SELECTIVE INSURANCE GROUP INC
Form 10-K
February 25, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2010
or

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

For the transition period from __________ to __________

Commission file number 001-33067

SELECTIVE INSURANCE GROUP, INC.
(Exact Name of Registrant as Specified in Its Charter)

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

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $2 per share	NASDAQ Global Select Market
7.5% Junior Subordinated Notes due September 27, 2066	New York Stock Exchange

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

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

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

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

Large accelerated filer 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 x 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 $774,466,983 on June 30, 2010. As of February 15, 2011, the registrant had outstanding 53,934,038 shares of common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for the 2011 Annual Meeting of Stockholders to be held on April 27, 2011 are incorporated by reference into Part III of this report.

SELECTIVE INSURANCE GROUP, INC.
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PART I

Item 1. Business.

Overview

Selective Insurance Group, Inc. (referred to as the "Parent") is a New Jersey holding company, incorporated in 1977, for seven insurance subsidiaries (individually and collectively referred to as "we," "us," or "our") that principally offer property and casualty insurance products and services in the Eastern and Midwestern regions of the United States. Our headquarters are in Branchville, New Jersey. Our common stock is traded on the NASDAQ Global Select Market under the symbol "SIGI." In 2010, we were ranked as the 49th largest property and casualty group in the United States in A.M. Best and Company's ("A.M. Best") annual list of "Top 200 U.S. Property/Casualty Writers." 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.

We classify our business into two operating segments:

- Insurance Operations, which sells property and casualty insurance policies and products; and
- Investments, which invests the premiums collected by the Insurance Operations.

In 2009, we eliminated a third operating segment, Diversified Insurance Services in the following two steps: (i) in the first quarter of 2009, we reclassified our federal flood insurance administrative services ("Flood") business into Insurance Operations because of changes in the way we managed the business; and (ii) in the fourth quarter of 2009, we sold our human resource administration outsourcing ("HR Outsourcing") business. See Note 12. "Discontinued Operations" in Item 8. "Financial Statements and Supplementary Data." of this Form 10-K for additional information. Also see Note 11. "Segment Information" for our revenue from continuing operations and income from continuing operations, before federal income tax, by segment.

We derive substantially all of our income in three ways:

- Underwriting income from Insurance Operations. Underwriting income is comprised of revenues, which are the premiums earned on our insurance products and services, less expenses. The gross premiums we bill our insureds are direct premium written ("DPW") plus premiums assumed from other insurers. Gross premiums billed less premium ceded to reinsurers, is net premium written ("NPW"). NPW is recognized as revenue ratably over the policy's term as net premiums earned ("NPE"). Insurance Operations expenses fall into three main categories: (i) losses associated with claims and various loss expenses incurred for adjusting claims (referred to as "loss and loss expenses"); (ii) expenses related to insurance policy issuance, such as agent commissions, premium taxes, reinsurance, 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 Investments. We generate income from investing insurance premiums from the time they are collected until the time we need to make certain expenditures such as paying loss and loss expenses, underwriting expenses, equity and debt offering obligations, and policyholder dividends. Net investment income consists primarily of interest earned on fixed maturity investments, dividends earned on equity securities, and other income primarily generated from our alternative investment portfolio.

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

We measure Insurance Operations performance by the combined ratio. Under U.S. generally accepted accounting principles ("GAAP"), the combined ratio is calculated by adding: (i) the loss and loss adjustment expense ratio, which is the ratio of incurred loss and loss adjustment expense to NPE; (ii) the expense ratio, which is the ratio of policy acquisition and other underwriting expenses to NPE; and (iii) the dividend ratio, which is the ratio of policyholder dividends to NPE. A combined ratio under 100% indicates an underwriting profit and a combined ratio over 100% indicates an underwriting loss. The combined ratio does not reflect investment income, federal income taxes, or other non-insurance related income or expense.

We measure the performance of our Investments segment by pre- and after-tax investment income and the associated return on invested assets. Our investment philosophy includes setting certain risk and return objectives for the fixed maturity, equity, and other investment portfolios. We generally measure our performance by comparing our returns for each of these components of our portfolio to a weighted-average benchmark of comparable indices.

Our Insurance Operations and Investments segments are heavily regulated by the state insurance regulators in the states in which our Insurance Subsidiaries are organized and licensed. The Insurance Subsidiaries are required to file financial statements with these states prepared in accordance with statutory accounting principles ("SAP"), promulgated by the National Association of Insurance Commissioners ("NAIC") and adopted by the various states. Because of these regulatory requirements, we use SAP to manage our Insurance Operations. The purpose of state insurance regulation is to protect policyholders, so SAP focuses on solvency and liquidation value unlike GAAP, which focuses on the potential for shareholder profits. Consequently, significant differences exist between SAP and GAAP that are discussed further under "Measure of Insurance Operations Profitability."

Insurance Operations

Overview

We derive all of our Insurance Operations revenue from selling insurance products and services to businesses and individuals for premium. Our sales to businesses, non-profit organizations, and local government entities, which we refer to as Commercial Lines, represent about 82% of our NPW. Our sales to individuals, which we refer to as Personal Lines, represent about 18% of our NPW. The majority of our sales are annual insurance policies. Commercial Lines sales are seasonally heaviest in January and July and lightest during the fourth quarter of the year.

Insurance Operations Products and Services

The types of insurance we sell in our Insurance Operations fall into two 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; and

- 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. Some casualty claims may take several years to be reported and settled.

The main Commercial Lines we underwrite and insure primarily through traditional insurance and, to a lesser extent, through alternative risk management products, such as retrospective rating plans, self-insured group retention programs, or individual self-insured accounts, are as follows:

Type of Policy	Category of Insurance
Commercial Property	Property
Commercial Automobile	Property/Casualty

General Liability (including Excess Liability/Umbrella)	Casualty
Workers Compensation	Casualty
Business Owners Policy	Property/Casualty
Bonds (Fidelity and Surety)	Casualty

The main Personal Lines we underwrite and insure are as follows:

Type of Policy	Category of Insurance
Homeowners	Property/Casualty
Personal Automobile	Property/Casualty

Product Development and Pricing

Our Insurance Operations policies are contracts that specify our coverages – what we will pay to or for an insured upon specified losses. 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"). Determining the price to charge for our coverages is complicated. 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. In the last five years, we have also developed predictive models for our Insurance Operations. Predictive models analyze historical statistical data regarding our insureds and their loss experience and, applying and analyzing that information to risks of current insureds and prospective insureds, provide us with an analysis and prediction of the likely profitability of the account. A model's predictive capabilities are limited by the amount and quality of the statistical data available. As a regional insurance group, our loss experience is not always statistically large enough to analyze and project future costs. Consequently, we use ISO data to supplement our own. By using ISO's policy language, policy writing rules, retrospective loss cost information, and rates, we also improve the compliance of our Insurance Operations with applicable legal and regulatory requirements.

Customers and Customer Markets

Commercial Lines customers represent 82% of our total DPW. We categorize this business as follows:

	Percent of Total Commercial Lines	Average Premium per Policy	Description
Small Business	20%	$2,717	Policies under $25,000, with certain restrictions for hazard grade and exposure, that can be written through our internet-based One & Done® and Two & Done automated underwriting templates.
Middle Market Business	70%	8,806	Policies that cannot be written through our automated systems and are the focus of our field-based underwriters, known as agency management specialists ("AMSs").
Large Account Business	10%	121,546	Policies that are larger in size or include alternative risk transfer. This business is written by large account specialists. Approximately 21% of these accounts include alternative risk transfer mechanisms.

