratio	91.8	%	92.4	95.7

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

Insurance Segments

Overview

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

To that end, we establish losses and loss expense reserves that are estimates of the amounts that we will need to pay in the future for claims and related expenses for insured losses that have already occurred. Estimating reserves as of any given date involves a considerable degree of judgment and is inherently uncertain. We regularly review our reserving techniques and our overall amount of reserves. For disclosures concerning our unpaid losses and loss expenses, as well as a full discussion regarding our loss reserving process, see "Critical Accounting Policies and Estimates" in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations." of this Form 10-K. Additionally, for an analysis of changes in our loss reserves over the most recent three-year period, see Note 9. "Reserves for Losses and Loss Expenses" in Item 8. "Financial Statements and Supplementary Data." of this Form 10-K.

As part of our risk management efforts associated with the sale of our products and services, we use reinsurance to protect our capital resources and insure us against losses on the risks that we underwrite. We use two main reinsurance vehicles: (i) a reinsurance pooling agreement among our Insurance Subsidiaries in which each company agrees to share in premiums and losses based on certain specified percentages; and (ii) reinsurance contracts and arrangements with third parties that cover various policies that we issue to our customers. For information regarding reinsurance treaties and agreements, see "Reinsurance" in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations." of this Form 10-K.

Insurance Segments Products and Services
The types of insurance we sell in our insurance segments fall into three broad categories:

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

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

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

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

Types of Policies	Category of Insurance	Standard Commercial Lines	Standard Personal Lines	E&S Lines
Commercial Property (including Inland Marine)	Property	X		X
Commercial Automobile	Property/Casualty	X		X
	Casualty	X		X

General Liability (including Excess Liability/Umbrella)			
Workers Compensation	Casualty	X	
Businessowners' Policy	Property/Casualty	X	
Bonds (Fidelity and Surety)	Casualty	X	
Homeowners	Property/Casualty		X
Personal Automobile	Property/Casualty		X
Personal Umbrella	Casualty		X
Flood[1]	Flood/Property	X	X

[1]Flood insurance premiums and losses are 100% ceded to the Federal Government’s WYO Program. Certain other policies contain minimal flood or flood related coverages.

Product Development and Pricing

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

Customers and Customer Markets

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

	Percentage of Standard Commercial Lines	Description
Contractors	35%	General contractors and trade contractors
Mercantile and Services	26%	Focuses on retail, office, service businesses, restaurants, golf courses, and hotels
Community and Public Services	20%	Focuses on public entities, social services, and religious institutions
Manufacturing and Wholesale	18%	Includes manufacturers, wholesalers, and distributors
Bonds	1%	Includes fidelity and surety
Total Standard Commercial Lines	100%	

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

The following are general guidelines that can be used as indicators of the approximate size of our customers:
- The average Standard Commercial Lines account size is approximately $11,000.
- The average Standard Personal Lines account size is approximately $2,000.
- The average E&S Lines policy is approximately $3,000.

Although our average E&S Lines policy size is approximately $3,000, we have recently expanded into the wholesale brokerage business and therefore expect this average policy size to increase gradually over time.

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

Geographic Markets

We principally sell in the following geographic markets:

- Standard Commercial Lines products and services are primarily sold in 22 states located in the Eastern and Midwestern regions of the United States and the District of Columbia. In 2017, we also plan on expanding into the

Southwest region of the United States.

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

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

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

	Years ended December 31,			
% of NPW	2016		2015	2014
New Jersey	20.2	%	21.2	22.6
Pennsylvania	11.8		11.7	11.4
New York	7.8		7.2	7.1
Maryland	5.4		5.4	5.6
Virginia	4.6		4.6	4.6
Georgia	4.3		4.1	3.8
Indiana	3.9		4.3	4.5
North Carolina	3.9		3.7	3.4
Illinois	3.6		3.7	4.0
Michigan	3.3		3.5	3.3
South Carolina	3.1		3.0	3.1
Massachusetts	2.9		2.8	2.7
Other states	25.2		24.8	23.9
Total	100.0	%	100.0	100.0

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

Region	Office Location
Heartland	Carmel, Indiana
New Jersey	Hamilton, New Jersey
Northeast	Branchville, New Jersey
Mid-Atlantic	Allentown, Pennsylvania and Hunt Valley, Maryland
Southern	Charlotte, North Carolina
E&S	Horsham, Pennsylvania and Scottsdale, Arizona

We recently established a Southwest region in anticipation of expanding our geographic footprint for Standard Commercial Lines. We currently expect to start writing premium in Arizona in the latter half of 2017 and may consider opening up more states in the Southwest region. In addition, we also expect to start writing business in New Hampshire in the latter half of 2017. These new states leverage our current operating model, which is predicated around our field-based underwriting, franchise distribution model, and excellent customer service. Over time, we currently expect to expand into additional states.

Distribution Channel

We sell our insurance products and services through the following types of distribution partners:

- Standard Commercial Lines: independent retail agents;

- Standard Personal Lines: independent retail agents; and

- E&S Lines: wholesale general agents and brokers.

We pay our distribution partners commissions that are based on a percentage of gross premiums written, and in some cases are further based on profit calculations, and other consideration for business placed with us. We seek to compensate them fairly and in a manner consistent with market practices. No one distribution partner is responsible for 10% or more of our combined insurance segments' premium.

As our customers rely heavily on our distribution partners, it is sometimes difficult to develop brand recognition as these customers cannot always differentiate between their insurance agents and their insurance carriers. We continue to evolve our service model, post policy-acquisition, with an increasing focus on the customer. Our goal is to provide our customers with 24/7 access to transactional capabilities and account information. Customers expect this level of access from every business and, while many insurers offer such solutions in the personal lines space, we want to be a leader in this area for the small commercial lines market. When combined with our digital strategy, we believe this level of access will significantly improve the customer experience. Within our digital strategy, we provide self-servicing capabilities via a mobile application and a web-based portal where our customers have access to basic account information on demand. These efforts will allow us to continue to offer customers a shared experience with our distribution partners, while positioning us to more directly demonstrate our value proposition.

Independent Retail Agents

According to a study released in 2016 by the Independent Insurance Agents & Brokers of America, independent retail insurance agents and brokers write approximately 80% of standard commercial lines insurance and 35% of standard personal lines insurance in the United States. We believe that independent retail insurance agents will remain a significant force in overall insurance industry premium production because they represent more than one insurance carrier and therefore are able to provide a wider choice of commercial and personal lines insurance products and risk-based consultation to customers.

We currently have approximately 1,180 independent retail agents selling our Standard Commercial Lines business, 710 of which also sell our Standard Personal Lines business (excluding flood). In total, these 1,180 distribution partners have approximately 2,200 office locations selling our business. In addition, we have approximately 5,600 distribution partners selling our flood insurance products.

