

SELECTIVE INSURANCE GROUP INC  
Form 10-Q  
October 31, 2013  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-Q  
(Mark One)

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

For the quarterly period ended: September 30, 2013  
or

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

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

Commission File Number: 001-33067

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

New Jersey 22-2168890  
(State or Other Jurisdiction of Incorporation or (I.R.S. Employer Identification No.)  
Organization)

40 Wantage Avenue 07890  
Branchville, New Jersey (Zip Code)  
(Address of Principal Executive Offices)

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

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

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

Yes  No

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

Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

As of September 30, 2013, there were 55,774,851 shares of common stock, par value \$2.00 per share, outstanding.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

SELECTIVE INSURANCE GROUP, INC.  
CONSOLIDATED BALANCE SHEETS

|   | Unaudited             |                      |
|---|-----------------------|----------------------|
|   | September 30,<br>2013 | December 31,<br>2012 |
| (\$ in thousands, except share amounts)   |                       |                      |
| <b>ASSETS</b>   |                       |                      |
| Investments:  |                       |                      |
| Fixed maturity securities, held-to-maturity – at carrying value (fair value: \$448,529 – 2013; \$594,661 – 2012)          | \$421,962             | 554,069              |
| Fixed maturity securities, available-for-sale – at fair value (amortized cost: \$3,573,751 – 2013; \$3,130,683 – 2012)    | 3,633,432             | 3,296,013            |
| Equity securities, available-for-sale – at fair value (cost: \$158,323 – 2013; \$132,441 – 2012)                          | 180,506               | 151,382              |
| Short-term investments (at cost which approximates fair value)  | 172,087               | 214,479              |
| Other investments   | 108,073               | 114,076              |
| Total investments (Note 5)  | 4,516,060             | 4,330,019            |
| Cash  | 177                   | 210                  |
| Interest and dividends due or accrued   | 36,044                | 35,984               |
| Premiums receivable, net of allowance for uncollectible accounts of: \$4,513 – 2013; \$3,906 – 2012                       | 569,214               | 484,388              |
| Reinsurance recoverables, net   | 555,579               | 1,421,109            |
| Prepaid reinsurance premiums  | 149,182               | 132,637              |
| Current federal income tax  | 1,551                 | 2,569                |
| Deferred federal income tax   | 131,603               | 119,136              |
| Property and equipment – at cost, net of accumulated depreciation and amortization of: \$176,718 – 2013; \$169,428 – 2012 | 50,020                | 47,131               |
| Deferred policy acquisition costs   | 177,211               | 155,523              |
| Goodwill  | 7,849                 | 7,849                |
| Other assets  | 71,855                | 57,661               |
| Total assets  | \$6,266,345           | 6,794,216            |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                       |                      |
| Liabilities:  |                       |                      |
| Reserve for loss and loss expenses  | \$3,316,291           | 4,068,941            |
| Unearned premiums   | 1,111,539             | 974,706              |
| Notes payable (Note 9)  | 392,407               | 307,387              |
| Accrued salaries and benefits   | 116,682               | 152,396              |
| Other liabilities   | 205,217               | 200,194              |
| Total liabilities   | \$5,142,136           | 5,703,624            |
| Stockholders' Equity:   |                       |                      |
| Preferred stock of \$0 par value per share:   | \$—                   | —                    |
| Authorized shares 5,000,000; no shares issued or outstanding  |                       |                      |
| Common stock of \$2 par value per share:  |                       |                      |
| Authorized shares 360,000,000   |                       |                      |

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|  |             |              |
|--|-------------|--------------|
| Issued: 98,957,182 – 2013; 98,194,224 – 2012                               | 197,914     | 196,388      |
| Additional paid-in capital   | 284,067     | 270,654      |
| Retained earnings  | 1,184,084   | 1,125,154    |
| Accumulated other comprehensive income (Note 11)                           | 17,083      | 54,040       |
| Treasury stock – at cost<br>(shares: 43,182,331 – 2013; 43,030,776 – 2012) | (558,939    | ) (555,644 ) |
| Total stockholders' equity   | 1,124,209   | 1,090,592    |
| Commitments and contingencies (Note 14)                                    |             |              |
| Total liabilities and stockholders' equity                                 | \$6,266,345 | 6,794,216    |

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

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| SELECTIVE INSURANCE GROUP, INC.  |                             |         |                                 |           |
|--|-----------------------------|---------|---------------------------------|-----------|
| UNAUDITED CONSOLIDATED STATEMENTS  |                             |         |                                 |           |
| OF INCOME  | Quarter ended September 30, |         | Nine Months ended September 30, |           |
| (\$ in thousands, except per share amounts)  | 2013                        | 2012    | 2013                            | 2012      |
| Revenues:  |                             |         |                                 |           |
| Net premiums earned  | \$437,568                   | 406,225 | 1,284,760                       | 1,177,266 |
| Net investment income earned   | 32,457                      | 30,650  | 99,330                          | 97,284    |
| Net realized gains (losses):   |                             |         |                                 |           |
| Net realized investment gains  | 14,111                      | 1,856   | 25,124                          | 6,907     |
| Other-than-temporary impairments   | (680                        | ) (921  | ) (3,107                        | ) (1,218  |
| Other-than-temporary impairments on fixed maturity securities recognized in other comprehensive income | —                           | (2,023  | ) (77                           | ) (2,241  |
| Total net realized gains (losses)  | 13,431                      | (1,088  | ) 21,940                        | 3,448     |
| Other income   | 3,357                       | 1,085   | 9,677                           | 7,129     |
| Total revenues   | 486,813                     | 436,872 | 1,415,707                       | 1,285,127 |
| Expenses:  |                             |         |                                 |           |
| Loss and loss expense incurred   | 283,317                     | 272,251 | 832,760                         | 813,060   |
| Policy acquisition costs   | 145,314                     | 131,849 | 428,570                         | 391,026   |
| Interest expense   | 5,570                       | 4,725   | 16,971                          | 14,148    |
| Other expenses   | 8,127                       | 7,733   | 27,852                          | 24,080    |
| Total expenses   | 442,328                     | 416,558 | 1,306,153                       | 1,242,314 |
| Income from continuing operations, before federal income tax   | 44,485                      | 20,314  | 109,554                         | 42,813    |
| Federal income tax expense (benefit):  |                             |         |                                 |           |
| Current  | 6,367                       | (5,088  | ) 20,041                        | 1,590     |
| Deferred   | 5,465                       | 7,128   | 7,433                           | 4,568     |
| Total federal income tax expense   | 11,832                      | 2,040   | 27,474                          | 6,158     |
| Net income from continuing operations  | 32,653                      | 18,274  | 82,080                          | 36,655    |
| Loss on disposal of discontinued operations, net of tax of \$(538)                                     | —                           | —       | (997                            | ) —       |
| Net income   | \$32,653                    | 18,274  | 81,083                          | 36,655    |
| Earnings per share:  |                             |         |                                 |           |
| Basic net income from continuing operations  | \$0.59                      | 0.33    | 1.48                            | 0.67      |
| Basic net loss from discontinued operations  | —                           | —       | (0.02                           | ) —       |
| Basic net income   | \$0.59                      | 0.33    | 1.46                            | 0.67      |
| Diluted net income from continuing operations  | \$0.57                      | 0.33    | 1.45                            | 0.66      |
| Diluted net loss from discontinued operations  | —                           | —       | (0.02                           | ) —       |
| Diluted net income   | \$0.57                      | 0.33    | 1.43                            | 0.66      |
| Dividends to stockholders  | \$0.13                      | 0.13    | 0.39                            | 0.39      |

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

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| SELECTIVE INSURANCE GROUP, INC.<br>UNAUDITED CONSOLIDATED STATEMENTS OF<br>COMPREHENSIVE INCOME<br>(\$ in thousands) | Quarter ended<br>September 30, |        | Nine Months ended<br>September 30, |          |
|--|--------------------------------|--------|------------------------------------|----------|
|  | 2013                           | 2012   | 2013                               | 2012     |
| Net income   | \$32,653                       | 18,274 | 81,083                             | 36,655   |
| Other comprehensive income, net of tax:  |                                |        |                                    |          |
| Unrealized gains (losses) on investment securities:  |                                |        |                                    |          |
| Unrealized holding gains (losses) arising during period  | 6,383                          | 23,803 | (50,576 )                          | 41,777   |
| Non-credit portion of other-than-temporary impairments<br>recognized in other comprehensive income                   | —                              | 1,315  | 50                                 | 1,457    |
| Amount reclassified into net income:   |                                |        |                                    |          |
| Held-to-maturity securities  | (307 )                         | (219 ) | (1,172 )                           | (1,236 ) |
| Non-credit other-than-temporary impairment   | 1                              | 6      | 9                                  | 177      |
| Realized (gains) losses on available for sale securities   | (8,785 )                       | 674    | (16,107 )                          | (2,243 ) |
| Total unrealized (losses) gains on investment securities   | (2,708 )                       | 25,579 | (67,796 )                          | 39,932   |
| Defined benefit pension and post-retirement plans:   |                                |        |                                    |          |
| Net actuarial gain   | —                              | —      | 28,600                             | —        |
| Amounts reclassified into net income:  |                                |        |                                    |          |
| Net actuarial loss   | 513                            | 904    | 2,222                              | 2,712    |
| Prior service cost   | —                              | 24     | 6                                  | 73       |
| Curtailment expense  | —                              | —      | 11                                 | —        |
| Total defined benefit pension and post-retirement plans  | 513                            | 928    | 30,839                             | 2,785    |
| Other comprehensive (loss) income  | (2,195 )                       | 26,507 | (36,957 )                          | 42,717   |
| Comprehensive income   | \$30,458                       | 44,781 | 44,126                             | 79,372   |