We do not sub-divide our Personal Lines customers by size or class. No one customer accounts for 10% or more of our premium within our Insurance Operations segment.

Geographic Markets

Our Insurance Operations are limited to the United States, and we principally operate in 22 states in the Eastern and Midwestern regions of the country. We believe this geographic diversification lessens our exposure to regulatory, competitive, and catastrophic risk. The principal states where we conduct business and their respective percentage of our total NPW over the last three fiscal years is shown in the following table:

	Year Ended December 31,			
% of NPW	2010		2009	2008
New Jersey	26.2	%	26.9	28.6
Pennsylvania	13.8		14.0	14.5
New York	9.0		10.1	10.2
Maryland	6.9		7.1	7.4
Illinois	5.5		5.6	4.8
Virginia	5.3		5.4	5.7
Indiana	4.8		4.1	3.7
North Carolina	3.3		3.5	4.0
Georgia	3.1		3.5	3.7
Michigan	3.0		2.7	2.3
South Carolina	2.6		2.6	2.7
Ohio	2.5		2.3	2.0
Other states	14.0		12.2	10.4
Total	100.0	%	100.0	100.0

Distribution and Marketing

We sell and distribute our Insurance Operations products and services exclusively through independent insurance agents. As of December 31, 2010, we had agency agreements with approximately 980 independent agencies. As these agencies often have multiple offices, we have approximately 2,000 independent agency offices selling our products and services. We pay our agencies commissions and other consideration for business placed with us. We seek to compensate our agencies fairly and consistent with market practices. No one agency is responsible for 10% or more of our Insurance Operations premium.

Independent insurance agents and brokers write approximately 80% of commercial property and casualty insurance and approximately 35% of the personal lines insurance business in the United States according to a 2008 study released in 2010 by the Independent Insurance Agents & Brokers of America. We believe that independent insurance agents will remain a significant force in overall insurance industry premium production because they represent more than one insurance group and can provide a wider choice of commercial lines and personal lines insurance products to insureds. Because our agencies generally represent several of our competitors and we face competition within our distribution channel, it is sometimes difficult to develop brand recognition among our customers, who do not always differentiate between insurance carriers and insurance coverages because of their reliance on their independent insurance agent. Our primary marketing strategy with agents is to:

- Use a business model that provides them resources within close geographic proximity, including: (i) field underwriters; (ii) safety management specialists; and (iii) field claims personnel. These resources make timely underwriting and claim decisions based on established authority parameters;

- Develop close relationships with each agency and its principals: (i) by soliciting their feedback on products and services; (ii) by advising them concerning company developments; and (iii) through significant interaction with them; and

- Develop with each agency, and then carefully monitor, annual goals regarding: (i) types and mix of risks placed with us; (ii) amounts of premium or numbers of policies placed with us; (iii) customer service levels; and (iv) profitability of business placed with us.

We received an overall satisfaction score of 8.3 out of 10 from our agent survey, which highlighted our agents' satisfaction with our Commercial Lines products, the ease of reporting claims, and the professionalism and effectiveness of our employees.

Field and Technology Strategies Supporting Independent Agent Distribution

We use the service mark "High-tech x High-touch = HT2 SM" to describe our Insurance Operations business strategy. "High-tech" refers to our technology that we use to make it easy for our independent insurance agents and customers to do business with us. "High-touch" refers to the close relationships that we have with our independent insurance agents and customers due to our field business model that places underwriters, claims representatives, technical staff, and safety management representatives near our agents and customers.

Employees

To support our independent agents, we employ a field model in both underwriting and claims. The field model places various employees in the field, usually working from home offices near our agents. We believe that we build better and stronger relationships with our agents because of the close proximity of our field employees to our agents and the resulting direct and regular interaction with our agents and our customers.

At December 31, 2010, we had approximately 1,900 employees, 300 of which work in the field.

We support our field model with our corporate headquarters in Branchville, New Jersey, and five regional branch offices ("Regions"). As of December 31, 2010, the Regions and their office locations were as follows:

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

Underwriting Process Involving Agents and Field Model

Our underwriting process requires communication and interaction among:

- Our independent agents, who act as front-line underwriters, our AMSs, and our corporate underwriters;
- Our corporate underwriting department, which includes our strategic business units ("SBUs"), organized by product and customer type, and our lines-of-business unit. These units develop our pricing and underwriting guidelines in conjunction with the Regions;
- Our Regions, which establish: (i) annual premium and pricing goals in consultation with the SBUs; (ii) agency new business targets; and (iii) agency profit improvement plans; and
- Our Actuarial Department, located in our corporate headquarters, which assists in the determination of rate and pricing levels while also monitoring pricing and profitability.

We also have an underwriting service center ("USC") located in Richmond, Virginia. The USC assists our independent agents by servicing Personal Lines and Commercial Lines Small Business and Middle Market accounts. At the USC, 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 independent agents agree to receive a slightly lower than standard commission for the premium associated with the USC. As of December 31, 2010, our USC was servicing Commercial Lines NPW of $49 million and Personal Lines NPW of $32 million. The $81 million total serviced by the USC represents 6% of our total NPW.

We believe that our field model has a distinct advantage in its ability to provide a wide range of front-line safety management services focused on improving an insured's safety and risk management programs – and we have obtained the service mark "Safety Management: Solutions for a safer workplace®." Safety management services include: (i) risk evaluation and improvement surveys intended to evaluate potential exposures and provide solutions for mitigation; (ii) 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 partner with our insureds to identify and eliminate potential loss exposures.

Claims Management and Field Claims Model

Effective, fair, and timely claims management is one of the most important services that we provide our customers and agents. It also is one of the critical factors in achieving underwriting profitability. We have structured our claims organization to emphasize: (i) cost-effective delivery of claims services and control of loss and loss expenses; and (ii) maintenance of timely and adequate claims reserves. We believe that we can achieve lower claims expenses through our field model and locating claims representatives in close proximity to our customers and independent agents.

Claims management specialists ("CMSs") are primarily responsible for investigating and settling a significant portion of our claims directly with insureds and claimants. By promptly and personally investigating claims, we believe CMSs are able to provide better customer and agent service and quickly resolve claims within their authority. In the rare circumstances where we have insufficient claim volume to justify the placement of a CMS or when a particular claim expertise is required, we use independent adjusters. All workers compensation claims are handled in the Regions. Because of the special nature of property claims, CMSs refer those claims above certain amounts to our general property adjusters for consultation. All environmental claims are referred to our specialized corporate environmental unit.

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

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

Technology

We leverage the use of technology in our business. In recent years, we have made significant investments in information technology platforms, integrated systems, Internet-based applications, and predictive modeling initiatives. We did this to provide:

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

In 2010, for the third consecutive year, we received the Interface Partner Award from Applied Systems, an automated solutions provider to independent insurance agents, for our commitment to real-time communication with agencies. The award recognized our leadership and innovation, specifically citing our interface advancements in download and real-time rating.

We manage our information technology projects through an enterprise project management office ("EPMO"). The EPMO is staffed by certified individuals who apply methodologies to: (i) communicate project management standards; (ii) provide project management training and tools; (iii) review project status and cost; and (iv) provide non-technology project management consulting services to the rest of the organization. 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 that the EPMO is an important factor in the success of our technology implementation. Our technology operations are located in Branchville, New Jersey and Glastonbury, Connecticut. We also have agreements with two consulting and information technology services companies from India that have a significant presence in the United States to provide supplemental staffing services to our information technology operation. Together, they provide approximately 25% of our total capacity for skilled technology resources. 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 either vendor.