In a 2016 survey, we received an overall satisfaction score of 8.76 out of 10 from our standard market distribution partners, which, we believe, highlighted their satisfaction with our products, the ease of reporting claims, and the professionalism and effectiveness of our employees.

Wholesale General Agents

E&S Lines are written almost exclusively through approximately 80 wholesale general agents and brokers with 205 office locations, who are our distribution partners in the E&S market, although we recently expanded into the wholesale brokerage business. We have granted contract binding authority to these partners for business that meets our prescribed underwriting and pricing guidelines.

Marketing

Our primary marketing strategy is to:

- Use an empowered field underwriting model to provide our Standard Commercial Lines retail distribution partners with resources within close geographic proximity to their businesses and our customers. For further discussion on this, see the “Field Model and Technology” section below.
- Develop close relationships with each distribution partner, as well as their principals and producers: (i) by soliciting their feedback on products and services; (ii) by advising them concerning our product developments; and (iii) through education and development focusing on producer recruitment, sales training, enhancing customer experience, online marketing, and distribution operations.
- Develop with each distribution partner, and then carefully monitor, annual goals regarding: (i) types and mix of risks placed with us; (ii) amount of premium or number of policies placed with us; (iii) customer service and retention levels; and (iv) profitability of business placed with us.
- Develop brand recognition with our customers through our marketing efforts, which include radio and television advertising, as well as advertising at certain national and local sporting events.

Field Model and Technology

We use the service mark “High-tech x High-touch = HT^{2} $^{\text{SM}}$” to describe our business strategy. “High-tech” refers to our technology that we use to make it easy for our distribution partners and customers to do business with us. “High-touch” refers to the close relationships that we have with our distribution partners and customers through our field business model.

High Tech

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

- Our distribution partners and customers with access to accurate business information and the ability to process certain transactions from their locations, seamlessly integrating those transactions into our systems;

- Our underwriters with targeted underwriting and pricing tools to enhance profitability while growing the business;

- Our workers compensation claims adjusters with predictive tools to indicate when claims are likely to escalate;
- Our Special Investigations Unit ("SIU") investigators access to our business intelligence systems to better identify claims with potential fraudulent activities;
- Our claims recovery and subrogation departments with the ability to expand and enhance their models through the use of our business intelligence systems; and
- Our customers with 24/7 access to transactional capabilities and information through a web-based customer portal and a customer mobile application.

In 2016, we received the following awards:

- NetVu Automation Excellence Award, which recognizes carriers that make it easier for agencies to do business;
- ACORD Leadership Award, which is presented to an organization or an individual demonstrating leadership in the areas of standards development, advocacy, and/or implementation. It recognizes carriers that are guiding the insurance industry towards greater clarity in the sharing of insurance data; and
- IIBA Leadership Excellence in the Advancement of the Practice of Business Analysis, which is presented annually to a company that adapts, optimizes, and evolves business analysis best practices and standards by implementing effective tools, processes, and methodologies that enable better business capabilities.

We manage our information technology projects through an Enterprise Project Management Office (“EPMO”) governance model. The EPMO is supported by certified project managers who apply methodologies to: (i) communicate project management standards; (ii) provide project management training and tools; (iii) manage projects; (iv) review project status and cost; and (v) provide non-technology project management consulting services to the rest of the organization. The EPMO, which includes senior management representatives from all major business areas, corporate functions, and information technology, meets regularly to review all major initiatives and receives reports on the status of other projects. We believe the EPMO is an important factor in the success of our technology implementation.

Our primary technology operations are located in Branchville, New Jersey and Glastonbury, Connecticut. We have agreements with multiple consulting, information technology, and service providers for supplemental staffing services. Collectively, these providers supply approximately 54% of our skilled technology capacity and are principally based in the U.S., although we do contract with some service providers who are based, or utilize resources, outside the U.S. We retain management oversight of all projects and ongoing information technology production operations. We believe we would be able to manage an efficient transition to new vendors without significant impact to our operations if we terminated an existing vendor.

High Touch

To support our distribution partners, we employ a field model for both underwriting and claims, with various employees in the field, usually working from home offices near our distribution partners. We believe that we build better and stronger relationships with our distribution partners because of the close proximity of our field employees, and the resulting direct interaction with our distribution partners and customers. At December 31, 2016, we had approximately 2,250 employees, of which 310 worked in the field, 870 worked in one of our regional offices, and the remainder worked in our corporate office.

Underwriting Process

Our underwriting process requires communication and interaction among:

- Our Regions, which establish and execute upon: (i) annual premium and pricing goals; (ii) specific new business targets by distribution partner; and (iii) profit improvement plans as needed across lines, states, and/or distribution partners;
- Our corporate underwriting department, which develops our underwriting appetite, products, policy forms, pricing, and underwriting guidelines for our standard market and E&S market business;
- Our corporate actuaries who assist in the determination of rate and pricing levels, while monitoring pricing and profitability along with the Regions, corporate underwriting department, and business intelligence staff for our standard market and with E&S market business;

- Our distribution partners, which include independent retail agents for our standard market business and wholesale general agents for our E&S market business, that provide front-line underwriting within our prescribed guidelines;
- Our Agency Management Specialists (“AMSs”), who: (i) manage the growth and profitability of business that their assigned distribution partners write with us; and (ii) perform field underwriting for new Standard Commercial Lines business;
- Our territory managers who have oversight of the AMS production team, ensure that: (i) annual profit and growth plans are developed on a state by state basis; (ii) the achievement of these state plans are monitored at the state, AMS territory and account level; and (iii) individual agency plans are developed and monitored for achievement annually.
- Our Standard Commercial Lines small business teams that are responsible for handling: (i) new business in need of review that was submitted by our distribution partners through our automated underwriting platform, One & Done®; and (ii) other new small accounts and middle market accounts with low underwriting complexity;
- Our Safety Management Specialists (“SMSs”), who provide a wide range of front-line safety management services to our Standard Commercial Lines customers as discussed more fully below;
- Our regional underwriters, who manage the in force policies for their assigned distribution partners, including, but not limited to, managing profitability and pricing levels within their portfolios by developing policy-specific pricing;
- Our premium auditors, who supplement the underwriting process by working with insureds to accurately audit exposures for certain policies that we write;
- Our field technical coordinators, who are responsible for technology assistance and training to aid our employees and distribution partners;
- Our Standard Personal Lines Marketing Specialists (“PLMSs”), who have primary responsibility for identifying new opportunities to grow our Standard Personal Lines; and
- Our E&S territory managers, who have primary responsibility for identifying new opportunities to grow our E&S Lines.