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

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| SELECTIVE INSURANCE GROUP, INC.<br>UNAUDITED CONSOLIDATED STATEMENTS OF STOCKHOLDERS'<br>EQUITY<br>(\$ in thousands) | Nine Months ended September<br>30, |            |
|--|------------------------------------|------------|
|  | 2013                               | 2012       |
| Common stock:  |                                    |            |
| Beginning of year  | \$196,388                          | 194,494    |
| Dividend reinvestment plan (shares: 49,964 – 2013; 68,640 – 2012)  | 100                                | 137        |
| Stock purchase and compensation plans (shares: 712,994 – 2013; 698,723 – 2012)                                       | 1,426                              | 1,397      |
| End of period  | 197,914                            | 196,028    |
| Additional paid-in capital:  |                                    |            |
| Beginning of year  | 270,654                            | 257,370    |
| Dividend reinvestment plan   | 1,052                              | 1,064      |
| Stock purchase and compensation plans  | 12,361                             | 9,093      |
| End of period  | 284,067                            | 267,527    |
| Retained earnings:   |                                    |            |
| Beginning of year  | 1,125,154                          | 1,116,319  |
| Net income   | 81,083                             | 36,655     |
| Dividends to stockholders (\$0.39 per share – 2013 and 2012)   | (22,153                            | ) (21,859  |
| End of period  | 1,184,084                          | 1,131,115  |
| Accumulated other comprehensive income:  |                                    |            |
| Beginning of year  | 54,040                             | 42,294     |
| Other comprehensive (loss) income  | (36,957                            | ) 42,717   |
| End of period  | 17,083                             | 85,011     |
| Treasury stock:  |                                    |            |
| Beginning of year  | (555,644                           | ) (552,149 |
| Acquisition of treasury stock (shares: 151,555 – 2013; 176,513 – 2012)   | (3,295                             | ) (3,154   |
| End of period  | (558,939                           | ) (555,303 |
| Total stockholders' equity   | \$1,124,209                        | 1,124,378  |

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

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

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| SELECTIVE INSURANCE GROUP, INC.<br>UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOW<br>(\$ in thousands) | Nine Months ended September<br>30, |             |
|--|------------------------------------|-------------|
|  | 2013                               | 2012        |
| Operating Activities   |                                    |             |
| Net income   | \$81,083                           | 36,655      |
| Adjustments to reconcile net income to net cash provided by operating activities:                      |                                    |             |
| Depreciation and amortization  | 32,861                             | 29,386      |
| Loss on disposal of discontinued operations  | 997                                | —           |
| Stock-based compensation expense   | 7,428                              | 6,263       |
| Undistributed losses of equity method investments  | 248                                | 1,090       |
| Net realized gains   | (21,940)                           | (3,448)     |
| Retirement income plan curtailment expense   | 16                                 | —           |
| Changes in assets and liabilities:   |                                    |             |
| Increase in reserve for loss and loss expenses, net of reinsurance recoverables                        | 112,876                            | 37,463      |
| Increase in unearned premiums, net of prepaid reinsurance and advance premiums                         | 120,667                            | 119,269     |
| Decrease (increase) in net federal income taxes  | 8,990                              | (1,050)     |
| Increase in premiums receivable  | (84,826)                           | (53,659)    |
| Increase in deferred policy acquisition costs  | (21,688)                           | (25,744)    |
| (Decrease) increase in interest and dividends due or accrued   | (45)                               | 721         |
| Increase in accrued salaries and benefits  | 8,286                              | 5,365       |
| Increase in accrued insurance expenses   | 6,895                              | 299         |
| Other-net  | (13,859)                           | 15,144      |
| Net adjustments  | 156,906                            | 131,099     |
| Net cash provided by operating activities  | 237,989                            | 167,754     |
| Investing Activities   |                                    |             |
| Purchase of fixed maturity securities, available-for-sale  | (838,634)                          | (676,408)   |
| Purchase of equity securities, available-for-sale  | (112,742)                          | (41,004)    |
| Purchase of other investments  | (7,864)                            | (9,050)     |
| Purchase of short-term investments   | (1,619,948)                        | (1,231,519) |
| Purchase of subsidiary   | —                                  | 255         |
| Sale of subsidiary   | 1,225                              | 600         |
| Sale of fixed maturity securities, available-for-sale  | 6,851                              | 92,170      |
| Sale of short-term investments   | 1,662,340                          | 1,263,684   |
| Redemption and maturities of fixed maturity securities, held-to-maturity                               | 87,952                             | 91,665      |
| Redemption and maturities of fixed maturity securities, available-for-sale                             | 413,722                            | 297,980     |
| Sale of equity securities, available-for-sale  | 109,399                            | 58,749      |
| Distributions from other investments   | 10,546                             | 13,910      |
| Sale of other investments  | —                                  | 1           |
| Purchase of property and equipment   | (10,493)                           | (9,382)     |
| Net cash used in investing activities  | (297,646)                          | (148,349)   |
| Financing Activities   |                                    |             |
| Dividends to stockholders  | (20,532)                           | (20,188)    |
| Acquisition of treasury stock  | (3,295)                            | (3,154)     |
| Net proceeds from stock purchase and compensation plans  | 4,305                              | 2,586       |
| Proceeds from issuance of notes payable, net of debt issuance costs                                    | 178,435                            | —           |

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|   |          |         |   |
|---|----------|---------|---|
| Repayment of notes payable                                | (100,000 | ) —     |   |
| Excess tax benefits from share-based payment arrangements | 1,479    | 904     |   |
| Repayments of capital lease obligations                   | (768     | ) —     |   |
| Net cash provided by (used in) financing activities       | 59,624   | (19,852 | ) |
| Net decrease in cash                                      | (33      | ) (447  | ) |
| Cash, beginning of year                                   | 210      | 762     |   |
| Cash, end of period                                       | \$177    | 315     |   |

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

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NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. Organization

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

We classify our business into three operating segments:

Our Standard Insurance Operations segment, which is comprised of both commercial lines (“Commercial Lines”) and personal lines (“Personal Lines”) business, sells property and casualty insurance products and services in the standard market, including flood insurance through the National Flood Insurance Program’s (“NFIP”) write-your-own (“WYO”) program;

Our E&S Insurance Operations segment, which is comprised of Commercial Lines property and casualty insurance products and services that are unavailable in the standard market due to market conditions or characteristics of the insured that are caused by the insured’s claim history or the characteristics of their business; and

Our Investments segment, which invests the premiums collected by our Standard and E&S Insurance Operations, as well as amounts generated through our capital management strategies, which may include the issuance of debt and equity securities.

NOTE 2. Basis of Presentation

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

Certain amounts in our prior years’ Financial Statements and related notes have been reclassified to conform to the 2013 presentation. Such reclassifications had no effect on our net income, stockholders’ equity, or cash flows.

These Financial Statements reflect all adjustments that, in our opinion, are normal, recurring, and necessary for a fair presentation of our results of operations and financial condition. The Financial Statements cover the third quarters ended September 30, 2013 (“Third Quarter 2013”) and September 30, 2012 (“Third Quarter 2012”) and the nine-month periods ended September 30, 2013 (“Nine Months 2013”) and September 30, 2012 (“Nine Months 2012”). The Financial Statements do not include all of the information and disclosures required by GAAP and the SEC for audited annual financial statements. Results of operations for any interim period are not necessarily indicative of results for a full year. Consequently, the Financial Statements should be read in conjunction with the consolidated financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2012 (“2012 Annual Report”).

NOTE 3. Adoption of Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (“ASU 2013-02”), which adds new disclosure requirements for items reclassified out of Accumulated Other Comprehensive Income (“AOCI”). ASU 2013-02 requires entities to disclose additional information about reclassification adjustments, including: (i) changes in AOCI balances by component; and (ii) significant items reclassified out of AOCI. Prospective application of ASU 2013-02 was effective for fiscal years, and interim periods within those years,

beginning after December 15, 2012. We have included the disclosures required by ASU 2013-02 in the notes to our Financial Statements, as required.

In July 2013, the FASB issued ASU No. 2013-11, Income Taxes, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (a consensus of the FASB Emerging Issues Task Force) ("ASU 2013-11"). ASU 2013-11 applies to all entities with unrecognized tax benefits that also have tax loss or tax credit carryforwards in the same tax jurisdiction as of the reporting date. An unrecognized tax benefit is the difference between a tax position taken or expected to be taken in a tax return and the benefit that is more likely than not sustainable under examination. Under ASU 2013-11, an entity must net an unrecognized tax benefit, or a portion of an unrecognized tax benefit, against deferred tax assets for a net operating loss ("NOL") carryforward, a similar tax loss, or a tax credit carryforward except when:

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An NOL carryforward, a similar tax loss, or a tax credit carryforward is not available as of the reporting date under the governing tax law to settle taxes that would result from the disallowance of the tax position; or  
 The entity does not intend to use the deferred tax asset for this purpose.

If either of these conditions exists, an entity should present an unrecognized tax benefit in the financial statements as a liability and should not net the unrecognized tax benefit with a deferred tax asset.

ASU 2013-11 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The adoption of this guidance will not impact our financial condition or results of operation.

## NOTE 4. Statements of Cash Flow

Cash paid during Nine Months 2013 and 2012 for interest and federal income taxes was as follows:

| (\$ in thousands)                | Nine Months ended September 30, |        |
|----------------------------------|---------------------------------|--------|
|                                  | 2013                            | 2012   |
| Cash paid during the period for: |                                 |        |
| Interest                         | \$13,325                        | 11,504 |
| Federal income tax               | 17,000                          | 6,300  |

At September 30, 2013, included in "Other assets" on the Consolidated Balance Sheets was \$7.0 million of cash received from the NFIP, which is restricted to pay flood claims under the WYO program.