Insurance Operations Competition

Market Competition

The commercial lines property and casualty market is highly competitive and market share is fragmented among many companies. Recently, A.M. Best revised its outlook for the commercial lines industry from stable to negative. This revision reflects the continued competitive market conditions and gradual price deterioration within the marketplace. We compete with three types of companies, primarily on the basis of price, coverage terms, claims service, safety management services, ease of technology, and financial ratings:

- Regional insurers, such as Cincinnati Financial Corporation, The Hanover Insurance Group, Inc., and Harleysville Group, Inc., which offer commercial lines and personal lines products and services;

- National insurers, such as Liberty Mutual Group, The Travelers Companies, Inc., The Hartford Financial Services Group, Inc., and Zurich Financial Services Group, which offer commercial lines and personal lines products and services; and

- Alternative risk insurers, which includes entities that self-insure their risks. Generally, only large entities have the capacity to self-insure. In the public sector, some small and mid-sized public entities have the opportunity to partially self-insure their risks through the use of risk pools or joint insurance funds that are generally created by legislative act.

We also face competition in personal lines, although the market is less fragmented than commercial lines and carriers have been more successful at obtaining rate increases. Unlike commercial lines, the A.M. Best outlook for personal lines is stable, attributable to stability in the automobile line, improving risk management in the homeowners line, and strong risk-based capitalization levels. Our Personal Lines business faces competition primarily from the regional and national carriers noted above as well as direct insurers such as GEICO and The Progressive Corporation, which primarily offer personal lines coverage and market through a direct response model.

Some of these competitors are public companies and some are mutual companies. Some, like us, rely solely on independent insurance agents for distribution of their products and services and have competition within their distribution channel. Others either employ their own agents who only represent one insurance group or use a combination of independent and captive agents.

Financial Ratings

Because agent and customer concerns about our ability to pay claims in the future are such an important factor in our competitiveness, our financial ratings are important to our ability to compete. Major financial rating agencies evaluate us on our financial strength, operating performance, strategic position, and ability to meet policyholder obligations. We believe that our ability to write insurance business is most significantly influenced by our rating from A.M. Best. We have had our current rating of "A+ (Superior)" for the last 49 years. A.M. Best uses its Financial Strength Rating of "Secure," and a descriptor of "Superior," for its "A+" rating, which it defines as, "assigned to companies that have, in our opinion, a superior ability to meet their ongoing obligations." It is the second highest of 15 ratings. Only approximately 10% of ratings groups carry an "A+" or better rating from A.M. Best.

Our A.M. Best Financial Strength Rating of "A+ (Superior)" with a "negative" outlook was most recently reaffirmed in the second quarter of 2010. They cited our strong capitalization, solid level of operating profitability and established presence within our targeted regional markets in establishing their rating. A downgrade from A.M. Best to a rating below "A-" could affect our ability to write new business with customers and/or agents, some of whom are required (under various third party agreements) to obtain insurance with a carrier that maintains a minimum A.M. Best rating; usually an "A-."

Our ratings by other major rating agencies are as follows:

Rating Agency	Financial Strength Rating	Outlook
Standard & Poors ("S&P")	A	Stable
Moody's Investors Service ("Moody's")	A2	Stable
Fitch Ratings ("Fitch")	A+	Stable

While customers and agents may be aware of our S&P and Moody's financial strength ratings, these ratings are not as important in insurance decision-making. They do, however, affect our ability to access capital markets. For further discussion on this, please see the "Financial Condition, Liquidity, Short-term Borrowsings and Capital Resources" section of Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations." of this Form 10-K.

Other factors that might impact our competitiveness are discussed in Item 1A. "Risk Factors." of this Form 10-K.

Reinsurance

We use reinsurance to protect our capital resources and insure us against losses on property and casualty risks that we underwrite. We use two main reinsurance vehicles: (i) a reinsurance pooling agreement between 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 that cover various policies that our Insurance Operations issue to insureds.

Reinsurance Pooling Agreement
The primary purposes of the reinsurance pooling agreement between our Insurance Subsidiaries are the following;

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

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

Insurance Subsidiary	Respective Percentage	
Selective Insurance Company of America (SICA)	49.5	%
Selective Way Insurance Company (SWIC)	21.0	%
Selective Insurance Company of South Carolina (SICSC)	9.0	%

Selective Insurance Company of the Southeast (SICSE)	7.0	%
Selective Insurance Company of New York (SICNY)	7.0	%
Selective Auto Insurance Company of New Jersey (SAICNJ)	6.0	%
Selective Insurance Company of New England (SICNE)	0.5	%

Reinsurance Treaties and Arrangements

By entering reinsurance treaties and arrangements, we are able to increase underwriting capacity and accept larger risks and a larger number of risks without directly increasing capital or surplus. All of our reinsurance treaties are for traditional reinsurance; we do not purchase finite reinsurance. Under our reinsurance treaties, the reinsurer generally assumes a portion of the losses we cede to them in exchange for a portion of the premium. Amounts not reinsured are known as retention. Reinsurance does not legally discharge us from liability under the terms and limits of our policies, but it does make our reinsurer liable to us for the amount of liability we cede to them. Accordingly, we have counterparty credit risk to our reinsurers. We attempt to mitigate this credit risk by: (i) pursuing relationships with reinsurers rated “A-” or higher; and (ii) requiring collateral to secure reinsurance obligations. Some of our reinsurance contracts include provisions that permit us to terminate or commute the reinsurance treaty if the reinsurer’s financial condition or rating deteriorates. We continuously monitor the financial condition of our reinsurers. We also continuously review the quality of reinsurance recoverables and reserves for uncollectible reinsurance.

We primarily use the following three reinsurance treaty and arrangement types for property and casualty insurance:

- Treaty reinsurance, under which certain types of policies are automatically reinsured without prior approval by the reinsurer of the underlying individual insured risks;

- Facultative reinsurance, under which an individual insurance policy or a specific risk is reinsured with the prior approval of the reinsurer. We use facultative reinsurance for policies with limits greater than those available under our treaty reinsurance; and

- Protection provided under the Terrorism Risk Insurance Act of 2002 as modified and extended through December 31, 2014 by the Terrorism Risk Insurance Program Reauthorization Act of 2007 (collectively referred to as “TRIA”). TRIA requires private insurers and the United States government to share the risk of loss on future acts of terrorism that are certified by the U.S. Secretary of the Treasury. All insurers with commercial lines DPW in the United States are required to participate in TRIA, and TRIA applies to almost every line of commercial insurance. Under TRIA, terrorism coverage is mandatory for all primary workers compensation policies. Insureds with non-workers compensation commercial policies, however, have the option to accept or decline our terrorism coverage or negotiate with us for other terms. TRIA rescinded all previously approved coverage exclusions for terrorism. Under TRIA, 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 commercial lines DPW. In 2010, the deductible would have been approximately $189 million, and will be approximately $180 million for 2011. For losses above the deductible, the federal government will pay 85% and the insurer retains 15%. Although TRIA’s provisions will mitigate our loss exposure to a large-scale terrorist attack, our deductible is substantial. In 2010, approximately 86% of our Commercial Lines non-workers compensation policyholders purchased terrorism coverage. Also in 2010, 45% or 10 of the 22 primary states in which we underwrite commercial property coverage mandated the coverage of fire following an act of terrorism.