We have an underwriting service center (“USC”) located in Richmond, Virginia. The USC assists our distribution partners by servicing certain Standard Personal Lines and smaller Standard Commercial Lines accounts. At the USC, many of our employees are licensed agents who respond to customer inquiries about insurance coverage, billing transactions, and other matters. For the convenience of using the USC and our handling of certain transactions, our distribution partners agree to receive a slightly lower than standard commission for the premium associated with the USC. As of December 31, 2016, our USC was servicing Standard Commercial Lines NPW of $51.8 million and Standard Personal Lines NPW of $28.5 million. The $80.3 million total serviced by the USC represents 4% of our total NPW.

As mentioned above, our field model provides a wide range of front-line safety management services focused on improving a Standard Commercial Lines insured’s safety and risk management programs. Our service mark “Safety Management: Solutions for a safer workplace℠ includes: (i) risk evaluation and improvement surveys intended to evaluate potential exposures and provide solutions for mitigation; (ii) internet-based safety management educational resources, including a large library of coverage-specific safety materials, videos and online courses, such as defensive driving and employee educational safety courses; (iii) thermographic infrared surveys aimed at identifying electrical hazards; and (iv) Occupational Safety and Health Administration construction and general industry certification training. Risk improvement efforts for existing customers are designed to improve loss experience and policyholder retention through valuable ongoing consultative service. Our safety management goal is to work with our customers to identify, mitigate, and eliminate potential loss exposures.

Claims Management

Effective, fair, and timely claims management is one of the most important services that we provide to our customers and distribution partners. It is also one of the critical factors in achieving underwriting profitability. We have structured our claims organization to emphasize: (i) cost-effective delivery of claims services and control of losses and loss expenses; and (ii) maintenance of timely and adequate claims reserves. In connection with our Standard Commercial Lines and Standard Personal Lines, we achieve better claim outcomes through a field model that locates claim representatives in close proximity to our customers and distribution partners.

We have a claims service center ("CSC"), co-located with the USC, in Richmond, Virginia. The CSC receives first notices of loss from our customers and claimants related to our Standard Commercial Lines and Standard Personal Lines and manages routine automobile and property claims with no injuries. The CSC is designed to help: (i) reduce the claims settlement time on first- and third-party automobile property damage claims; (ii) increase the use of body shops, glass repair shops, and car rental agencies that have contracted with us at discounted rates and specified service levels; (iii) handle and settle small property claims; and (iv) investigate and negotiate auto liability claims. The CSC, as appropriate, will assign claims to the appropriate regional claims office or other specialized area within our claims organization.

Claims Management Specialists ("CMSs") are responsible for investigating and resolving the majority of our standard marketplace commercial automobile bodily injury, general liability, and property losses with low severities. We also have Property Claims Specialists ("PCSs") to handle property claims with severities ranging from $5,000 to $100,000. Strategically located throughout our footprint, CMSs and PCSs are able to provide highly responsive customer and distribution partner service to quickly resolve claims within their authority.

Our E&S claims processing is consistent with our Standard Commercial Lines and Standard Personal Lines claims processing. E&S claims are handled in our standard lines regional offices and are segregated by line of business (property and liability), litigation, and complexity. Our Quality Assurance Unit conducts monthly file reviews on all of our operations to validate compliance with our quality claim handling standards. Complex claims oversight is handled by the Complex Claims Unit ("CCU").

We have implemented specialized claims handling as follows:

- Liability claims with high severity or technically complex losses are handled by the CCU. The CCU specialists are primarily field based and handle losses based on injury type or with severities greater than $250,000.

- Litigated matters not meeting the CCU criteria are handled within our regional offices by our litigation claim units. These teams are aligned based upon jurisdictional knowledge and technical experience. In addition, they are supervised by litigation managers within the regional claim offices. These claims are segregated from the CMSs to allow for focused management.

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

- Low severity/high volume property claims are handled by the CSC. Certain complex claims that do not involve structural damage (i.e. employee dishonesty and equipment breakdown losses) are handled by a small group of specialists in the CSC.

- The Large Loss Unit ("LLU") handles complex property claims, typically those in excess of $100,000.

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

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

All insurance segments are supported by the SIU that investigates potential insurance fraud and abuse, and supports efforts by regulatory bodies and trade associations to curtail the cost of fraud. We have developed a proprietary SIU fraud detection model that identifies the potential fraud cases early on in the life of the claim. The SIU adheres to uniform internal procedures to improve detection and take action on potentially fraudulent claims. It is our practice to notify the proper authorities of SIU findings, which we believe sends a clear message that we will not tolerate fraud against us or our customers. The SIU supervises anti-fraud training for all claims adjusters and AMSs.

Insurance Operations Competition

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

Standard Commercial Lines

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

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

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

Standard Personal Lines

Our Standard Personal Lines face competition primarily from the regional and national carriers noted above, as well as companies such as State Farm Mutual Automobile Insurance Company and Allstate Corporation. In addition, we face competition from direct insurers such as The Government Employees Insurance Company and The Progressive Corporation, which primarily offer personal auto coverage and market through a direct-to-consumer model.

E&S Lines

Our E&S Lines face competition from the E&S subsidiaries of the regional and national carriers named above, as well as the following companies:

- Nautilus Insurance Group, a member of W. R. Berkley Company;
- Colony Specialty, a member of the Argo Group International Holding Ltd;
- Western World Insurance Group, a member of the Validus Group;
- Century Insurance Group, a member of the Meadowbrook Insurance Group;
- The Burlington Insurance Company, a member of IFG Companies;
- United States Liability Insurance Group, a member of Berkshire Hathaway, Inc.;
- Scottsdale Insurance Company, a member of Nationwide Mutual Insurance Company; and
- Markel Corporation.

Other

In addition, both existing competitors and new industry participants are developing new platforms that are leveraging technology and the Internet to provide a low cost "direct to the customer" model. New competitors emerging under this digital platform include, but are not limited to, Lemonade, Attune, and Metromile. Many of these new entrants have significant financial backing. Further, reinsurers have entered certain primary property and casualty insurance markets to diversity their operations and compete with us.

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Industry Comparison

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

	Simple Average of All Periods Presented	2016	2015	2014	2013	2012
Insurance Operations Ratios:[1]						
Loss and loss expense	62.5 %	57.4	57.7	62.4	64.5	70.7
Underwriting expense	33.4	34.2	34.4	33.0	32.8	32.6
Policyholder dividends	0.2	0.2	0.3	0.3	0.2	0.2
Statutory combined ratio	96.2	91.8	92.4	95.7	97.5	103.5
Growth in NPW	8.6	8.1	9.8	4.1	8.7	12.2
Industry Ratios:[1, 2]						
Loss and loss expense	70.7	73.0	69.8	69.3	67.7	73.7
Underwriting expense	27.7	27.1	27.8	27.4	28.0	28.2
Policyholder dividends	0.7	0.6	0.7	0.7	0.7	0.6
Statutory combined ratio	99.1	100.7	98.3	97.4	96.4	102.5
Growth in NPW	3.8	2.7	3.3	4.3	4.4	4.4
Favorable (Unfavorable) to Industry:						
Statutory combined ratio	2.9	8.9	5.9	1.7	(1.1)	(1.0)
Growth in NPW	4.8	5.4	6.5	(0.2)	4.3	7.8

Note: Some amounts may not foot due to rounding.