## NOTE 5. Investments

(a) The amortized cost, net unrealized gains and losses, carrying value, unrecognized holding gains and losses, and fair value of held-to-maturity ("HTM") fixed maturity securities as of September 30, 2013 and December 31, 2012 were as follows:

## September 30, 2013

| (\$ in thousands)                               | Amortized Cost | Net Unrealized Gains (Losses) | Carrying Value | Unrecognized Holding Gains | Unrecognized Holding Losses | Fair Value |
|---|----------------|-------------------------------|----------------|----------------------------|-----------------------------|------------|
| Foreign government                              | \$5,292        | 151                           | 5,443          | 122                        | —                           | 5,565      |
| Obligations of state and political subdivisions | 372,281        | 4,065                         | 376,346        | 19,297                     | —                           | 395,643    |
| Corporate securities                            | 29,228         | (466)                         | 28,762         | 3,015                      | —                           | 31,777     |
| Asset-backed securities ("ABS")                 | 5,890          | (755)                         | 5,135          | 776                        | —                           | 5,911      |
| Commercial mortgage-backed securities ("CMBS")  | 7,241          | (965)                         | 6,276          | 3,357                      | —                           | 9,633      |
| Total HTM fixed maturity securities             | \$419,932      | 2,030                         | 421,962        | 26,567                     | —                           | 448,529    |

## December 31, 2012

| (\$ in thousands)  | Amortized Cost | Net Unrealized Gains (Losses) | Carrying Value | Unrecognized Holding Gains | Unrecognized Holding Losses | Fair Value |
|--------------------|----------------|-------------------------------|----------------|----------------------------|-----------------------------|------------|
| Foreign government | \$5,292        | 212                           | 5,504          | 367                        | —                           | 5,871      |

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|   |           |        |         |        |       |   |         |
|---|-----------|--------|---------|--------|-------|---|---------|
| Obligations of state and political subdivisions | 491,180   | 6,769  | 497,949 | 28,996 | (23   | ) | 526,922 |
| Corporate securities                            | 38,285    | (812   | )       | 37,473 | 4,648 | — | 42,121  |
| ABS   | 6,980     | (1,052 | )       | 5,928  | 1,170 | — | 7,098   |
| CMBS  | 8,406     | (1,191 | )       | 7,215  | 5,434 | — | 12,649  |
| Total HTM fixed maturity securities             | \$550,143 | 3,926  | 554,069 | 40,615 | (23   | ) | 594,661 |

Unrecognized holding gains and losses of HTM securities are not reflected in the Financial Statements, as they represent fair value fluctuations from the later of: (i) the date a security is designated as HTM; or (ii) the date that an other-than-temporary impairment (“OTTI”) charge is recognized on an HTM security, through the date of the balance sheet. Our HTM securities had an average duration of 2.3 years as of September 30, 2013.



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During Nine Months 2013, 16 securities with a carrying value of \$39.6 million and a net unrecognized gain position of \$1.4 million, were reclassified from an HTM designation to an available-for-sale (“AFS”) designation due to credit rating downgrades by Moody’s Investors Services (“Moody’s”) and/or Standard and Poor’s Financial Services (“S&P”). These unexpected rating downgrades raised concerns about the issuers’ credit worthiness, which changed our intention to hold these securities to maturity.

(b) The cost/amortized cost, unrealized gains and losses, and fair value of AFS securities as of September 30, 2013 and December 31, 2012 were as follows:

## September 30, 2013

| (\$ in thousands)   | Cost/<br>Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Fair<br>Value |
|---|----------------------------|---------------------|----------------------|---------------|
| U.S. government and government agencies                       | \$169,163                  | 11,953              | (330)                | ) 180,786     |
| Foreign government  | 28,797                     | 996                 | (84)                 | ) 29,709      |
| Obligations of states and political subdivisions              | 918,403                    | 27,705              | (16,610)             | ) 929,498     |
| Corporate securities  | 1,629,698                  | 47,932              | (14,479)             | ) 1,663,151   |
| ABS   | 150,179                    | 1,063               | (476)                | ) 150,766     |
| CMBS <sup>1</sup>   | 152,464                    | 2,747               | (3,263)              | ) 151,948     |
| Residential mortgage-backed securities (“RMBS <sup>2</sup> ”) | 525,047                    | 8,932               | (6,405)              | ) 527,574     |
| AFS fixed maturity securities                                 | 3,573,751                  | 101,328             | (41,647)             | ) 3,633,432   |
| AFS equity securities   | 158,323                    | 24,061              | (1,878)              | ) 180,506     |
| Total AFS securities  | \$3,732,074                | 125,389             | (43,525)             | ) 3,813,938   |

## December 31, 2012

| (\$ in thousands)                                | Cost/<br>Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Fair<br>Value |
|--|----------------------------|---------------------|----------------------|---------------|
| U.S. government and government agencies          | \$241,874                  | 17,219              | (1)                  | ) 259,092     |
| Foreign government                               | 28,813                     | 1,540               | (124)                | ) 30,229      |
| Obligations of states and political subdivisions | 773,953                    | 44,398              | (327)                | ) 818,024     |
| Corporate securities                             | 1,368,954                  | 81,696              | (402)                | ) 1,450,248   |
| ABS  | 126,330                    | 2,319               | (9)                  | ) 128,640     |
| CMBS <sup>1</sup>                                | 133,763                    | 4,572               | (1,216)              | ) 137,119     |
| RMBS <sup>2</sup>                                | 456,996                    | 15,961              | (296)                | ) 472,661     |
| AFS fixed maturity securities                    | 3,130,683                  | 167,705             | (2,375)              | ) 3,296,013   |
| AFS equity securities                            | 132,441                    | 19,400              | (459)                | ) 151,382     |
| Total AFS securities                             | \$3,263,124                | 187,105             | (2,834)              | ) 3,447,395   |

<sup>1</sup> CMBS includes government guaranteed agency securities with a fair value of \$35.5 million at September 30, 2013 and \$48.9 million at December 31, 2012.

<sup>2</sup> RMBS includes government guaranteed agency securities with a fair value of \$61.4 million at September 30, 2013 and \$91.0 million at December 31, 2012.

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

(c) The following tables summarize, for all securities in a net unrealized/unrecognized loss position at September 30, 2013 and December 31, 2012, the fair value and gross pre-tax net unrealized/unrecognized loss by asset class and by length of time those securities have been in a net loss position:

| September 30, 2013<br>(\$ in thousands)          | Less than 12 months |                                | 12 months or longer |                                |
|--|---------------------|--------------------------------|---------------------|--------------------------------|
|  | Fair Value          | Unrealized Losses <sup>1</sup> | Fair Value          | Unrealized Losses <sup>1</sup> |
| AFS securities                                   |                     |                                |                     |                                |
| U.S. government and government agencies          | \$13,173            | (327                           | ) 510               | (3                             |
| Foreign government                               | 1,056               | (12                            | ) 2,925             | (72                            |
| Obligations of states and political subdivisions | 417,866             | (16,610                        | ) —                 | —                              |
| Corporate securities                             | 422,816             | (14,200                        | ) 3,837             | (279                           |
| ABS  | 87,786              | (471                           | ) 302               | (5                             |
| CMBS   | 69,322              | (2,771                         | ) 2,030             | (492                           |
| RMBS   | 202,428             | (6,231                         | ) 1,579             | (174                           |
| Total fixed maturity securities                  | 1,214,447           | (40,622                        | ) 11,183            | (1,025                         |
| Equity securities                                | 35,275              | (1,878                         | ) —                 | —                              |
| Subtotal   | \$1,249,722         | (42,500                        | ) 11,183            | (1,025                         |

| (\$ in thousands)                                | Less than 12 months |                                |                                 | 12 months or longer |                                |                                 |
|--|---------------------|--------------------------------|---------------------------------|---------------------|--------------------------------|---------------------------------|
|  | Fair Value          | Unrealized Losses <sup>1</sup> | Unrecognized Gains <sup>2</sup> | Fair Value          | Unrealized Losses <sup>1</sup> | Unrecognized Gains <sup>2</sup> |
| HTM securities                                   |                     |                                |                                 |                     |                                |                                 |
| Obligations of states and political subdivisions | \$492               | (20                            | ) 19                            | 571                 | (24                            | ) 17                            |
| ABS  | —                   | —                              | —                               | 2,476               | (690                           | ) 642                           |
| Subtotal   | \$492               | (20                            | ) 19                            | 3,047               | (714                           | ) 659                           |
| Total AFS and HTM                                | \$1,250,214         | (42,520                        | ) 19                            | 14,230              | (1,739                         | ) 659                           |

| December 31, 2012<br>(\$ in thousands)           | Less than 12 months |                                | 12 months or longer |                                |
|--|---------------------|--------------------------------|---------------------|--------------------------------|
|  | Fair Value          | Unrealized Losses <sup>1</sup> | Fair Value          | Unrealized Losses <sup>1</sup> |
| AFS securities                                   |                     |                                |                     |                                |
| U.S. government and government agencies          | \$518               | (1                             | ) —                 | —                              |
| Foreign government                               | —                   | —                              | 2,871               | (124                           |
| Obligations of states and political subdivisions | 32,383              | (327                           | ) —                 | —                              |
| Corporate securities                             | 50,880              | (402                           | ) —                 | —                              |
| ABS  | 9,137               | (9                             | ) —                 | —                              |
| CMBS   | 7,637               | (19                            | ) 11,830            | (1,197                         |
| RMBS   | 8,710               | (59                            | ) 5,035             | (237                           |
| Total fixed maturity securities                  | 109,265             | (817                           | ) 19,736            | (1,558                         |
| Equity securities                                | 15,901              | (459                           | ) —                 | —                              |
| Subtotal   | \$125,166           | (1,276                         | ) 19,736            | (1,558                         |



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| (\$ in thousands)                                | Less than 12 months |                                |                                 | 12 months or longer |                                |                                 |
|--|---------------------|--------------------------------|---------------------------------|---------------------|--------------------------------|---------------------------------|
|  | Fair Value          | Unrealized Losses <sup>1</sup> | Unrecognized Gains <sup>2</sup> | Fair Value          | Unrealized Losses <sup>1</sup> | Unrecognized Gains <sup>2</sup> |
| HTM securities                                   |                     |                                |                                 |                     |                                |                                 |
| Obligations of states and political subdivisions | \$1,218             | (33                            | ) 29                            | 1,108               | (47                            | ) 38                            |
| ABS  | —                   | —                              | —                               | 2,860               | (840                           | ) 753                           |
| Subtotal   | 1,218               | (33                            | ) 29                            | 3,968               | (887                           | ) 791                           |
| Total AFS and HTM                                | \$126,384           | (1,309                         | ) 29                            | 23,704              | (2,445                         | ) 791                           |

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

<sup>2</sup> Unrecognized gains represent fair value fluctuations from the later of: (i) the date a security is designated as HTM; or (ii) the date that an OTTI charge is recognized on an HTM security.