The following is a summary of our property reinsurance treaties and arrangements covering our Insurance Subsidiaries:

PROPERTY REINSURANCE		
Treaty Name	Reinsurance Coverage	Terrorism Coverage
Property Excess of Loss	$28 million above $2 million retention in two layers. Losses other than TRIA certified losses are subject to the following reinstatements and annual aggregate limits: · $8 million in excess of $2 million layer provides unlimited reinstatements; and · $20 million in excess of $10 million layer provides three reinstatements, $80 million in aggregate limits.	All nuclear, biological, chemical, and radioactive (“NBCR”) losses are excluded regardless of whether or not they are certified under TRIA. For non-NBCR losses, the treaty distinguishes between acts certified under TRIA and those that are not. The treaty provides annual aggregate limits for TRIA certified (other than NBCR) acts of $24 million for the first layer and $40 million for the second layer. Non-certified terrorism losses (other than NBCR) are subject to the normal limits under the treaty.
Property Catastrophe Excess of Loss	$360 million above $40 million retention in three layers: · 95% of losses in excess of $40 million up to $100 million; · 88% of losses in excess of $100 million up to $200 million; and · 95% of losses in excess of $200 million up to $400 million. The treaty provides one reinstatement per layer, $670 million annual aggregate limit, net of the Insurance Subsidiaries’ co-participation.	All nuclear, biological, and chemical (“NBC”) losses are excluded regardless of whether or not they are certified under TRIA. TRIA losses related to foreign acts of terrorism are excluded from the treaty. Domestic terrorism is included regardless of whether it is certified under TRIA or not. Please see Item 1A. “Risk Factors.” of this Form 10-K for further discussion regarding changes in TRIA.
Flood	100% reinsurance by the federal government’s write-your-own (“WYO”) Program.	None

The following is a summary of our casualty reinsurance treaties and arrangements covering our Insurance Subsidiaries:

CASUALTY REINSURANCE		
Treaty Name	Reinsurance Coverage	Terrorism Coverage
Casualty Excess of Loss	The 1st layer of $3 million in excess of $2 million is covered at 85%. The 2nd through 6th layers are covered at 100%. Losses other than terrorism losses are subject to the following reinstatements and annual aggregate limits: · 85% of $3 million in excess of $2 million layer provides up to $2.6	All NBCR losses are excluded. All other losses stemming from the acts of terrorism are subject to the following reinstatements and annual aggregate limits: · 85% of $3 million in excess of $2 million layer provides up to $2.6 million of per occurrence coverage net of co-participation with four

	million of per occurrence coverage net of co-participation with 23 reinstatements, $61 million net annual aggregate limit; · $7 million in excess of $5 million layer provides three reinstatements, $28 million annual aggregate limit; · $9 million in excess of $12 million layer provides two reinstatements, $27 million annual aggregate limit; · $9 million in excess of $21 million layer provides one reinstatement, $18 million annual aggregate limit; · $20 million in excess of $30 million layer provides one reinstatement, $40 million annual aggregate limit; and · $40 million in excess of $50 million layer provides with one reinstatement, $80 million in net annual aggregate limit.	reinstatements for terrorism losses, $13 million net annual aggregate limit; · $7 million in excess of $5 million layer provides two reinstatements for terrorism losses, $21 million annual aggregate limit; · $9 million in excess of $12 million layer provides two reinstatements for terrorism losses, $27 million annual aggregate limit; · $9 million in excess of $21 million layer provides one reinstatement for terrorism losses, $18 million annual aggregate limit; · $20 million in excess of $30 million layer provides one reinstatement for terrorism losses, $40 million annual aggregate limit; and · $40 million in excess of $50 million layer provides one reinstatement for terrorism losses, $80 million in net annual aggregate limit.
National Workers Compensation Reinsurance Pool ("NWCRP")	Covers business assumed from involuntary National Council on Compensation Insurance ("NCCI") pool. 100% quota share up to a maximum ceded combined ratio cap of 140%. Provides up to 5 points in pool participant insolvency assessment protection.	Provides full terrorism coverage including NBCR.

We also have other smaller reinsurance treaties, such as our Surety and Fidelity Excess of Loss Reinsurance Treaty and our Equipment Breakdown Coverage Reinsurance Treaty. For further discussion on reinsurance, see the "Reinsurance" section of Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations." of this Form 10-K.

Claims Reserves

Net Loss and Loss Expense Reserves
We establish loss and loss expense reserves that are estimates of the amounts 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 date involves a considerable degree of judgment by management and is inherently uncertain. We regularly review our reserving techniques and our overall amount of reserves. We also review:

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

See "Critical Accounting Policies and Estimates" in Item 7. "Management's Discussion and Analysis of Financial Condition and Results for Operations." of this Form 10-K for full discussion regarding our loss reserving process.

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

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

- Section II shows the re-estimated amount of the previously recorded net liability as of the end of each succeeding year. Estimates of the liability of unpaid loss and loss expenses are increased or decreased as payments are made and more information regarding individual claims and trends, such as overall frequency and severity patterns, becomes known.

- Section III shows the cumulative amount of net loss and loss expenses paid relating to recorded liabilities as of the end of each succeeding year.

- Section IV shows the re-estimated gross liability and re-estimated reinsurance recoverables through December 31, 2010.

- Section V shows the cumulative net (deficiency)/redundancy representing the aggregate change in the liability from the original balance sheet dates and the re-estimated liability through December 31, 2010.

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

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($ in millions)	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
I. Gross reserves for unpaid losses and loss expenses at December 31	$1,272.7	1,298.3	1,403.4	1,587.8	1,835.2	2,084.0	2,288.8	2,542.5	2,641.0	2,745.8	2,830.1
Reinsurance recoverables on unpaid losses and loss expenses at December 31	$(160.9)	(166.5)	(160.4)	(184.6)	(218.8)	(218.2)	(199.7)	(227.8)	(224.2)	(271.6)	(313.7)
Net reserves for unpaid losses and loss expenses at December 31	$1,111.8	1,131.8	1,243.1	1,403.2	1,616.4	1,865.8	2,089.0	2,314.7	2,416.8	2,474.2	2,516.3
II. Net reserves estimate as of:											
One year later	$1,125.5	1,151.7	1,258.1	1,408.1	1,621.5	1,858.5	2,070.2	2,295.4	2,387.4	2,430.6	
Two years later	1,152.7	1,175.8	1,276.3	1,452.3	1,637.3	1,845.1	2,024.0	2,237.8	2,324.6		
Three years later	1,181.9	1,210.7	1,344.6	1,491.1	1,643.7	1,825.2	1,982.4	2,169.7			
Four years later	1,220.2	1,290.2	1,371.5	1,522.9	1,649.8	1,808.9	1,931.1				
Five years later	1,278.3	1,306.8	1,413.8	1,529.2	1,653.6	1,780.7					
Six years later	1,287.5	1,349.6	1,420.8	1,538.4	1,639.5						
Seven years later	1,325.5	1,357.6	1,428.7	1,535.6							
Eight years later	1,332.8	1,363.4	1,430.0								
Nine years later	1,338.6	1,362.7									
Ten years later	1,338.2										
Cumulative net redundancy (deficiency)	$(226.4)	(230.8)	(186.9)	(132.4)	(23.1)	85.1	158.0	145.1	92.2	43.6	
III. Cumulative amount of net reserves paid through:											
One year later	$399.2	377.1	384.0	414.5	422.4	468.6	469.4	579.4	584.5	561.3	
Two years later	649.1	627.3	653.3	691.4	729.5	775.0	841.3	945.5	966.8		
Three years later	815.3	807.2	836.3	903.7	942.4	1,026.9	1,080.0	1,201.6			
Four years later	930.9	926.9	966.2	1,033.5	1,101.0	1,174.2	1,235.2				
Five years later	1,002.4	1,003.3	1,044.6	1,128.4	1,189.2	1,267.1					
Six years later	1,046.3	1,053.8	1,110.0	1,184.5	1,245.4						
Seven years later	1,081.7	1,100.3	1,151.8	1,225.3							
Eight years later	1,115.9	1,133.9	1,183.0								
Nine years later	1,143.6	1,157.4									
Ten years later	1,162.2										
IV. Re-estimated gross liability	$1,613.7	1,651.1	1,692.0	1,819.1	1,930.1	2,085.6	2,194.6	2,428.1	2,591.7	2,714.8	