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

[2]Source: A.M. Best. The industry ratios for 2016 have been estimated by A.M. Best.

Insurance Regulation

Primary Oversight by the States in Which We Operate

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

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

NAIC Monitoring Tools

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

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

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- Risk-Based Capital. Risk-based capital is measured by four major areas of risk to which property and casualty insurers are exposed: (i) asset risk; (ii) credit risk; (iii) underwriting risk; and (iv) off-balance sheet risk. Insurers face a steadily increasing amount of regulatory scrutiny and potential intervention as their total adjusted capital declines below two times their "Authorized Control Level". Based on our 2016 statutory financial statements, which have been prepared in accordance with SAP, the total adjusted capital for each of our Insurance Subsidiaries substantially exceeded two times their Authorized Control Level.

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

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

In addition to the formal regulation above, we are subject to capital adequacy monitoring by rating agencies, for example, Best's Capital Adequacy Ratio ("BCAR"). BCAR, which was developed by A.M. Best, examines an insurer's leverage, underwriting activities, and financial performance.

Federal Regulation

Notable federal legislation and administrative policies that affect the insurance industry are:

- The Terrorism Risk Insurance Program Reauthorization Act ("TRIPRA");
- The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”); and
- Various privacy laws that apply to us because we have personal non-public information, including the:

Gramm-Leach-Bliley Act;
Fair Credit Reporting Act;
Drivers Privacy Protection Act; and
Health Insurance Portability and Accountability Act.

Like all businesses, we are required to enforce the economic and trade sanctions of the Office of Foreign Assets Control (“OFAC”).

FEMA oversees the WYO Program enacted by Congress. Congress sets the WYO Program's budgeting, rules, and rating parameters. Two significant pieces of legislation that impact the WYO Program are the Biggert-Waters Flood Insurance Reform Act of 2012 ("Bigger-Waters Act") and the Homeowner Flood Insurance Affordability Act of 2014 ("Flood Affordability Act"). The Biggert-Waters Act: (i) extended the NFIP funding to September 30, 2017; and (ii) moved the program to more market based rates for certain flood policies. The Flood Affordability Act repealed and modified certain provisions in the Biggert-Waters Act regarding premium adjustments. The NFIP authorization expires on September 30, 2017. Congress has been considering options to the NFIP and it is expected that the program will be extended.

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

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

The FIO, the Federal Reserve, state regulators, and other regulatory bodies have been developing models for capital standards, negotiating a covered agreement on reinsurance collateral, and have been gathering data as required under the Dodd-Frank Act. Changes to the Dodd-Frank Act and FIO are expected in 2017 as the Trump Administration and the Republican Congress seek opportunities to pare down the Dodd-Frank Act and its regulations. For additional information on the potential impact of the Dodd-Frank Act, refer to the risk factor related to this legislation within Item 1A. "Risk Factors." of this Form 10-K.

International Regulation
We believe that development of global capital standards will influence the development of similar standards by domestic regulators. Notable international developments include the following:

- In 2014, the International Association of Insurance Supervisors proposed Basic Capital Standards for Global Systemically Important Insurers as well as a uniform capital framework for internationally active insurers; and

- The European Union enacted Solvency II, which sets out new requirements on capital adequacy and risk management for insurers operating in Europe, which was implemented in 2016.

For additional information on the potential impact of international regulation on our business, refer to the risk factor related to regulation within Item 1A. "Risk Factors." of this Form 10-K.

Investment Segment
Our Investment segment invests insurance premiums, as well as amounts generated through our capital management strategies, which may include the issuance of debt and equity securities, to generate investment income and to satisfy obligations to our customers, our shareholders, and our debt holders, among others. At December 31, 2016, our investment portfolio consisted of the following:

Category of Investment ($ in millions, except invested assets per dollar of stockholders' equity)	Carrying Value	% of Investment Portfolio
Fixed income securities	$ 4,894.1	92
Equity securities	146.7	2
Short-term investments	221.7	4
Other investments, including alternatives	102.4	2
Total	$ 5,364.9	100
Invested assets per dollar of stockholders' equity	$ 3.50	

Our investment philosophy includes certain return and risk objectives for the fixed income, equity, and other investment portfolios. After-tax yield and income generation are key drivers to our investment strategy, which has historically been balanced with a long-term "buy-and-hold," low turnover approach.

During 2016, we determined that a more active management approach to our investment portfolio was appropriate to maximize the risk-adjusted after-tax income and total return of the portfolio, while maintaining a similar level of credit quality and duration risk. We evaluated our previous buy-and-hold low turnover approach in the context of the current market environment, and concluded that a change was appropriate to more effectively diversify, navigate, and manage the portfolio in response to a persistently low and volatile interest rate environment, the potential for rising inflation, and an uncertain political and tax landscape.

To execute on this revised approach, we hired several new investment managers who were on-boarded in the fourth quarter of 2016. We modestly increased our exposure to below investment grade fixed income securities, private equity, and private credit strategies to further diversify our allocation within risk assets, which principally includes public equities, high-yield fixed income securities, and private equity, in conjunction with repositioning the portfolio to a long-term target risk asset allocation of approximately 10% of total invested assets. While our approach to managing the investment portfolio has changed, our core investment philosophy has not changed. We remain focused on diversification, capital preservation, investment quality, and liquidity to meet our needs and obligations.

For further information regarding our risks associated with the overall investment portfolio, see Item 7A. “Quantitative and Qualitative Disclosures About Market Risk.” and Item 1A. “Risk Factors.” of this Form 10-K. For additional information about investments, see the section entitled, “Investments,” in Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” and Item 8. “Financial Statements and Supplementary Data.” Note 5. of this Form 10-K.

Reports to Security Holders

We file with the SEC all required disclosures, including our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Proxy Statements, and other required information under Sections 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended ("Exchange Act"). We provide access to these filed materials on our Internet website, www.Selective.com.

Item 1A. Risk Factors.

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

In an effort to highlight recent trends that may impact our business, we have identified risk factors impacted by: (i) potential changes to the U.S. federal tax code; (ii) other impacts of the Presidential election and Republican Congress; and (iii) other evolving legislation. Following these sections are the ongoing risks that continue to impact our business segments, as well as our corporate structure and governance.