As evidenced by the table below, our net unrealized/unrecognized loss positions increased by \$40.6 million as of September 30, 2013 compared to December 31, 2012 as follows:

| (\$ in thousands)<br>September 30, 2013 |                  |                              | December 31, 2012 |                  |                              |
|---|------------------|------------------------------|-------------------|------------------|------------------------------|
| Number of Issues                        | % of Market/Book | Unrealized/Unrecognized Loss | Number of Issues  | % of Market/Book | Unrealized/Unrecognized Loss |
| 501                                     | 80% - 99%        | \$43,295                     | 100               | 80% - 99%        | \$2,701                      |
| —                                       | 60% - 79%        | —                            | 1                 | 60% - 79%        | 233                          |
| 1                                       | 40% - 59%        | 286                          | —                 | 40% - 59%        | —                            |
| —                                       | 20% - 39%        | —                            | —                 | 20% - 39%        | —                            |
| —                                       | 0% - 19%         | —                            | —                 | 0% - 19%         | —                            |
|   |                  | \$43,581                     |                   |                  | \$2,934                      |

We have reviewed the securities in the tables above in accordance with our OTTI policy, as described in Note 2. "Summary of Significant Accounting Policies" in Item 8. "Financial Statements and Supplementary Data." of our 2012 Annual Report.

At September 30, 2013, we had 502 securities in an aggregate unrealized/unrecognized loss position of \$43.6 million, \$1.1 million of which have been in a loss position for more than 12 months. At December 31, 2012, we had 101 securities in an aggregate unrealized/unrecognized loss position of \$2.9 million, \$1.7 million of which had been in a loss position for more than 12 months. During Nine Months 2013, interest rates on the 10-year U.S. Treasury Note rose by 85 basis points. This interest rate movement has negatively impacted our fixed maturity securities portfolio's valuation, thus increasing the number of securities in a loss position and the corresponding dollar amount of unrealized losses. The increase in the unrealized losses does not correspond to any issuer specific credit concerns; however, it does reflect an expected reduction in market value due to higher market interest rates. For a discussion regarding the sensitivity of interest rate movements and the related impacts on the fixed maturity securities portfolio, refer to Item 7A. "Quantitative and Qualitative Disclosures About Market Risk" in our 2012 Annual Report.

We do not intend to sell any securities in an unrealized/unrecognized loss position, nor do we believe we will be required to sell these securities, and therefore we have concluded that they are temporarily impaired as of September 30, 2013. This conclusion reflects our current judgment as to the financial position and future prospects of

the entity that issued the investment security and underlying collateral. If our judgment about an individual security changes in the future, we may ultimately record a credit loss after having originally concluded that one did not exist, which could have a material impact on our net income and financial position in future periods.

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(d) Fixed maturity securities at September 30, 2013, by contractual maturity, are shown below. Mortgage-backed securities ("MBS") are included in the maturity tables using the estimated average life of each security. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations, with or without call or prepayment penalties.

Listed below are HTM fixed maturity securities at September 30, 2013:

| (\$ in thousands)                     | Carrying Value | Fair Value |
|---------------------------------------|----------------|------------|
| Due in one year or less               | \$72,099       | 74,953     |
| Due after one year through five years | 312,318        | 331,927    |
| Due after five years through 10 years | 34,747         | 38,176     |
| Due after 10 years                    | 2,798          | 3,473      |
| Total HTM fixed maturity securities   | \$421,962      | 448,529    |

Listed below are AFS fixed maturity securities at September 30, 2013:

| (\$ in thousands)                     | Fair Value  |
|---------------------------------------|-------------|
| Due in one year or less               | \$324,743   |
| Due after one year through five years | 1,951,770   |
| Due after five years through 10 years | 1,329,795   |
| Due after 10 years                    | 27,124      |
| Total AFS fixed maturity securities   | \$3,633,432 |

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

| Other Investments<br>(\$ in thousands) | Carrying Value        |                      | September 30,<br>2013   |
|--|-----------------------|----------------------|-------------------------|
|  | September 30,<br>2013 | December 31,<br>2012 | Remaining<br>Commitment |
| Alternative Investments                |                       |                      |                         |
| Secondary private equity               | \$25,954              | 28,032               | 7,703                   |
| Private equity                         | 18,951                | 18,344               | 10,502                  |
| Energy/power generation                | 17,049                | 18,640               | 7,076                   |
| Mezzanine financing                    | 12,921                | 12,692               | 18,796                  |
| Real estate                            | 12,385                | 11,751               | 10,205                  |
| Distressed debt                        | 11,911                | 12,728               | 2,964                   |
| Venture capital                        | 7,018                 | 7,477                | 400                     |
| Total alternative investments          | 106,189               | 109,664              | 57,646                  |
| Other securities                       | 1,884                 | 4,412                | 1,289                   |
| Total other investments                | \$108,073             | 114,076              | 58,935                  |

For a description of our seven alternative investment strategies, as well as information regarding redemption, restrictions, and fund liquidations, refer to Note 5. "Investments" in Item 8. "Financial Statements and Supplementary Data." of our 2012 Annual Report.

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The following table sets forth aggregated summarized financial information for our other investments portfolio that is carried under the equity method of accounting. The last line of the table below reflects our share of the aggregate income, which is the portion included in our Financial Statements. As the majority of these investments report results to us on a quarter lag, the summarized financial statement information for the nine-month periods ended June 30 is as follows:

| Income Statement Information<br>(\$ in millions)             | Quarter ended June 30, |        | Nine Months ended June 30, |         |
|--|------------------------|--------|----------------------------|---------|
|  | 2013                   | 2012   | 2013                       | 2012    |
| Net investment income  | \$97.8                 | 80.0   | 352.8                      | 170.1   |
| Realized gains   | 162.8                  | 19.6   | 762.5                      | 1,004.9 |
| Net change in unrealized depreciation                        | 104.8                  | (117.1 | ) 85.9                     | (551.1  |
| Net income (loss)  | \$365.4                | (17.5  | ) 1,201.2                  | 623.9   |
| Selective's insurance subsidiaries' other investments income | \$2.6                  | 0.5    | 10.1                       | 5.5     |

(f) At September 30, 2013, we had fixed maturity securities, with a carrying value of \$61.9 million, that were pledged as collateral for our outstanding borrowing of \$58.0 million with the Federal Home Loan Bank of Indianapolis ("FHLBI"). This outstanding borrowing is included in "Notes payable" on the Consolidated Balance Sheets. In accordance with the terms of our agreement with the FHLBI, we retain all rights regarding these securities, which are included in the "U.S. government and government agencies," "RMBS," and "CMBS" classifications of our AFS fixed maturity securities portfolio.

Also at September 30, 2013, we had fixed maturity securities, with a carrying value of \$21.3 million, and short-term investments with a carrying value of \$1.7 million, that collateralize reinsurance obligations related to our 2011 acquisition of our E&S book of business. Similar to the FHLBI collateral discussion above, we retain all rights regarding these investments. These fixed maturity securities are included in the "Municipal," "Corporate," "U.S. government and government agencies," "RMBS," and "ABS" classifications of our AFS fixed maturity securities portfolio.

In addition, fixed maturity securities with a carrying value of \$27.0 million were on deposit with various state and regulatory agencies to comply with insurance laws. We retain all rights regarding these securities, which are primarily included in the "U.S. government and government agencies" classification of our AFS fixed maturity securities portfolio.

(g) The components of net investment income earned for the periods indicated were as follows:

| (\$ in thousands)            | Quarter ended September 30, |          | Nine Months ended September 30, |          |
|------------------------------|-----------------------------|----------|---------------------------------|----------|
|                              | 2013                        | 2012     | 2013                            | 2012     |
| Fixed maturity securities    | \$30,569                    | 30,839   | 90,956                          | 93,948   |
| Equity securities            | 1,341                       | 1,268    | 4,422                           | 3,785    |
| Short-term investments       | 21                          | 36       | 102                             | 103      |
| Other investments            | 2,639                       | 497      | 10,110                          | 5,460    |
| Miscellaneous income         | —                           | 41       | —                               | 105      |
| Investment expenses          | (2,113                      | ) (2,031 | ) (6,260                        | ) (6,117 |
| Net investment income earned | \$32,457                    | 30,650   | 99,330                          | 97,284   |

Net investment income before tax increased in both Third Quarter and Nine Months 2013 compared to the same periods last year, primarily due to higher income from our alternative investments. Partially offsetting this increase in Nine Months 2013 is a decrease in fixed maturity securities income due to lower investment yields than in the prior

year period.