Re-estimated reinsurance recoverables	$(275.5)	(288.4)	(262.1)	(283.4)	(290.6)	(304.9)	(263.6)	(258.5)	(267.1)	(284.2)
Re-estimated net liability	$1,338.2	1,362.7	1,430.0	1,535.6	1,639.5	1,780.7	1,931.1	2,169.7	2,324.6	2,430.6
V. Cumulative gross redundancy (deficiency)	$(341.1)	(352.7)	(288.6)	(231.3)	(94.9)	(1.6)	94.1	114.4	49.2	31.0
Cumulative net redundancy (deficiency)	$(226.4)	(230.8)	(186.9)	(132.4)	(23.1)	85.1	158.0	145.1	92.2	43.6

Note: Some amounts may not foot due to rounding.

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We experienced favorable prior year loss and loss expense reserve development in 2010, 2009, and 2008:

- The primary drivers of 2010's favorable development of $43.6 million were the following:

  - Our commercial automobile line experienced favorable development of approximately $28 million driven by accident years 2004 through 2009. This represents a consistent trend in recent years, as reported loss activity continues to emerge lower than expected.

  - Our general liability line had favorable development of approximately $26 million. This is driven by favorable development on the premises and operations coverages for accident years 2006 and prior. Favorable premises development for 2007 through 2009 was essentially offset by increases for the products coverage.

  - Our workers compensation line experienced unfavorable loss development of approximately $22 million. This was driven by increases in the 2008 and 2009 accident years, which have experienced increases in average severity.

  - Our remaining lines of business collectively experienced approximately $11 million of favorable development. While there were some offsetting impacts among these lines, homeowners contributed $6 million of favorable development towards the total. This was due to lower than expected liability losses in accident years 2008 and 2009.

- The primary drivers of 2009's favorable development of $29.4 million were the following:

  - Our workers compensation line experienced favorable development of approximately $11 million. Accident years 2005 to 2007 had favorable development of approximately $36 million from the impact of a series of underwriting improvement strategies in that period, partially offset by approximately $22 million of adverse development due to higher than expected severity in accident year 2008.

  - Our commercial automobile line experienced favorable development of approximately $10 million from lower than anticipated severity emergence primarily in accident year 2007.

  - Our general liability line had favorable development of approximately $8 million. We had favorable loss emergence in accident years 2004 through 2007 in our premises coverage business that was partially offset by adverse development in our products/completed operations business.

- The primary drivers of 2008's favorable development of $19.3 million were the following:

  - Our workers compensation line experienced favorable prior year development of approximately $24 million. This was primarily driven by favorable development in accident years 2004 to 2006 of approximately $28 million attributable to underwriting improvements, better than expected medical trends, and the redesign and re-contracting of our managed care process. However, accident year 2007 had adverse prior year development of approximately $6 million from higher severity.

  - Our general liability line experienced adverse development of approximately $3 million that reflected normal volatility for this line of business.

  - Our remaining lines of business collectively contributed approximately $2 million of adverse development. Individually, none reflected any significant trends related to prior year development.

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The significant cumulative loss and loss expense reserve net deficiencies seen between 2000 and 2003 reflect the property and casualty industry's soft market pricing during those years. As a whole, the property and casualty industry underestimated reserves and loss trends and created intense pricing competition.

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

($ in thousands)		2010	2009
Statutory losses and loss expense reserves	$	2,513,065	2,471,833
Provision for uncollectible reinsurance		3,400	2,500
Other		(146)	(144)
GAAP losses and loss expense reserves – net		2,516,319	2,474,189
Reinsurance recoverables on unpaid losses and loss expenses		313,739	271,610
GAAP losses and loss expense reserves – gross	$	2,830,058	2,745,799

Environmental Reserves

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

"Asbestos claims" are claims for bodily injury alleged to have occurred from exposure to asbestos-containing products. In the past, we were the insurer of various distributors of asbestos-containing products, such as electrical and plumbing materials, and, in some cases, the manufacturers of these products. Over the last 20 years, a large number of asbestos claims have been made against the insurance industry. While most of our claims are the result of incidental exposure, we insure a former manufacturer of asbestos related products, which comprises approximately half of our outstanding claims. These claims are associated with two policies, each written with a $1.0 million policy aggregate limit, which have been adequately reserved for as of December 31, 2010. At December 31, 2010, asbestos claims constituted 21% of our $39.4 million net environmental reserves compared to 22% of $41.6 million net environmental reserves at December 31, 2009.

"Non-asbestos claims" are claims alleging bodily injury or property damage from pollution or other environmental contaminants other than asbestos. These claims primarily include landfills and leaking underground storage tanks. Landfill claims continue to account for a significant portion of our environmental claim unit's litigation costs. In past years, we experienced adverse development in our homeowners line of business due to unfavorable trends in claims for groundwater contamination from leaking underground heating oil storage tanks in New Jersey. Over the past couple of years, claims related to leaking underground heating oil storage tanks began to stabilize. In addition, we instituted a fuel oil system exclusion on our personal lines policies that limits our exposure to leaking underground storage tanks for certain customers, beginning in 2007. Insureds would be able to buy back oil tank coverage upon meeting certain criteria including, but not limited to, the age of the tanks.

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

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

Measure of Insurance Operations Profitability

We manage and evaluate the performance and profitability of our Insurance Operations in accordance with SAP, which differs from GAAP. We base our incentive compensation to our employees and our independent agents on the SAP results of our Insurance Operations. In addition, our rating agencies use SAP information to evaluate our performance, including against our industry peers.

We measure our statutory underwriting performance by four different ratios:

1. Loss and loss expense ratio, which is calculated by dividing incurred loss and loss expenses by NPE;
2. Underwriting expense ratio, which is calculated by dividing all expenses related to the issuance of insurance policies by NPW;
3. Dividend ratio, which is calculated by dividing policyholder dividends by NPE; and
4. Combined ratio, which is the sum of the loss and loss expense ratio, the underwriting expense ratio, and the dividend ratio.