U.S. Federal Tax Code

Changes in tax legislation initiatives could adversely affect our results of operations and financial condition.
We are subject to the tax laws and regulations of U.S. federal, state, and local governments, which may be amended in ways that adversely impact us. Recently, there has been significant debate about reform of the current U.S. federal tax code. Although some reform proposals may be beneficial to the insurance industry overall, we cannot predict what impact any enacted reform proposals could have on our results of operations, liquidity, financial condition, financial strength, and debt ratings. For example, if the existing U.S. federal corporate income tax rate is reduced from its current 35%, any deferred tax assets would be reduced and we would likely be required to recognize a reduction of a previously-recognized federal tax benefit in the period when enacted. This and other potential tax rule changes may increase or decrease our actual tax expense and could materially and adversely affect our results of operations. If the corporate tax rate is reduced to between 15% and 20%, we would be required to record a non-cash write off of deferred tax assets to income of approximately $36 million to $49 million.

Recent tax reform proposals have included border adjustment provisions that could tax imports of products and services from foreign states. Some proposals call for significant tariffs. We have agreements for products and services with foreign domiciled companies, such as information technology services. In addition, risk transfer may or may not be included in the definition of products and services; therefore, our reinsurance treaties, many of which are with non-U.S. reinsurance companies, may be impacted by any new proposals. If new taxes are imposed on these products and services, it is possible that our expenses for these items could increase, perhaps significantly. We cannot predict the impact such proposals could have on our products and services supplier relationships, results of operations, liquidity, financial condition, financial strength, and debt ratings if enacted.

Changes in tax legislation initiatives could adversely affect our investments results.

Amendments to the tax laws and regulations of U.S. federal, state, and local governments may adversely impact us. Our investment portfolio has benefited from tax exemptions and certain other tax laws, including, but not limited to, those governing dividends received deductions and tax-advantaged municipal bond interest. Future federal and/or state tax legislation could be enacted to lessen or eliminate some or all of these favorable tax advantages. This could negatively impact the value of our investment portfolio and, in turn, materially and adversely impact our results of operations.

If the recent renewed debate about revamping the current U.S. federal tax code results in enacted changes, it is possible that some changes may be beneficial to the insurance industry overall. We, however, cannot predict what impact such enacted proposals could have on our results of operations, liquidity, financial condition, financial strength, and debt ratings.

If we experience difficulties with outsourcing relationships, our ability to conduct our business might be negatively impacted.
We outsource certain business and administrative functions to third parties for efficiencies and cost savings, and may do so increasingly in the future. If we fail to develop and implement our outsourcing strategies or our third-party providers fail to perform as anticipated, we may experience operational difficulties, increased costs, and a loss of business that may have a material adverse effect on our results of operations or financial condition. Currently, we have agreements with multiple consulting, information technology, and service providers for supplemental staffing services. Collectively, these providers supply approximately 54% of our skilled technology capacity and are principally based in the U.S., although we do contract with some service providers who are based, or utilize resources, outside of the U.S. As mentioned above, the availability and cost of these services may be impacted by potential tax reform proposals.

Other Potential Impacts of the Presidential Election and the Republican Majority Congress

We are subject to the risk that legislation will be passed that significantly changes insurance regulation and adversely impacts our business, financial condition, and/or the results of operations.
In 2009, the Dodd-Frank Act was enacted to address corporate governance and control issues identified in the financial markets crises in 2008 and 2009 and issues identified in the operations of non-insurance subsidiaries of American International Group, Inc. The Dodd-Frank Act created the FIO as part of the U.S. Department of Treasury to advise the federal government on insurance issues. The Dodd-Frank Act also requires the Federal Reserve, through the Financial Services Oversight Council (“FSOC”), to supervise financial services firms designated as systemically important financial institutions ("SIFI"). The FSOC has not designated us as a SIFI. The Dodd-Frank Act also included a number of corporate governance reforms for publicly traded companies, including proxy access, say-on-pay, and other compensation and governance issues. Critics of the Dodd-Frank Act are proposing various reforms to the act, and it is possible that some provisions of the law may be modified to lessen regulatory burdens.

In general, the Trump Administration and the Republican Majority in Congress favor less federal involvement in insurance. It is possible, however, that there may be legislative proposals in Congress that could result in the federal government directly regulating the business of insurance. President Trump and the Republican Majority in Congress favor the repeal of the Affordable Care Act ("ACA"). Repeal of the law raises some legal and practical challenges. Some reform proposals include a provision to permit sales of insurance across state lines, which under current federal law cannot be sold across state lines without the approval of the respective state insurance regulators. As part of some ACA reform proposals, there are calls for the elimination of the anti-trust exemptions for health insurers under the McCarran-Ferguson Act. While we are not a health insurer, we and the property and casualty industry operate under anti-trust exemptions that permit the aggregation of claims and other data necessary under the law of large numbers to price insurance. If similar proposals related to the property and casualty industry were made and enacted, we would have to seek a business practices exemption from the Department of Justice to share information with other insurers. We cannot predict the impact such proposals, if enacted, could have on our product and services supplier relationships, results of operations, liquidity, financial condition, financial strength, and debt ratings.

There also are legislative and regulatory proposals in various states that seek to limit the ability of insurers to assess insurance risk. From time-to-time, proposals in various states seek to limit the ability of insurers to use certain factors or predictive measures in the underwriting of property and casualty risks. Among the proposed legislation and regulation have been limits on the use of insurance scores and marketplace considerations. These proposals, if enacted, could impact underwriting pricing and results.

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

Deterioration in the public debt and equity markets, the private investment marketplace, uncertainty regarding political developments and the economy could lead to investment losses, which may adversely affect our results of operations, financial condition, liquidity, and debt ratings.
Like most property and casualty insurance companies, we depend on income from our investment portfolio for a significant portion of our revenue and earnings. Our investment portfolio is exposed to significant financial and capital market risks, both in the U.S. and abroad, and volatile changes in general market or economic conditions could lead to a decline in the market value of our portfolio as well as the performance of the underlying collateral of our structured securities. Concerns over weak economic growth globally, elevated unemployment, volatile energy and commodity prices, and geopolitical issues, among other factors, contribute to increased volatility in the financial markets, increased potential for credit downgrades, and decreased liquidity in certain investment segments. In addition, President Donald J. Trump has proposed significant changes in United

States domestic and foreign policy. The uncertainty regarding these proposed changes, and whether they will be implemented, may elevate the volatility of the financial markets and adversely impact our investment portfolio.