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

| Third Quarter 2013<br>(\$ in thousands) | Gross | Included in Other<br>Comprehensive<br>Income ("OCI") | Recognized in<br>Earnings |
|---|-------|--|---------------------------|
| Equity securities                       | \$680 | —  | 680                       |
| OTTI losses                             | \$680 | —  | 680                       |

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| Third Quarter 2012<br>(\$ in thousands) | Gross   | Included in OCI | Recognized in<br>Earnings |
|---|---------|-----------------|---------------------------|
| AFS fixed maturity securities           |         |                 |                           |
| ABS                                     | \$36    | —               | 36                        |
| CMBS                                    | (1,504) | ) (2,023        | ) 519                     |
| Total AFS fixed maturities              | (1,468) | ) (2,023        | ) 555                     |
| Equity securities                       | 2,389   | —               | 2,389                     |
| OTTI losses                             | \$921   | (2,023          | ) 2,944                   |
|   |         |                 |                           |
| Nine Months 2013<br>(\$ in thousands)   | Gross   | Included in OCI | Recognized in<br>Earnings |
| HTM fixed maturity securities:          |         |                 |                           |
| ABS                                     | \$(44   | ) (47           | ) 3                       |
| Total HTM fixed maturity securities     | (44     | ) (47           | ) 3                       |
| AFS fixed maturity securities:          |         |                 |                           |
| RMBS                                    | (22     | ) (30           | ) 8                       |
| Total AFS fixed maturity securities     | (22     | ) (30           | ) 8                       |
| Equity securities                       | 1,326   | —               | 1,326                     |
| Total AFS securities                    | 1,304   | (30             | ) 1,334                   |
| Other investments                       | 1,847   | —               | 1,847                     |
| OTTI losses                             | \$3,107 | (77             | ) 3,184                   |
|   |         |                 |                           |
| Nine Months 2012<br>(\$ in thousands)   | Gross   | Included in OCI | Recognized in<br>Earnings |
| AFS fixed maturity securities           |         |                 |                           |
| ABS                                     | \$98    | —               | 98                        |
| CMBS                                    | (1,396) | ) (2,023        | ) 627                     |
| RMBS                                    | (44     | ) (218          | ) 174                     |
| Total AFS fixed maturity securities     | (1,342) | ) (2,241        | ) 899                     |
| Equity securities                       | 2,560   | —               | 2,560                     |
| OTTI losses                             | \$1,218 | (2,241          | ) 3,459                   |

The majority of the OTTI charges in Nine Months 2013 relate to an investment in a limited liability company within our other investments portfolio that has sustained significant losses for which we do not anticipate recovery. In addition, OTTI charges on our equity portfolio include: (i) \$0.7 million recorded in Third Quarter 2013 on securities that we did not believe would recover in the near term; and (ii) \$0.6 million recorded within the first half of 2013 primarily related to securities for which we had the intent to sell. For a discussion of our evaluation for OTTI of fixed maturity securities, short-term investments, equity securities and other investments, refer to Note 2. "Summary of Significant Accounting Policies" in Item 8. "Financial Statements and Supplementary Data" of our 2012 Annual Report.

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

|  | Quarter ended September 30,     |       |
|--|---------------------------------|-------|
| (\$ in thousands)  | 2013                            | 2012  |
| Balance, beginning of period   | \$7,488                         | 6,775 |
| Addition for the amount related to credit loss for which an OTTI was not previously recognized   | —                               | —     |
| Reductions for securities sold during the period   | —                               | —     |
| Reductions for securities for which the amount previously recognized in OCI was recognized in earnings because of intention or potential requirement to sell before recovery of amortized cost | —                               | —     |
| Reductions for securities for which the entire amount previously recognized in OCI was recognized in earnings due to a decrease in cash flows expected   | —                               | —     |
| Additional increases to the amount related to credit loss for which an OTTI was previously recognized  | —                               | 519   |
| Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected   | —                               | —     |
| Balance, end of period   | \$7,488                         | 7,294 |
|  | Nine Months ended September 30, |       |
| (\$ in thousands)  | 2013                            | 2012  |
| Balance, beginning of period   | \$7,477                         | 6,602 |
| Addition for the amount related to credit loss for which an OTTI was not previously recognized   | —                               | —     |
| Reductions for securities sold during the period   | —                               | —     |
| Reductions for securities for which the amount previously recognized in OCI was recognized in earnings because of intention or potential requirement to sell before recovery of amortized cost | —                               | —     |
| Reductions for securities for which the entire amount previously recognized in OCI was recognized in earnings due to a decrease in cash flows expected   | —                               | —     |
| Additional increases to the amount related to credit loss for which an OTTI was previously recognized  | 11                              | 692   |
| Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected   | —                               | —     |
| Balance, end of period   | \$7,488                         | 7,294 |

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

|                               | Quarter ended September 30, |        | Nine Months ended September 30, |        |
|-------------------------------|-----------------------------|--------|---------------------------------|--------|
| (\$ in thousands)             | 2013                        | 2012   | 2013                            | 2012   |
| HTM fixed maturity securities |                             |        |                                 |        |
| Gains                         | \$32                        | 40     | 35                              | 195    |
| Losses                        | (37                         | ) (90  | ) (86                           | ) (196 |
| AFS fixed maturity securities |                             |        |                                 |        |
| Gains                         | 662                         | 2,168  | 2,580                           | 2,941  |
| Losses                        | (31                         | ) (262 | ) (330                          | ) (379 |
| AFS equity securities         |                             |        |                                 |        |
| Gains                         | 13,801                      | —      | 24,272                          | 4,775  |
| Losses                        | (236                        | ) —    | (407                            | ) (428 |

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|   |          |          |          |          |   |
|---|----------|----------|----------|----------|---|
| Short-term investments                    |          |          |          |          |   |
| Losses                                    | —        | —        | —        | (2       | ) |
| Other Investments                         |          |          |          |          |   |
| Gains                                     | —        | —        | —        | 1        |   |
| Losses                                    | (80      | ) —      | (940     | ) —      |   |
| Total other net realized investment gains | 14,111   | 1,856    | 25,124   | 6,907    |   |
| Total OTTI charges recognized in earnings | (680     | ) (2,944 | ) (3,184 | ) (3,459 | ) |
| Total net realized gains (losses)         | \$13,431 | (1,088   | ) 21,940 | 3,448    |   |

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Realized gains and losses on the sale of investments are determined on the basis of the cost of the specific investments sold. Of the \$14.1 million and \$25.1 million in net realized gains in Third Quarter and Nine Months 2013, \$13.5 million and \$19.1 million, respectively, were related to the sale of AFS equity securities due to the rebalancing of our high-dividend yield strategy holdings within our equity portfolio. In addition, \$4.7 million in net realized gains in Nine Months 2013 related to the sale of a private equity security. Of the \$6.9 million of net realized gains in Nine Months 2012, \$4.3 million were related to the sale of AFS equity securities due to the rebalancing of our high dividend yield strategy holdings within our equity portfolio.

Proceeds from the sale of AFS securities were \$67.2 million in Third Quarter 2013 and \$116.3 million in Nine Months 2013, and \$55.0 million and \$150.9 million in the same periods a year ago.

## NOTE 6. Fair Value Measurements

The following table presents the carrying amounts and estimated fair values of our financial instruments as of September 30, 2013 and December 31, 2012:

| (\$ in thousands)   | September 30, 2013 |            | December 31, 2012 |            |
|---|--------------------|------------|-------------------|------------|
|   | Carrying Amount    | Fair Value | Carrying Amount   | Fair Value |
| <b>Financial Assets</b>   |                    |            |                   |            |
| Fixed maturity securities:  |                    |            |                   |            |
| HTM   | \$421,962          | 448,529    | 554,069           | 594,661    |
| AFS   | 3,633,432          | 3,633,432  | 3,296,013         | 3,296,013  |
| Equity securities, AFS  | 180,506            | 180,506    | 151,382           | 151,382    |
| Short-term investments  | 172,087            | 172,087    | 214,479           | 214,479    |
| Receivable for proceeds related to sale of Selective HR Solution ("Selective HR") | —                  | —          | 2,705             | 2,705      |
| <b>Financial Liabilities</b>  |                    |            |                   |            |
| Notes payable:  |                    |            |                   |            |
| 2.90% borrowings from FHLBI   | 13,000             | 13,392     | 13,000            | 13,595     |
| 1.25% borrowings from FHLBI   | 45,000             | 45,171     | 45,000            | 45,590     |
| 7.50% Junior Notes  | —                  | —          | 100,000           | 101,480    |
| 6.70% Senior Notes  | 99,492             | 100,200    | 99,475            | 107,707    |
| 7.25% Senior Notes  | 49,915             | 51,858     | 49,912            | 52,689     |
| 5.875% Senior Notes   | 185,000            | 153,550    | —                 | —          |
| Total notes payable   | \$392,407          | 364,171    | 307,387           | 321,061    |

The fair values of our financial assets and liabilities are generated using various valuation techniques and are placed into the fair value hierarchy considering the following: (i) the highest priority is given to quoted prices in active markets for identical assets (Level 1); (ii) the next highest priority is given to quoted prices in markets that are not active or inputs that are observable either directly or indirectly, including quoted prices for similar assets in markets that are not active and other inputs that can be derived principally from, or corroborated by, observable market data for substantially the full term of the assets (Level 2); and (iii) the lowest priority is given to unobservable inputs supported by little or no market activity and that reflect our assumptions about the exit price, including assumptions that market participants would use in pricing the asset (Level 3). An asset or liability's classification within the fair value hierarchy is based on the lowest level of significant input to its valuation. Transfers between levels in the fair value hierarchy are recognized at the end of the reporting period.