SAP differs in several ways from GAAP, under which we report our financial results to shareholders and the United States Securities Exchange Commission ("SEC"):

- With regard to the underwriting expense ratio, NPE is the denominator for GAAP; whereas NPW is the denominator for SAP.
- With regard to income:
  - o Underwriting expenses are deferred and amortized to expense over the life of an insurance policy under GAAP; whereas they are recognized when incurred under SAP.
  - o Deferred taxes are recognized in our Consolidated Statements of Income as either a deferred tax expense or a deferred tax benefit under GAAP; whereas they are recorded directly to surplus under SAP.
  - o 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.
- With regard to equity under GAAP and statutory surplus under SAP:
  - o The timing difference in income due to the GAAP/SAP differences in expense recognition creates a difference between GAAP equity and SAP statutory surplus.
  - o Regarding unrealized gains and losses on fixed maturity securities:
    - § Under GAAP, unrealized gains and losses on available-for-sale ("AFS") fixed maturity 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 maturity securities assigned certain NAIC Security Valuation Office ratings (specifically designations of one or two which generally equate to investment grade bonds) are not

recognized in statutory surplus. However, fixed maturity securities that have a designation of three or higher must recognize changes in unrealized gains and losses as an adjustment to statutory surplus.

- Certain assets are designated under insurance regulations as "non-admitted," including, but not limited to, certain deferred tax assets, overdue premium receivables, furniture and equipment, and prepaid expenses. These assets are excluded from statutory surplus under SAP, but are recorded in the Consolidated Balance Sheets net of applicable allowances under GAAP; and o Regarding recognition of the liability for our defined benefit plan:

§ Under GAAP, the liability is recognized in an amount equal to the excess of the projected benefit obligation over the fair value of the plan assets, and any changes in this balance not recognized in income are recognized in equity as a component of other comprehensive income ("OCI").

§ Under SAP, the liability is recognized in an amount equal to the excess of the vested accumulated benefit obligation over the fair value of the plan assets, and any changes in this balance not recognized in income are recognized in statutory surplus.

Our Insurance Operations statutory results for the last three completed fiscal years are shown on the following table:

	Year Ended December 31,		
($ in thousands)	2010	2009	2008
Insurance Operations Results			
NPW	$ 1,388,556	1,422,655	1,492,938
NPE	$ 1,414,612	1,431,047	1,504,387
Losses and loss expenses incurred	980,534	972,040	1,011,700
Net underwriting expenses incurred	445,172	459,758	471,629
Policyholders' dividends	3,878	3,640	5,211
Underwriting (loss) profit	$ (14,972)	(4,391)	15,847
Ratios:			
Loss and loss expense ratio	69.3 %	67.9	67.2
Underwriting expense ratio	32.0	32.3	31.7
Policyholders' dividends ratio	0.3	0.3	0.3
Combined ratio	101.6 %	100.5	99.2
GAAP combined ratio	101.6 %	99.8	100.0

A comparison of certain statutory ratios for our Insurance Operations and our industry are shown in the following table:

	Simple Average of All Periods Presented	2010	2009	2008	2007	2006
Insurance Operations Ratios:1						
Loss and loss expense	66.7	69.3	67.9	67.2	65.4	63.7
Underwriting expense	31.8	32.0	32.3	31.7	31.6	31.3
Policyholders' dividends	0.4	0.3	0.3	0.3	0.5	0.4
Statutory combined ratio	98.8	101.6	100.5	99.2	97.5	95.4
Growth in NPW	(1.0)	(2.4)	(4.7)	(4.5)	1.4	5.3
Industry Ratios:1, 2						
Loss and loss expense	71.5	74.5	72.7	77.1	67.7	65.6
Underwriting expense	27.3	28.0	27.9	27.4	27.1	26.1
Policyholders' dividends	0.7	0.5	0.6	0.6	0.7	0.9
Statutory combined ratio	99.5	103.0	101.2	105.1	95.5	92.5

Growth in NPW	(0.4)	0.5	(4.1)	(2.0)	(0.8)	4.2
Favorable (Unfavorable) to Industry:						
Statutory combined ratio	0.7	1.4	0.7	5.9	(2.0)	(2.9)
Growth in NPW	(0.6)	(2.9)	(0.6)	(2.5)	2.2	1.1

1The 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 2010 have been estimated by A.M. Best.

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Insurance Regulation

Primary Oversight from the States in Which we Operate

Our Insurance Operations 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. For our seven insurance subsidiaries, the primary regulators of their business and financial condition 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 the various state legislatures enact it. The adoption of certain NAIC model laws and regulations, however, is a key aspect of the NAIC Financial Regulations Standards and Accreditation Program, which also sets forth minimum staffing and resource levels for state insurance departments.

IRIS, RBC, and the Model Audit Rule

Among the various financial regulatory initiatives of the NAIC that are material to the regulators in which our seven Insurance Subsidiaries are organized are the following:

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

- Risk-Based Capital. Risk-based capital is measured by the four major areas of risk to which property and casualty insurers are exposed: (i) asset risk; (ii) credit risk; (iii) underwriting risk; and (iv) off-balance sheet risk. Insurers with total adjusted capital that is less than two times their calculated "Authorized Control Level," are subject to different levels of regulatory intervention and action. Based upon the unaudited 2010 statutory financial statements, 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"). Effective January 1, 2010, the regulators of our Insurance Subsidiaries adopted this regulation, modeled closely on the Sarbanes-Oxley Act, concerning: (i) auditor independence; (ii) corporate governance; and (iii) internal control over financial reporting. As permitted under the regulation, the Audit Committee of the Board of Directors (the "Board") of our Parent also serves as the audit committee of each of our Insurance Subsidiaries.

Federal Regulation

Federal legislation and administrative policies also affect the insurance industry. Among the most notable are TRIA, the Dodd-Frank Act ("Dodd-Frank"), and various privacy laws that apply to us because we have personal non-public information, including the Gramm-Leach-Bliley Act, the Fair Credit Reporting Act, the Drivers Privacy Protection Act, and the Health Insurance Portability and Accountability Act. Like all businesses, we also are required to enforce the economic and trade sanctions of the Office of Foreign Assets Control ("OFAC").

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

- The establishment of the Federal Insurance Office ("FIO");

- Federal Reserve oversight of financial services firms designated as systemically risky; and
- Corporate governance reforms of publicly traded companies.

For additional information on the potential impact of Dodd-Frank, refer to the risk factor related to legislation within Item 1A. “Risk Factors.” of this Form 10-K.

Investments

Like many other property and casualty insurance companies, we depend on income from our investment portfolio for a significant portion of our revenues and earnings. We are exposed to significant financial and capital markets risks, primarily relating to interest rates, credit spreads, equity prices, and the change in market value of our alternative investment portfolio. A decline in 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.

Our Investments segment invests the premiums collected by the Insurance Operations to satisfy our equity and debt obligations and generate investment income. At December 31, 2010, our investment portfolio consisted of the following:

Category of Investment

($ in millions)		Carrying Value	% of Investment Portfolio	
Fixed maturities	$	3,557.1	91	%
Equities	$	69.6	2	%
Short-term investments	$	161.1	4	%
Other investments, including alternatives	$	137.9	3	%
Total	$	3,925.7	100	%

Our investment philosophy includes setting certain return and risk objectives for the fixed maturity and equity portfolios. The primary fixed maturity portfolio return objective is to maximize after-tax investment yield and income while balancing risk. A secondary objective is to meet or exceed a weighted-average benchmark of public fixed income indices. The equity portfolio return objective is to meet or exceed a weighted-average benchmark of public equity indices. The risk objectives for our portfolios are focused on: (i) asset diversification; (ii) investment quality; (iii) liquidity, particularly to coincide with cash obligations of the Insurance Operations; (iv) consideration of taxes; and (v) preservation of capital. Our overall philosophy is to invest with a long-term horizon along with a "buy-and-hold" principle; however, yield and income generation remain the key drivers to our investment strategy.