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

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

Other Evolving Legislation

We face risks regarding our flood business because of uncertainties regarding the NFIP.
We are the sixth largest insurance group participating in the WYO arrangement of the NFIP, which is managed by the Mitigation Division of the Federal Emergency Management Agency ("FEMA") in the U.S. Department of Homeland Security. For WYO participation, we receive an expense allowance for policies written and a servicing fee for claims administered. Under the program, all losses are 100% reinsured by the Federal Government. Currently, the expense allowance is 30.9% of DPW. The servicing fee is the combination of 0.9% of DPW and 1.5% of incurred losses.

As a WYO carrier, we are required to follow certain NFIP procedures when administering flood policies and claims. Some of these requirements may differ from our normal business practices and may present a reputational risk to our brand. Insurance companies are regulated by states and the NFIP requires WYO carriers to be licensed in the states in which they operate. The NFIP, however, is a federal program and WYO carriers are fiscal agents of the U.S. Government and must follow the directives of the NFIP. Consequently, we have the risk that directives of the NFIP and a state regulator on the same issue may conflict.

There has been significant public policy and political debate regarding the NFIP and its outstanding debt, including the obtainment of reinsurance coverage for NFIP losses. In 2016, FEMA secured its first placement of reinsurance for the NFIP. In January 2017, FEMA expanded its September 2016 placement and transferred $1 billion of the NFIP's financial risk to reinsurers through January 1, 2018. In addition, there are several legislative proposals in Congress regarding NFIP reauthorization. The NFIP statute will expire on September 30, 2017, unless reauthorized by Congress. While it is possible that the NFIP program will be reauthorized with limited changes to the underlying structure, there is substantial uncertainty about the future of the program given the changing political environment. Our flood business could be impacted by: (i) any mandate for primary insurance carriers to provide flood insurance; or (ii) private writers becoming more prevalent in the marketplace. The uncertainty created by the public policy debate and politics of flood insurance reform make it difficult for us to predict the future of the NFIP and our continued participation in the program.

We are subject to attempted cyber-attacks and other cybersecurity risks.
Our business heavily relies on various information technology and application systems that are connected to, or may be accessed from, the Internet and may be impacted by a malicious cyber-attack. Our systems also contain confidential and proprietary information regarding our operations, our employees, our agents, and our customers and their employees and property, including personally identifiable information. We have developed and invested, and expect to continue to do both, in a variety of controls to prevent, detect, and appropriately react to such cyber-attacks,

including frequently testing our systems' security and access controls. Cyber-attacks continue to become more complex and broad ranging and our internal controls provide only a reasonable, not absolute, assurance that we will be able to protect ourselves from significant cyber-attack incidents. By outsourcing certain business and administrative functions to third parties, we may be exposed to enhanced risk of data security breaches. Any breach of data security could damage our reputation and/or result in monetary damages, which, in turn, could have a material adverse effect on our results of operations, liquidity, financial condition, financial strength, and debt ratings. Although we have not experienced a material cyber-attack, it is possible that might occur. We have insurance coverage for certain cybersecurity risks, including privacy breach incidents, that provides protection up to $20 million above a deductible of $250,000.

Given the increased number of identity thefts from cyber-attacks, federal and state policymakers have proposed, and will likely continue to propose, increased regulation of the protection of personally identifiable information and the steps to be followed after a related cybersecurity breach. Compliance with these regulations and efforts to address continuingly developing cybersecurity risks may result in a material adverse effect on our results of operations, liquidity, financial condition, financial strength, and debt ratings.

Risks Related to our Insurance Segments

Our loss and loss expense reserves may not be adequate to cover actual losses and expenses.
We are required to maintain loss and loss expense reserves for our estimated liability for losses and loss expenses associated with reported and unreported insurance claims. Our estimates of reserve amounts are based on facts and circumstances that we know, including our expectations of the ultimate settlement and claim administration expenses, including inflationary trends particularly regarding medical costs, predictions of future events, trends in claims severity and frequency, and other subjective factors relating to our insurance policies in force. There is no method for precisely estimating the ultimate liability for settlement of claims. We cannot be certain that the reserves we establish are adequate or will be adequate in the future. From time-to-time, we increase reserves if they are inadequate or reduce them if they are redundant. An increase in reserves: (i) reduces net income and stockholders’ equity for the period in which the reserves are increased; and (ii) could have a material adverse effect on our results of operations, liquidity, financial condition, financial strength, and debt ratings.

We are subject to losses from catastrophic events.
Our results are subject to losses from natural and man-made catastrophes, including, but not limited to: hurricanes, tornadoes, windstorms, earthquakes, hail, terrorism, explosions, severe winter weather, floods, and fires, some of which may be related to climate changes. The frequency and severity of these catastrophes are inherently unpredictable. One year may be relatively free of such events while another may have multiple events. For further discussion regarding man-made catastrophes that relate to terrorism, see the risk factor directly below regarding the potential for significant losses from acts of terrorism.

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

The magnitude of catastrophe losses is determined by the severity of the event and the total amount of insured exposures in the area affected by the event as determined by ISO's Property Claim Services unit. Most of the risks underwritten by our insurance segments are concentrated geographically in the Eastern and Midwestern regions of the country. In 2016, approximately 20% of NPW were related to insurance policies written in New Jersey. Catastrophes in the Eastern and Midwestern regions of the United States could adversely impact our financial results, as was the case in 2010, 2011, and 2012.

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

We are subject to potentially significant losses from acts of terrorism.
As a Standard Commercial Lines and E&S Lines writer, we are required to participate in TRIPRA, which was extended by Congress to December 31, 2020. TRIPRA requires private insurers and the United States government to share the risk of loss on future acts of terrorism certified by the U.S. Secretary of the Treasury. Under TRIPRA, insureds with non-workers compensation commercial policies have the option to accept or decline our terrorism coverage or negotiate with us for other terms. In 2016, 89% of our Standard Commercial Lines non-workers compensation policyholders purchased terrorism coverage that included nuclear, biological, chemical, and radioactive ("NBCR") events. Terrorism coverage is mandatory for all primary workers compensation policies, so the TRIPRA back-stop applies to these policies. A risk exists that, if the U.S. Secretary of Treasury does not certify certain future terrorist events, we would be required to pay related covered losses without TRIPRA's risk sharing benefits. Examples of this potential risk are the 2013 Boston Marathon bombing and the 2015 shootings in San Bernardino, California, neither of which were certified as terrorism events.

Under TRIPRA, each participating insurer is responsible for paying a deductible of specified losses before federal assistance is available. This deductible is based on a percentage of the prior year’s applicable Standard Commercial Lines and E&S Lines premiums. In 2017, our deductible is approximately $304 million. For losses above the deductible, the federal government will pay 83% of losses to an industry limit of $100 billion, and the insurer retains 17%. The federal share of losses will be reduced by 1% each year to 80% by 2020. Although TRIPRA's provisions will mitigate our loss exposure to a large-scale terrorist attack, our deductible is substantial and could have a material adverse effect on our results of operations, liquidity, financial condition, financial strength, and debt ratings.