For a discussion of the techniques used to value the majority of our financial assets and liabilities, refer to Note 2. "Summary of Significant Accounting Policies" in Item 8. "Financial Statements and Supplementary Data." of our 2012 Annual Report. The 5.875% Senior Notes were valued based on a quoted market price (Level 1). The fair value

at September 30, 2013 of the 6.70% Senior Notes due November 1, 2035 is based on a matrix pricing model prepared by an external pricing service due to the availability and nature of the pricing at the valuation date (Level 2).

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The following tables provide quantitative disclosures of our financial assets that were measured at fair value at September 30, 2013 and December 31, 2012:

| September 30, 2013                               | Assets Measured at Fair Value at 9/30/13 | Fair Value Measurements Using Quoted Prices in                         |  |   |
|--|--|--|--|---|
|  |  | Active Markets for Identical Assets/Liabilities (Level 1) <sup>1</sup> | Significant Other Observable Inputs (Level 2) <sup>1</sup> | Significant Unobservable Inputs (Level 3) |
| (\$ in thousands)                                |  |  |  |   |
| Description                                      |  |  |  |   |
| Measured on a recurring basis:                   |  |  |  |   |
| AFS:   |  |  |  |   |
| U.S. government and government agencies          | \$ 180,786                               | 50,871   | 129,915  | —   |
| Foreign government                               | 29,709                                   | —  | 29,709   | —   |
| Obligations of states and political subdivisions | 929,498                                  | —  | 929,498  | —   |
| Corporate securities                             | 1,663,151                                | —  | 1,663,151  | —   |
| ABS  | 150,766                                  | —  | 144,804  | 5,962                                     |
| CMBS   | 151,948                                  | —  | 150,339  | 1,609                                     |
| RMBS   | 527,574                                  | —  | 527,574  | —   |
| Total AFS fixed maturity securities              | 3,633,432                                | 50,871   | 3,574,990  | 7,571                                     |
| Equity securities                                | 180,506                                  | 177,606  | —  | 2,900                                     |
| Short-term investments                           | 172,087                                  | 172,087  | —  | —   |
| Total assets                                     | \$3,986,025                              | 400,564  | 3,574,990  | 10,471                                    |

<sup>1</sup>There were no transfers of securities between Level 1 and Level 2.

| December 31, 2012                                | Assets Measured at Fair Value at 12/31/12 | Fair Value Measurements Using Quoted Prices in                         |  |   |
|--|---|--|--|---|
|  |   | Active Markets for Identical Assets/Liabilities (Level 1) <sup>1</sup> | Significant Other Observable Inputs (Level 2) <sup>1</sup> | Significant Unobservable Inputs (Level 3) |
| (\$ in thousands)                                |   |  |  |   |
| Description                                      |   |  |  |   |
| Measured on a recurring basis:                   |   |  |  |   |
| AFS:   |   |  |  |   |
| U.S. government and government agencies          | \$259,092                                 | 115,861  | 123,442  | 19,789                                    |
| Foreign government                               | 30,229                                    | —  | 30,229   | —   |
| Obligations of states and political subdivisions | 818,024                                   | —  | 818,024  | —   |
| Corporate securities                             | 1,450,247                                 | —  | 1,447,301  | 2,946                                     |
| ABS  | 128,640                                   | —  | 122,572  | 6,068                                     |
| CMBS   | 137,119                                   | —  | 129,957  | 7,162                                     |
| RMBS   | 472,662                                   | —  | 472,662  | —   |
| Total AFS fixed maturity securities              | 3,296,013                                 | 115,861  | 3,144,187  | 35,965                                    |
| Equity securities                                | 151,382                                   | 147,775  | —  | 3,607                                     |

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|   |             |         |           |        |
|---|-------------|---------|-----------|--------|
| Short-term investments                                  | 214,479     | 214,479 | —         | —      |
| Receivable for proceeds related to sale of Selective HR | 2,705       | —       | —         | 2,705  |
| Total assets  | \$3,664,579 | 478,115 | 3,144,187 | 42,277 |

<sup>1</sup> There were no transfers of securities between Level 1 and Level 2.

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The following tables provide a summary of the changes in the fair value of securities measured using Level 3 inputs and related quantitative information for the periods ended September 30, 2013 and December 31, 2012:

September 30, 2013

| (\$ in thousands)                                    | Government | Corporate | ABS    | CMBS   | Equity   | Receivable for Proceeds Related to Sale of Selective HR | Total     |
|--|------------|-----------|--------|--------|----------|---|-----------|
| Fair value, December 31, 2012                        | \$19,789   | 2,946     | 6,068  | 7,162  | 3,607    | 2,705   | 42,277    |
| Total net (losses) gains for the period included in: |            |           |        |        |          |   |           |
| OCI <sup>1</sup>                                     | (537       | ) (7      | ) (106 | ) 681  | 3,935    | —   | 3,966     |
| Net income <sup>2,3</sup>                            | (76        | ) —       | —      | 354    | —        | (1,480  | ) (1,202  |
| Purchases  | —          | —         | —      | —      | —        | —   | —         |
| Sales  | —          | —         | —      | —      | —        | —   | —         |
| Issuances  | —          | —         | —      | —      | —        | —   | —         |
| Settlements  | (1,847     | ) (168    | ) —    | (1,603 | ) —      | (225  | ) (3,843  |
| Transfers into Level 3                               | —          | —         | —      | —      | —        | —   | —         |
| Transfers out of Level 3                             | (17,329    | ) (2,771  | ) —    | (4,985 | ) (4,642 | ) (1,000  | ) (30,727 |
| Fair value, September 30, 2013                       | \$—        | —         | 5,962  | 1,609  | 2,900    | —   | 10,471    |

<sup>1</sup> Amounts are reported in “Unrealized holding gains (losses) arising during period” on the Unaudited Consolidated Statements of Comprehensive Income.

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

<sup>3</sup> For the receivable related to the sale of Selective HR, amounts in “Loss on disposal of discontinued operations, net of tax” relate to an impairment charge and amounts in “Other income” relate to interest accretion on the Unaudited Consolidated Statements of Income.

December 31, 2012

| (\$ in thousands)                                    | Government | Corporate | ABS   | CMBS  | Equity | Receivable for Proceeds Related to Sale of Selective HR | Total    |
|--|------------|-----------|-------|-------|--------|---|----------|
| Fair value, December 31, 2011                        | \$21,741   | 2,603     | —     | 354   | —      | 3,212   | 27,910   |
| Total net (losses) gains for the period included in: |            |           |       |       |        |   |          |
| OCI <sup>1</sup>                                     | (22        | ) 185     | 68    | 858   | —      | —   | 1,089    |
| Net income <sup>2,3</sup>                            | (193       | ) —       | —     | (51   | ) —    | 244   | —        |
| Purchases  | —          | —         | 7,300 | 5,611 | —      | —   | 12,911   |
| Sales  | —          | —         | —     | —     | —      | —   | —        |
| Issuances  | —          | —         | —     | —     | —      | —   | —        |
| Settlements  | (1,737     | ) (630    | ) —   | (624  | ) —    | (751  | ) (3,742 |
| Transfers into Level 3                               | —          | 788       | —     | 8,247 | 3,607  | —   | 12,642   |



|                               |           |       |          |          |       |       |          |
|-------------------------------|-----------|-------|----------|----------|-------|-------|----------|
| Transfers out of Level 3      | —         | —     | (1,300 ) | (7,233 ) | —     | —     | (8,533 ) |
| Fair value, December 31, 2012 | \$ 19,789 | 2,946 | 6,068    | 7,162    | 3,607 | 2,705 | 42,277   |

<sup>1</sup> Amounts are reported in “Unrealized holding gains arising during period” on the Consolidated Statements of Comprehensive Income in our 2012 Annual Report.

<sup>2</sup> Amounts are reported in “Net realized gains (losses)” for realized gains and losses and “Net investment income earned” for amortization for the CMBS securities on the Consolidated Statements of Income in our 2012 Annual Report.

<sup>3</sup> Amounts are reported in “Other income” for the receivable related to the sale of Selective HR on the Consolidated Statements of Income in our 2012 Annual Report and are related to interest accretion on the receivable.

As discussed in Note 2. "Summary of Significant Accounting Policies," in Item 8. "Financial Statements and Supplementary Data." in our 2012 Annual Report, the fair value of our Level 3 fixed maturity securities is typically obtained through non-binding broker quotes based on unobservable inputs, which we review for reasonableness. At September 30, 2013 and December 31, 2012, fixed maturity securities with aggregate fair values of \$7.6 million and \$36.0 million, respectively, were measured using Level 3 inputs primarily due to the availability and nature of the pricing used at the valuation dates.

During Nine Months 2013, fixed maturity securities with an aggregate fair value of \$25.1 million were transferred out of Level 3 due to the availability of Level 2 pricing that was not available previously.

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In 2012, fixed maturity securities with a fair value of \$9.0 million were transferred into Level 3 during the year. These transfers were primarily related to securities that had been previously priced using Level 2 inputs, but due to the availability and nature of the pricing used at the valuation dates, were priced using Level 3 inputs at December 31, 2012. In addition, certain of these transfers related to securities that had previously been classified as HTM, and therefore not measured at fair value, for which available pricing at December 31, 2012 used Level 3 inputs. Securities with a fair value of \$8.5 million were transferred out of Level 3 due to the availability of Level 2 pricing at December 31, 2012 that was not available previously.

Equity securities with fair values of \$2.9 million and \$3.6 million were measured using Level 3 inputs at September 30, 2013 and December 31, 2012, respectively. During 2012, two non-publicly traded equity securities were transferred into Level 3 due to the nature of the quotes used at the valuation date. One of these securities was transferred out of Level 3 and into Level 2 at March 31, 2013, as the pricing as of that date was based on a quoted price in an inactive market. This security was subsequently sold in the second quarter of 2013 for an amount that approximated the March 31, 2013 value. At each reporting date, we review the fair value of the remaining Level 3 security for reasonableness.