2010 was a transition year for our investment portfolio due to the outsourcing of our investment management operations to two external managers. This transition was completed and is fully operational. This outsourcing does not indicate a change to our overall investment strategy, only a change in the execution model. We expect to benefit from broader sector-specific knowledge, as well as greater flexibility in trade execution.

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.

Executive Officers of the Registrant

Biographical information about our Chief Executive Officer and other executive officers is as follows:

Name, Age, Title	Occupation and Background
Gregory E. Murphy, 55 Chairman, President, and Chief Executive Officer	· Present position since May 2000 · President, Chief Executive Officer, and Director, Selective, 1999 – 2000 · President, Chief Operating Officer, and Director, Selective, 1997 – 1999 · Other senior executive, management, and operational positions, Selective, since 1980 · Certified Public Accountant (New Jersey) (Inactive) · Trustee, Newton Memorial Hospital Foundation, since 1999 · Director, Property Casualty Insurers Association of America, since 2008 · Director, Insurance Information Institute, since 2000 · Trustee, the American Institute for CPCU (AICPCU) and the Insurance Institute of America (IIA), since June 2001 · Graduate of Boston College (B.S. Accounting) · Harvard University (Advanced Management Program) · M.I.T. Sloan School of Management
Richard F. Connell, 65 Senior Executive Vice President and Chief Administrative Officer	· Present position since October 2007 · Senior Executive Vice President and Chief Information Officer, Selective, 2006 – 2007 · Executive Vice President and Chief Information Officer, Selective 2000 – 2006 · Central Connecticut State University (B.S. Marketing)
Dale A. Thatcher, 49 Executive Vice President and Chief Financial Officer	· Present position since April 2010 · Executive Vice President, Chief Financial Officer and Treasurer, 2003 – 2010 · Senior Vice President, Chief Financial Officer and Treasurer, Selective, 2000 – 2003 · Certified Public Accountant (Ohio) (Inactive) · Chartered Property and Casualty Underwriter (CPCU) · Chartered Life Underwriter (CLU) · Member, American Institute of Certified Public Accountants · Member, Ohio Society of Certified Public Accountants · Member, Financial Executives Institute · Member, Insurance Accounting and Systems Association · University of Cincinnati (B.B.A. Accounting; M.B.A. Finance) · Harvard University (Advanced Management Program)
Ronald J. Zaleski Sr., 56 Executive Vice President and Chief Actuary	· Present position since February 2003 · Senior Vice President and Chief Actuary, Selective, 2000 – 2003 · Vice President and Chief Actuary, Selective, 1999 – 2000 · Fellow of Casualty Actuarial Society · Member, American Academy of Actuaries · Loyola College (B.A. Mathematics)
Steven B. Woods, 51 Executive Vice President, Human Resources	· Present position since January 2009 · Vice President, Human Resources, Corporate Affairs, Administration and Vice President, International for Crayola, LLC, 2000 – 2009 · Southeastern Massachusetts University (B.S.) · Old Dominion University (Ph.D., M.S.)

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Name, Age, Title	Occupation and Background
Michael H. Lanza, 49 Executive Vice President, General Counsel, and Chief Compliance Officer	· Present position since October 2007 · Senior Vice President and General Counsel, Selective, 2004 – 2007 · Member, Society of Corporate Secretaries and Corporate Governance Professionals · Member, National Investor Relations Institute · University of Connecticut (B.A.) · University of Connecticut School of Law (J.D.)
John J. Marchioni, 41 Executive Vice President, Insurance Operations	· Present position since February 2010 · Executive Vice President, Chief Underwriting and Field Operations Officer, 2008 – February 2010 · Executive Vice President, Chief Field Operations Officer, Selective 2007 – 2008 · Senior Vice President, Director of Personal Lines, Selective 2005 – 2007 · Various insurance operation and government affairs positions, Selective, 1998 – 2005 · Chartered Property Casualty Underwriter (CPCU) · Princeton University (B.A. History) · Harvard University (Advanced Management Program)

Information about our Board is in our definitive Proxy Statement for the 2011 Annual Meeting of Stockholders to be held on April 27, 2011 in "Information About Proposal 1, Election of Directors," and is also incorporated by reference into Part III 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 ("Exchange Act"). We also 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 also could have a significant impact on our business, liquidity, capital resources, results of operations and financial condition. These risk factors also might affect, alter, or change actions that we might take in executing our long-term capital strategy, including but not limited to, contributing capital to any or all of the Insurance Subsidiaries, issuing additional debt and/or equity securities, repurchasing our equity securities, redeeming our fixed income securities, or increasing or decreasing stockholders' dividends. The following list of risk factors is not exhaustive, and others may exist.

Risks Related to Insurance Operations

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

We employ a number of risk management strategies to reduce our exposure to risk that include, but are not limited to the following:

§ Being disciplined in our underwriting practices;

§ Being prudent in our claims management practices and establishing adequate loss and loss expense reserves;

§ Continuing to develop and implement predictive models to analyze historical statistical data regarding our insureds and their loss experience and to apply that information to risks of current insureds and prospective insureds so we can better predict the likely profitability of the account; and

§ Purchasing reinsurance.

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

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

We are subject to losses from catastrophic events.
Our results are subject to losses from natural and man-made catastrophes, including but not limited to: hurricanes, tornadoes, windstorms, earthquakes, hail, terrorism, explosions, severe winter weather, floods and fires, some of which may be related to climate changes. The frequency and severity of these catastrophes are inherently

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

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

Catastrophe losses are determined by the severity of the event and the total amount of insured exposures in the area affected by the event. Most of the risks underwritten by our Insurance Operations are concentrated geographically in the Eastern and Midwestern regions of the United States. New Jersey accounts for 26% of our total NPW during the year ended December 31, 2010. Catastrophes in the Eastern and Midwestern regions of the United States could adversely impact our business.

Although catastrophes can cause losses in a variety of property and casualty lines, most of our historic catastrophe-related claims have been from commercial property and homeowners coverages. In an effort to reduce our exposure to catastrophe losses, we purchase catastrophe reinsurance. Reinsurance could prove inadequate if: (i) the modeling software we use to analyze the Insurance Subsidiaries' risk results 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 their one reinstatement. Even after considering our reinsurance protection, our exposure to catastrophe risks could have a material adverse effect on our results of operations or financial condition.

We are subject to potential significant losses from acts of terrorism.
TRIA requires private insurers and the United States government to share the risk of loss on future acts of terrorism that are certified by the U.S. Secretary of the Treasury. As a Commercial Lines writer, we are required to participate in TRIA. Under TRIA, terrorism coverage is mandatory for all primary workers compensation policies. Insureds with non-workers compensation commercial policies, however, have the option to accept or decline our terrorism coverage or negotiate with us for other terms. In 2010, approximately 86% of our Commercial Lines non-workers compensation policyholders purchased terrorism coverage.

TRIA rescinded all previously approved coverage exclusions for terrorism. Many of the states in which we write commercial property insurance, however, mandate that we cover fire following an act of terrorism. Under TRIA, 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 commercial lines premiums. In 2010, the deductible would have been approximately $189 million, and it is approximately $180 million for 2011. For losses above the deductible, the federal government will pay 85%, up to an industry limit of $100 billion, and the insurer retains 15%. Although TRIA'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 or financial condition.

TRIA legislation is in effect through December 31, 2014. Currently, the Obama Administration's proposed budget includes provisions to scale back TRIA by removing coverage for domestically inspired acts of terrorism, increasing private insurer deductibles and co-payments, and allowing the program to expire at the end of 2014.