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

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

Our ability to reduce our risk exposure depends on the availability and cost of reinsurance.
We transfer a portion of our underwriting risk exposure to reinsurance companies. Through our reinsurance arrangements, a specified portion of our losses and loss expenses are assumed by the reinsurer in exchange for a specified portion of premiums. The availability, amount, and cost of reinsurance depend on market conditions, which may vary significantly. Most of our reinsurance contracts renew annually and may be impacted by the market conditions at the time of the renewal that are unrelated to our specific book of business or experience. Any decrease in the amount of our reinsurance will increase our risk of loss. Any increase in the cost of reinsurance that cannot be included in renewal price increases will reduce our earnings. Accordingly, we may be forced to incur additional expenses for reinsurance or may not be able to obtain sufficient reinsurance on acceptable terms. Either could adversely affect our ability to write future business or result in the assumption of more risk with respect to those policies we issue.

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

- Our reinsurers, who are obligated to us under our reinsurance agreements. Amounts recoverable from our reinsurers can increase quickly and significantly during periods of high catastrophe loss activity, such as in the fourth quarter of 2012 due to losses incurred from Superstorm Sandy, and thus our credit risk to our reinsurers can increase significantly and will fluctuate over time. The relatively small size of the reinsurance market and our objective to maintain an average weighted rating of "A" by A.M. Best on our current reinsurance programs constrains our ability to diversify this credit risk. However, some of our reinsurance credit risk is collateralized.

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

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

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

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

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

Difficult conditions in global capital markets and the economy may adversely affect our revenue and profitability and harm our business, and these conditions may not improve in the near future.
General economic conditions in the United States and throughout the world and volatility in financial and insurance markets may materially affect our results of operations. Factors such as business and consumer confidence, unemployment levels, consumer spending, business investment, government spending, the volatility and strength of the capital markets, and inflation all affect the business and economic environment and, indirectly, the amount and profitability of our business. During 2016, 34% of DPW in our Standard Commercial Lines business were based on payroll/sales of our underlying customers. An

economic downturn in which our customers decline in revenue or employee count can adversely affect our audit and endorsement premium in our Standard Commercial Lines.

Unfavorable economic developments could adversely affect our earnings if our customers have less need for insurance coverage, cancel existing insurance policies, modify coverage, or choose not to renew with us. Challenging economic conditions may impair the ability of our customers to pay premiums as they come due. Adverse economic conditions may have a material effect on our results of operations, liquidity, financial condition, financial strength, and debt ratings.

A downgrade or a potential downgrade in our financial strength or credit ratings could result in a loss of business and could have a material adverse effect on our financial condition and results of operations.
A significant financial strength rating downgrade, particularly from A.M. Best, would affect our ability to write new or renewal business with customers, some of whom are required under various third party agreements to maintain insurance with a carrier that maintains a specified minimum rating. In addition, our $30 million line of credit ("Line of Credit") requires our Insurance Subsidiaries to maintain an A.M. Best rating of at least “A-” (one level below our current rating) and a default could lead to acceleration of any outstanding principal. Such an event could trigger default provisions under certain of our other debt instruments and negatively impact our ability to borrow in the future. As a result, any significant downgrade in our financial strength ratings could have a material adverse effect on our results of operations, liquidity, financial condition, financial strength, and debt ratings. Refer to Item 1. "Business" for our current financial strength ratings.

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

NRSRO	Credit Rating	Long Term Credit Outlook
A.M. Best	bbb+	Stable
S&P	BBB	Stable
Moody’s	Baa2	Stable
Fitch	BBB+	Stable

Downgrades in our credit ratings could have a material adverse effect on our financial condition and results of operations in many ways, including making it more expensive for us to access capital markets. We cannot predict possible actions NRSROs may take regarding our ratings that could adversely affect our business or the possible actions we may take in response to any such actions.

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

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

- A pure price decline of approximately 1% would increase our statutory combined ratio by approximately 0.75 points;
- A 3% increase in our expected claim costs for the year would cause our loss and loss expense ratio to increase by approximately 1.75 points; and
- A combination of the two could raise the combined ratio by approximately 2.5 points.

We compete with regional, national, and direct-writer property and casualty insurance companies for customers, distribution partners, and employees. Some competitors are public companies and some are mutual companies. Many competitors are larger and may have lower operating costs and/or lower cost of capital. They may have the ability to absorb greater risk while maintaining their financial strength ratings. Consequently, some competitors may be able to price their products more competitively. These competitive pressures could result in increased pricing pressures on a number of our products and services, particularly as competitors seek to win market share, and may impair our ability to maintain or increase our profitability. Because of its relatively low cost of entry, the Internet has emerged as a significant place of new competition, both from existing competitors and new competitors. New competitors emerging under this digital platform include, but are not limited to, Lemonade, Attune, and Coverwallet. Additionally, reinsurers have entered certain primary property casualty insurance markets to diversify their operations and compete with us. Further new competition could cause changes in the supply or demand for insurance and adversely affect our business.

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

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

We are heavily regulated and changes in regulation may reduce our profitability, increase our capital requirements, and/or limit our growth.
Our Insurance Subsidiaries are heavily regulated by extensive laws and regulations that may change on short notice. The primary public policy behind insurance regulation is the protection of policyholders and claimants over all other constituencies, including shareholders. Historically by virtue of the McCarran-Ferguson Act, our Insurance

Subsidiaries are primarily regulated by the states in which they are domiciled and licensed. State insurance regulation is generally uniform throughout the U.S. by virtue of similar laws and regulations required by the NAIC to accredit state insurance departments so their examinations can be given full faith and credit by other state regulators. Despite their general similarity, various provisions of these laws and regulations vary from state to state. At any given time, there may be various legislative and regulatory proposals in each of the 50 states and District of Columbia that, if enacted, may affect our Insurance Subsidiaries.

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

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

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

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

Although Congress has largely delegated insurance regulation to the various states by virtue of the McCarran-Ferguson Act, we are also subject to federal legislation and administrative policies, such as disclosure under the securities laws, including the Sarbanes-Oxley Act and the Dodd-Frank Act, TRIPRA, OFAC, and various privacy laws, including the Gramm-Leach-Bliley Act, the Fair Credit Reporting Act, the Drivers Privacy Protection Act, the Health Insurance Portability and Accountability Act, and the policies of the Federal Trade Commission. As a result of issuing workers compensation policies, we are subject to Mandatory Medicare Secondary Payer Reporting under the Medicare, Medicaid, and SCHIP Extension Act of 2007.