At December 31, 2012, the receivable related to the sale of Selective HR was contingent on the purchaser's ability to retain business subsequent to the sale. At that time, the fair value of this receivable was measured using unobservable inputs, the most significant of which was our assumption regarding the retention of business. In the first quarter of 2013, we reached an agreement with the purchaser to settle this receivable for an aggregate of \$1.0 million, which was paid in two installments. As a result, the receivable was transferred out of Level 3. See Note 12. "Discontinued Operations" of this Form 10-Q for a discussion of the impairment charge that was recorded on this receivable in the first quarter of 2013.

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The following tables provide quantitative information regarding our financial assets and liabilities that were disclosed at fair value at September 30, 2013 and December 31, 2012:

September 30, 2013

| (\$ in thousands)                                | Assets/<br>Liabilities<br>Disclosed at<br>Fair Value at<br>9/30/2013 | Fair Value Measurements Using<br>Quoted Prices<br>in                      |   |  |
|--|--|---|---|--|
|  |  | Active<br>Markets for<br>Identical<br>Assets/<br>Liabilities<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>Financial Assets</b>                          |  |   |   |  |
| <b>HTM:</b>                                      |  |   |   |  |
| Foreign government                               | \$5,565  | —   | 5,565   | —  |
| Obligations of states and political subdivisions | 395,643  | —   | 395,643   | —  |
| Corporate securities                             | 31,777   | —   | 31,777  | —  |
| ABS  | 5,911  | —   | 4,854   | 1,057  |
| CMBS   | 9,633  | —   | 9,633   | —  |
| Total HTM fixed maturity securities              | \$448,529  | —   | 447,472   | 1,057  |

Financial Liabilities

Notes payable:

|                             |           |         |         |   |
|-----------------------------|-----------|---------|---------|---|
| 2.90% borrowings from FHLBI | \$13,392  | —       | 13,392  | — |
| 1.25% borrowings from FHLBI | 45,171    | —       | 45,171  | — |
| 6.70% Senior Notes          | 100,200   | —       | 100,200 | — |
| 7.25% Senior Notes          | 51,858    | —       | 51,858  | — |
| 5.875% Senior Notes         | 153,550   | 153,550 | —       | — |
| Total notes payable         | \$364,171 | 153,550 | 210,621 | — |

December 31, 2012

| (\$ in thousands)                                | Assets/<br>Liabilities<br>Disclosed at<br>Fair Value at<br>12/31/2012 | Fair Value Measurements Using<br>Quoted Prices<br>in                      |   |  |
|--|---|---|---|--|
|  |   | Active<br>Markets for<br>Identical<br>Assets/<br>Liabilities<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>Financial Assets</b>                          |   |   |   |  |
| <b>HTM:</b>                                      |   |   |   |  |
| Foreign government                               | \$5,871   | —   | 5,871   | —  |
| Obligations of states and political subdivisions | 526,922   | —   | 526,922   | —  |
| Corporate securities                             | 42,121  | —   | 37,289  | 4,832  |
| ABS  | 7,097   | —   | 5,698   | 1,399  |
| CMBS   | 12,650  | —   | 12,650  | —  |
| Total HTM fixed maturity securities              | \$594,661   | —   | 588,430   | 6,231  |
| <b>Financial Liabilities</b>                     |   |   |   |  |
| <b>Notes payable:</b>                            |   |   |   |  |
| 2.90% borrowings from FHLBI                      | \$13,595  | —   | 13,595  | —  |
| 1.25% borrowings from FHLBI                      | 45,590  | —   | 45,590  | —  |
| 7.50% Junior Notes                               | 101,480   | 101,480   | —   | —  |

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|                     |           |         |         |   |
|---------------------|-----------|---------|---------|---|
| 6.70% Senior Notes  | 107,707   | 107,707 | —       | — |
| 7.25% Senior Notes  | 52,689    | —       | 52,689  | — |
| Total notes payable | \$321,061 | 209,187 | 111,874 | — |

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## NOTE 7. Reinsurance

The following table contains a listing of direct, assumed, and ceded reinsurance amounts for premiums written, premiums earned, and loss and loss expenses incurred for the periods indicated. For more information concerning reinsurance, refer to Note 8. "Reinsurance" in Item 8. "Financial Statements and Supplementary Data." of our 2012 Annual Report.

| (\$ in thousands)               | Quarter ended September 30, |           | Nine Months ended September 30, |            |
|---------------------------------|-----------------------------|-----------|---------------------------------|------------|
|                                 | 2013                        | 2012      | 2013                            | 2012       |
| Premiums written:               |                             |           |                                 |            |
| Direct                          | \$570,849                   | 520,943   | 1,650,855                       | 1,504,429  |
| Assumed                         | 22,053                      | 17,976    | 34,913                          | 44,712     |
| Ceded                           | (100,154                    | ) (88,401 | ) (280,719                      | ) (252,888 |
| Net                             | \$492,748                   | 450,518   | 1,405,049                       | 1,296,253  |
| Premiums earned:                |                             |           |                                 |            |
| Direct                          | \$518,307                   | 474,055   | 1,516,454                       | 1,389,373  |
| Assumed                         | 11,066                      | 18,595    | 32,480                          | 49,683     |
| Ceded                           | (91,805                     | ) (86,425 | ) (264,174                      | ) (261,790 |
| Net                             | \$437,568                   | 406,225   | 1,284,760                       | 1,177,266  |
| Loss and loss expense incurred: |                             |           |                                 |            |
| Direct                          | \$350,648                   | 327,883   | 1,055,248                       | 881,537    |
| Assumed                         | 7,264                       | 13,970    | 22,758                          | 35,039     |
| Ceded                           | (74,595                     | ) (69,602 | ) (245,246                      | ) (103,516 |
| Net                             | \$283,317                   | 272,251   | 832,760                         | 813,060    |

The growth in direct premium written ("DPW") for our ten insurance subsidiaries ("Insurance Subsidiaries") in both Third Quarter and Nine Months 2013 compared to Third Quarter and Nine Months 2012 reflects: (i) pure price increases that we have achieved in our Standard Insurance Operations; and (ii) strong retention in our Standard Insurance Operations.

Direct premiums earned increases in Third Quarter and Nine Months 2013 were consistent with the fluctuation in DPW for the twelve-month period ended September 30, 2013 as compared to the twelve-month period ended September 30, 2012.

Assumed premiums written for Nine Months 2013 decreased compared to the same period last year as E&S business, which was previously written through a reinsurance fronting agreement, is now written directly by our Insurance Subsidiaries. Decreases in assumed premiums earned in Third Quarter and Nine Months 2013 compared to Third Quarter and Nine Months 2012 were driven by the E&S premiums.

Direct loss and loss expense incurred in Nine Months 2013 included an increase of approximately \$128 million related to flood losses covered under the NFIP for Hurricane Sandy, which occurred in October 2012. Total estimated gross flood losses covered by the Insurance Subsidiaries' WYO policies under the NFIP program for this storm were \$1,179 million at September 30, 2013 and \$1,052 million at December 31, 2012, of which approximately \$1,148 million was paid through September 30, 2013.

As all flood losses are fully ceded under the NFIP, the increase in direct loss and loss expense drives the corresponding increase in our ceded losses.

The ceded premiums and losses related to our participation in the NFIP, under which 100% of our flood premiums, losses, and loss expenses are ceded to the NFIP, are as follows:

| NFIP<br>(\$ in thousands) | Quarter ended September 30, |      | Nine Months ended September 30, |      |
|---------------------------|-----------------------------|------|---------------------------------|------|
|                           | 2013                        | 2012 | 2013                            | 2012 |

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|                                      |           |           |            |            |   |
|--------------------------------------|-----------|-----------|------------|------------|---|
| Ceded premiums written               | \$(64,196 | ) (58,923 | ) (183,364 | ) (171,172 | ) |
| Ceded premiums earned                | (57,920   | ) (53,222 | ) (169,697 | ) (157,895 | ) |
| Ceded loss and loss expense incurred | (34,879   | ) (32,702 | ) (162,780 | ) (24,534  | ) |

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## NOTE 8. Segment Information

The results of our three operating segments are used by senior management to manage our operations. These segments are evaluated based on the following:

Our Standard Insurance Operations segment and our E&S Insurance Operations segment are evaluated based on statutory underwriting results (net premiums earned, incurred loss and loss expenses, policyholders dividends, policy acquisition costs, and other underwriting expenses), and statutory combined ratios; and

Our Investments segment is evaluated based on net investment income and net realized gains and losses.