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 adjustment 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. Our major 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, absent a decrease in the amount of reinsurance, 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 Operations business, including from:

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

- Some of our independent agents, who collect premiums from insureds and are required to remit the collected premium to us.

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

- The invested assets in our defined benefit plan, which partially serve to fund the Insurance Operations 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 our Insurance Operations.

It is possible that current economic conditions could increase our credit risk. Our exposure to credit risk could have a material adverse effect on our results of operations or financial condition.

The property and casualty insurance industry is subject to general economic conditions and is cyclical.
The property and casualty insurance industry has experienced significant fluctuations in its historic results due to competition, occurrence or severity of catastrophic events, levels of capacity, general economic conditions, interest rates, and other factors. Demand for insurance is influenced significantly by prevailing general economic conditions. The supply of insurance is related to prevailing prices, the levels of insured losses and the levels of industry surplus which, in turn, may fluctuate in response to changes in rates of return on investments being earned in the insurance industry. As a result, the insurance industry historically has been a cyclical industry characterized by periods of intense price competition due to excessive underwriting capacity as well as periods when shortages of capacity permitted favorable premium levels. Competitors pricing business below technical levels could force us to reduce our profit margin in order to protect 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 1.2% increases the statutory combined ratio by approximately one point;
- A 3% increase in expected claim costs for the year will cause the loss and loss adjustment expense ratio to increase by approximately two points; and
- A combination of the two could raise the combined ratio approximately three points.

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

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

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

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 materially affect our results of operations. Concerns over such issues as the availability and cost of credit, the stability of the U.S. mortgage market, weak real estate markets, high unemployment, volatile energy and commodity prices, and geopolitical issues, also have led to declines in business and consumer confidence and precipitated an economic slowdown.

Factors such as consumer spending, business investment, government spending, the volatility and strength of the capital markets, and inflation all affect the business and economic environment and, indirectly, the amount and profitability of our business. In an economic downturn with higher unemployment, lower family income, lower corporate earnings, lower business investment, and lower consumer spending, the demand for insurance products is adversely affected. In addition, we are impacted by the recent decrease in commercial and new home construction and home ownership in 2010 because 35% of direct premiums written in our Commercial Lines business were generated through contractors business. In addition, 38% of direct premiums written in our Commercial Lines business are based on payroll/sales of our underlying insureds. The impact of the economic downturn on Commercial Lines can be seen in the approximately $48 million and $62 million of audit and endorsement premium we have returned to our insureds during 2010 and 2009, respectively. Further unfavorable economic developments could adversely affect our earnings if our customers have less need for insurance coverage, cancel existing insurance policies, modify coverage, or choose not to renew with us. These circumstances could have a material adverse effect on our business, results of operations and financial condition. Challenging economic conditions also may impair the ability of our customers to pay premiums as they come due. We are unable to predict the likely duration and severity of the current economic conditions in the U.S. and other countries, which may have an adverse effect on us.

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.
We are rated on our financial strength, primarily our ability to pay claims, by various Nationally Recognized Statistical Rating Organizations ("NRSROs"). The financial strength ratings on the Insurance Subsidiaries are as follows:

NRSRO	Financial Strength Rating	Outlook
A.M. Best and Company	"A+"	Negative
Standard & Poor's	"A"	Stable
Moody's Investor Service	"A2"	Stable
Fitch	"A+"	Stable

A significant rating downgrade, particularly from A.M. Best, could: (i) affect our ability to write new business with customers, some of whom are required under various third party agreements to maintain insurance with a carrier that maintains a specified minimum rating; or (ii) be an event of default under our line of credit with Wachovia Bank, National Association ("Line of Credit"). The Line of Credit requires our Insurance Subsidiaries to maintain an A.M. Best rating of at least "A-" (two levels below our current rating) and a default could lead to acceleration of any outstanding principal. Such an event also 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 ratings could have a material adverse effect on our financial condition and results of operations.

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 credit ratings are as follows:

NRSRO	Credit Rating	Long Term Credit Outlook
A.M. Best and Company	“a-”	Negative
Standard & Poor’s	“BBB”	Stable
Moody’s Investor Services	“Baa2”	Stable
Fitch	“A-”	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.

Because of the difficulties recently experienced by many financial institutions, including insurance companies, and the public criticism of NRSROs, we believe it is possible that the NRSROs: (i) will heighten their level of scrutiny of financial institutions; (ii) will increase the frequency and scope of their reviews; and (iii) may adjust upward the capital and other requirements employed in their models for maintaining certain rating levels. 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 action.

We have many competitors and potential competitors.
The insurance industry is highly competitive. The current economic environment has only served to further increase competition. We compete with regional, national, and direct-writer property and casualty insurance companies for customers, agents, and employees. Some competitors are public companies and some are mutual companies. Many competitors are larger and may have lower operating costs or costs of capital. They also 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. We also face competition, primarily in Commercial Lines, from entities that self-insure their own risks. Because of its relatively low cost of entry, the Internet has also emerged as a significant place of new competition, both from existing competitors and new competitors. It is also possible that reinsurers, who have significant knowledge of the primary property and casualty business because they reinsure it, could enter the market to diversify their operations. New competition could cause changes in the supply or demand for insurance and adversely affect our business.

We have less loss experience data than our larger competitors.
We believe that insurance companies are competing and will continue to compete on their ability to use reliable data about their insureds and loss experience in complex analytics and predictive models to select profitable risks. 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. We use data from ISO to obtain sufficient industry loss experience data. While statistically relevant, that data is not specific to the performance of risks we have underwritten. Larger competitors, particularly national carriers, have significantly more data regarding the performance of risks that they have underwritten. The analytics of their loss experience data may be more predictive of profitability of their risks than our analysis using, in part, general industry loss experience. For the same reason, should Congress repeal the McCarran-Ferguson Act and we are unable to access data from ISO, we will be at a competitive disadvantage to larger insurers who have more sufficient loss experience data on their own insureds.

We depend on independent insurance agents.
We market and sell our insurance products exclusively through independent insurance agents who are not our employees. We believe that independent insurance agents will remain a significant force in overall insurance industry premium production because they can provide insureds 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 agents before they sell them to our mutual customers. Our financial condition and results of operations are tied to the successful marketing and sales efforts of our products by our agents. In addition, under insurance laws and regulations and common law, we potentially can be held liable for business practices or actions taken by our agents.

We face risks regarding our Flood business because of uncertainties regarding the funding of the National Flood Insurance Program ("NFIP").
We are the sixth largest insurance group participating in the WYO arrangement of the NFIP, which is managed by the Mitigation Division of Federal Emergency Management Agency in the U.S. Department of Homeland Security. For WYO participation, we receive an expense allowance, or servicing fee, for policies written and claims serviced. Currently, the expense allowance is 30.2% of direct written premiums. The servicing fee is the combination of 1% of direct written premiums and 1.5% of incurred losses.

The NFIP is funded by Congress. In the last several years, funding of the program has continued through short extensions as part of continuing resolutions to temporarily maintain current spending. At present, the funding for the program is set to expire on September 30, 2011, although we expect Congress to extend the program past this date. Some members of Congress have expressed a desire to explore a comprehensive revision of the program, its costs, and its administration. We are actively monitoring developments in Washington regarding reform proposals to the NFIP, particularly regarding any changes to the fee structure. We cannot predict whether proposals will be adopted or, if adopted, what impact their adoption could have on our business, financial condition or results of operations.

We are heavily regulated and changes in regulation may reduce our profitability and limit our growth.
Our Insurance Operations are heavily regulated