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

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

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

Class action litigation could affect our business practices and financial results.
Our industry has been the target of class action litigation, including the following areas:

- After-market parts;
- Urban homeowner insurance underwriting practices, including those related to architectural or structural features and attempts by federal regulators to expand the Federal Housing Administration's guidelines to determine unfair discrimination;
- Credit scoring and predictive modeling pricing;
- Cybersecurity breaches;
- Investment disclosure;
- Managed care practices;
- Timing and discounting of personal injury protection claims payments;

- Direct repair shop utilization practices;
- Flood insurance claim practices; and
- Shareholder class action suits.

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

Risks Related to Our Investment Segment

We are exposed to interest rate risk in our investment portfolio.
We are exposed to interest rate risk primarily related to the market price, and cash flow variability, associated with changes in interest rates. A rise in interest rates may decrease the fair value of our existing fixed income investments and declines in interest rates may result in an increase in the fair value of our existing fixed income investments. Our fixed income investment portfolio, which currently has an effective duration of 3.8 years excluding short-term investments, contains interest rate sensitive instruments that may be adversely affected by changes in interest rates resulting from governmental monetary policies, domestic and international economic and political conditions, and other factors beyond our control. A rise in interest rates would decrease the net unrealized gain position of the investment portfolio, partially offset by our ability to earn higher rates of return on funds reinvested in new investments. Conversely, a decline in interest rates would increase the net unrealized gain position of the investment portfolio, partially offset by lower rates of return on new and reinvested cash in the portfolio. Changes in interest rates have an effect on the calculated duration of certain securities in the portfolio. We seek to mitigate our interest rate risk associated with holding fixed income investments by monitoring and maintaining the average duration of our portfolio with a view toward achieving an adequate after-tax return without subjecting the portfolio to an unreasonable level of interest rate risk. This may include investing in floating rate securities and other shorter duration securities that exhibit low effective duration and interest rate risk, but expose the portfolio to other risks, including the risk of a change in credit spreads, liquidity spreads, and other factors that may adversely impact the value of the portfolio. Although we take measures to manage the economic risks of investing in a changing interest rate environment, we may not be able to mitigate the interest rate risk of our assets relative to our liabilities, particularly our loss reserves. In addition, our pension and post-retirement benefit obligations include a discount rate assumption, which is an important element of expense and/or liability measurement. Changes in the discount rate assumption could materially impact our pension and post-retirement life valuation.

We are exposed to credit risk in our investment portfolio.
The value of our investment portfolio is subject to credit risk from the issuers and/or guarantors of the securities in the portfolio, other counterparties in certain transactions and, for certain securities, insurers that guarantee specific issuer’s obligations. Defaults by the issuer or an issuer’s guarantor, insurer, or other counterparties regarding any of our investments, could reduce our net investment income and net realized investment gains or result in investment losses. We are subject to the risk that the issuers, or guarantors, of fixed income securities we own may default on principal and interest payments due under the terms of the securities. At December 31, 2016, our fixed income securities portfolio represented approximately
92% of our total invested assets, of which approximately 97% were investment grade and 3% were below investment grade rated, resulting in an average credit rating of AA- of the fixed income securities portfolio. Over time, our exposure to below investment grade securities and other credit sensitive risk assets may fluctuate as we continue to diversify the portfolio and take advantage of opportunities to add or reduce risk commensurate with our risk-taking capacity and market conditions. The occurrence of a major economic downturn, acts of corporate malfeasance, widening credit spreads, budgetary deficits, municipal bankruptcies spurred by, among other things, pension funding issues, or other events that adversely affect the issuers or guarantors of these securities could cause the value of our fixed income securities portfolio and our net income to decline and the default rate of our fixed income securities

portfolio to increase.

With economic uncertainty, credit quality of issuers or guarantors could be adversely affected and a ratings downgrade of the issuers or guarantors of the securities in our portfolio could cause the value of our fixed income securities portfolio and our net income to decrease. As our stockholders' equity is leveraged at 3.5:1 to our investment portfolio, a reduction in the value of our investment portfolio could have a material adverse effect on our business, results of operations, financial condition, and debt ratings. Levels of write-downs are impacted by our assessment of the impairment, including a review of the underlying collateral of structured securities, and our intent and ability to hold securities that have declined in value until recovery. If we reposition or realign portions of the portfolio so that we determine not to hold certain securities in an unrealized loss position to recovery, we will incur an OTTI charge. For further information regarding credit and interest rate risk, see Item 7A. “Quantitative and Qualitative Disclosures About Market Risk.” of this Form 10-K.

Our statutory surplus may be materially affected by rating downgrades on investments held in our portfolio.
We are exposed to significant financial and capital markets risks, primarily relating to interest rates, credit spreads, equity prices, and the change in market value of our alternative investment portfolio. A decline in both income and our investment

portfolio asset values could occur as a result of, among other things, a decrease in market liquidity, fluctuations in interest rates, decreased dividend payment rates, negative market perception of credit risk with respect to types of securities in our portfolio, a decline in the performance of the underlying collateral of our structured securities, reduced returns on our alternative investment portfolio, or general market conditions. A global decline in asset values will be more amplified in our financial condition, as our statutory surplus is leveraged at a 3.4:1 ratio to our investment portfolio.

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

There can be no assurance that the actions of the U.S. Government, Federal Reserve, and other governmental and regulatory bodies will achieve their intended effect.
Over the past several years, the Federal Reserve has taken a number of actions related to interest rates and purchasing of financial instruments intended to spur economic recovery. The Federal Reserve's policy of quantitative easing and low interest rates since the financial crisis of 2008 have had an adverse effect on our investment income, as higher yielding securities mature and we reinvest the proceeds at lower yields. In December 2015 and again in December 2016, the Federal Reserve increased the Federal Fund Rate by 25 basis points each. It is unclear whether the Federal Reserve's economic stimulus actions will produce the desired results. The impact of these actions could materially and adversely affect our financial condition and the trading price of our common stock. In the event of future material deterioration in business conditions, we may need to raise additional capital or consider other transactions to manage our capital position.

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

We are subject to the types of risks inherent in investing in private limited partnerships.
Our other investments include investments in private limited partnerships that invest in various strategies, such as private equity, private credit, and real assets. Since these partnerships’ underlying investments consist primarily of assets or liabilities for which there are no quoted prices in active markets for the same or similar assets, the valuation of interests in these partnerships is subject to a higher level of subjectivity and unobservable inputs than substantially all of our other investments and as such, is subject to greater scrutiny and reconsideration from one reporting period to the next. As these investments are recorded under the equity method of accounting, any decreases in the valuation of these investments would negatively impact our results of operations. We currently expect to increase our allocation to these investments, which may result in additional variability in our net investment income.