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

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

| Revenue by Segment<br>(\$ in thousands)                 | Quarter ended September 30, |         | Nine Months ended September 30, |           |
|---|-----------------------------|---------|---------------------------------|-----------|
|   | 2013                        | 2012    | 2013                            | 2012      |
| Standard Insurance Operations:                          |                             |         |                                 |           |
| Net premiums earned:                                    |                             |         |                                 |           |
| Commercial automobile                                   | \$79,138                    | 72,758  | 230,191                         | 214,782   |
| Workers compensation                                    | 66,510                      | 65,592  | 197,449                         | 198,064   |
| General liability                                       | 100,925                     | 93,763  | 298,394                         | 276,538   |
| Commercial property                                     | 57,004                      | 52,197  | 165,356                         | 151,945   |
| Businessowners' policies                                | 19,629                      | 17,749  | 56,794                          | 51,872    |
| Bonds   | 4,705                       | 4,713   | 14,244                          | 14,076    |
| Other   | 3,051                       | 2,921   | 9,036                           | 9,202     |
| Total standard Commercial Lines                         | 330,962                     | 309,693 | 971,464                         | 916,479   |
| Personal automobile                                     | 38,513                      | 38,295  | 115,432                         | 113,648   |
| Homeowners  | 32,374                      | 29,919  | 95,211                          | 86,685    |
| Other   | 3,827                       | 3,591   | 10,655                          | 10,037    |
| Total standard Personal Lines                           | 74,714                      | 71,805  | 221,298                         | 210,370   |
| Total Standard Insurance Operations net premiums earned | 405,676                     | 381,498 | 1,192,762                       | 1,126,849 |
| Miscellaneous income                                    | 3,342                       | 1,009   | 9,590                           | 6,904     |
| Total Standard Insurance Operations revenue             | 409,018                     | 382,507 | 1,202,352                       | 1,133,753 |
| E&S Insurance Operations:                               |                             |         |                                 |           |
| Net premiums earned                                     | 31,892                      | 24,727  | 91,998                          | 50,417    |
| Investments:  |                             |         |                                 |           |
| Net investment income                                   | 32,457                      | 30,650  | 99,330                          | 97,284    |
| Net realized investment gains (losses)                  | 13,431                      | (1,088) | ) 21,940                        | 3,448     |
| Total investment revenues                               | 45,888                      | 29,562  | 121,270                         | 100,732   |
| Total all segments                                      | 486,798                     | 436,796 | 1,415,620                       | 1,284,902 |
| Other income  | 15                          | 76      | 87                              | 225       |
| Total revenues from continuing operations               | \$486,813                   | 436,872 | 1,415,707                       | 1,285,127 |

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| Income from Continuing Operations before Federal<br>Income Tax<br>(\$ in thousands)        | Quarter ended September 30, |           | Nine Months ended September<br>30, |            |
|--|-----------------------------|-----------|------------------------------------|------------|
|  | 2013                        | 2012      | 2013                               | 2012       |
| Standard Insurance Operations:   |                             |           |                                    |            |
| Commercial Lines underwriting gain (loss)  | \$8,776                     | (651)     | ) 24,621                           | (14,666)   |
| Personal Lines underwriting gain   | 1,362                       | 7,220     | 4,360                              | 2,903      |
| Total Standard Insurance Operations underwriting<br>gain (loss), before federal income tax | 10,138                      | 6,569     | 28,981                             | (11,763)   |
| GAAP combined ratio  | 97.5                        | % 98.3    | 97.6                               | 101.0      |
| Statutory combined ratio   | 96.0                        | % 96.9    | 96.6                               | 100.1      |
| E&S Insurance Operations:  |                             |           |                                    |            |
| Underwriting gain (loss)   | 13                          | (5,708)   | ) (2,186)                          | ) (15,701) |
| GAAP combined ratio  | 100.0                       | % 123.1   | 102.4                              | 131.1      |
| Statutory combined ratio   | 100.5                       | % 121.6   | 101.9                              | 120.3      |
| Investments:   |                             |           |                                    |            |
| Net investment income  | 32,457                      | 30,650    | 99,330                             | 97,284     |
| Net realized investment gains (losses)   | 13,431                      | (1,088)   | ) 21,940                           | 3,448      |
| Total investment income, before federal income tax   | 45,888                      | 29,562    | 121,270                            | 100,732    |
| Total all segments   | 56,039                      | 30,423    | 148,065                            | 73,268     |
| Interest expense   | (5,570)                     | ) (4,725) | ) (16,971)                         | ) (14,148) |
| General corporate and other expenses   | (5,984)                     | ) (5,384) | ) (21,540)                         | ) (16,307) |
| Income from continuing operations before federal<br>income tax                             | \$44,485                    | 20,314    | 109,554                            | 42,813     |

## NOTE 9. Indebtedness

## (a) Notes Payable

In the first quarter of 2013, we issued \$185 million of 5.875% Senior Notes due 2043. The Senior Notes pay interest on February 15, May 15, August 15, and November 15 of each year, beginning on May 15, 2013, and at maturity. The notes are callable by us on or after February 8, 2018, at a price equal to 100% of their principal outstanding amount, plus accrued and unpaid interest to, but excluding, the date of redemption. A portion of the proceeds from this debt issuance was used to fully redeem the \$100 million aggregate principal amount of our 7.5% Junior Subordinated Notes due 2066, which had an associated \$3.3 million pre-tax write-off for the remaining capitalized debt issuance costs on these notes. Of the remaining net proceeds, \$57.1 million was used to make capital contributions to the Insurance Subsidiaries, while the balance was used for general corporate purposes.

## (b) Short-Term Debt

Our line of credit ("Line of Credit") with Wells Fargo Bank, National Association, as administrative agent, and Branch Banking and Trust Company (BB&T), was renewed effective September 26, 2013 with a borrowing capacity of \$30 million, which can be increased to \$50 million with the approval of both lending partners. The Line of Credit provides the Parent with an additional source of short-term liquidity. The interest rate on our Line of Credit varies and is based on, among other factors, the Parent's debt ratings. The Line of Credit expires on September 26, 2017. There have been no balances outstanding under this Line of Credit or the previous credit facility at September 30, 2013 or at any time during Nine Months 2013.

The Line of Credit agreement contains representations, warranties, and covenants that are customary for credit facilities of this type, including, without limitation, financial covenants under which we are obligated to maintain a



minimum consolidated net worth, minimum combined statutory surplus, and maximum ratio of consolidated debt to total capitalization, as well as covenants limiting our ability to: (i) merge or liquidate; (ii) incur debt or liens; (iii) dispose of assets; (iv) make certain investments and acquisitions; and (v) engage in transactions with affiliates. The Line of Credit permits collateralized borrowings by the two Insurance Subsidiaries domiciled in Indiana ("Indiana Subsidiaries") from the FHLBI so long as the aggregate amount borrowed does not exceed 10% of the respective Indiana Subsidiary's admitted assets from the preceding calendar year.

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

|   | Required as of<br>September 30, 2013 | Actual as of<br>September 30, 2013 |
|---|--------------------------------------|------------------------------------|
| Consolidated net worth                    | \$785 million                        | \$1.1 billion                      |
| Statutory surplus                         | Not less than \$750<br>million       | \$1.2 billion                      |
| Debt-to-capitalization ratio <sup>1</sup> | Not to exceed 35%                    | 26.0%                              |
| A.M. Best financial strength rating       | Minimum of A-                        | A                                  |

<sup>1</sup>Calculated in accordance with the Line of Credit agreement.

For additional information related to all our outstanding debt, refer to Note 10. "Indebtedness" in Item 8. "Financial Statements and Supplementary Data." of our 2012 Annual Report.

## NOTE 10. Retirement Plans

The Retirement Income Plan for Selective Insurance Company of America and the Supplemental Excess Retirement Plan (jointly referred to as the "Retirement Income Plan") were amended in the first quarter of 2013 to curtail the accrual of additional benefits for all employees eligible to participate in the plans after March 31, 2016. The curtailment of the plans resulted in a net actuarial gain recognized in OCI of \$44.0 million on a pre-tax basis.

As a result of the curtailment, the Retirement Income Plan was re-measured as of March 31, 2013. When determining the most appropriate discount rate to be used in the valuation, we considered, among other factors, our expected payout patterns of the Retirement Income Plan's obligations, as well as our investment strategy. We ultimately selected the rate that we believe best represents our estimate of the inherent interest rate at which the Retirement Income Plan's liabilities can be effectively settled. The expected rate of return on plan assets at March 31, 2013 remained at 7.40%, consistent with our December 31, 2012 assumption. For re-measurement, we determined that the most appropriate discount rate was 4.66%, up slightly from 4.42% determined as of December 31, 2012.

Eligible employees impacted by the curtailment of the Retirement Income Plan began receiving, on April 5, 2013, an enhanced company contribution to the Selective Insurance Retirement Savings Plan of 4% of base salary, which is the enhanced company contribution currently provided to all employees not eligible to participate in the Retirement Income Plan.

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The funded status of the Retirement Income Plan recognized in the Consolidated Balance Sheets as of September 30, 2013, the valuation of which was updated as of March 31, 2013 as a result of the first quarter curtailment discussed above, and December 31, 2012, was as follows:

| (\$ in thousands)                                | Retirement Income Plan |                   |
|--|------------------------|-------------------|
|  | September 30, 2013     | December 31, 2012 |
| Change in Benefit Obligation:                    |                        |                   |
| Benefit obligation, beginning of year            | \$302,647              | 254,009           |
| Service cost                                     | 2,449                  | 8,091             |
| Interest cost                                    | 3,303                  | 12,981            |
| Actuarial (gain) losses                          | (11,485                | ) 33,596          |
| Benefits paid                                    | (1,598                 | ) (6,030          |
| Impact of curtailment                            | (29,603                | ) —               |
| Benefit obligation, end of period                | \$265,713              | 302,647           |
| Change in Fair Value of Assets:                  |                        |                   |
| Fair value of assets, beginning of year          | \$207,150              | 182,614           |
| Actual return on plan assets, net of expenses    | 6,760                  | 21,896            |
| Contribution by employer to funded plans         | 2,650                  | 8,550             |
| Contribution by employer to unfunded plans       | 30                     | 120               |
| Benefits paid                                    | (1,598                 | ) (6,030          |
| Fair value of assets, end of period              | \$214,992              | 207,150           |
| Funded status                                    | \$(50,721              | ) (95,497         |
| Amount Recognized in Consolidated Balance Sheet: |                        |                   |
| Liabilities                                      | \$(50,721              | ) (95,497         |
| Net pension liability, end of period             | \$(50,721              | ) (95,497         |
| Amount Recognized in AOCI:                       |                        |                   |
| Prior service cost                               | \$—                    | 26                |
| Net actuarial loss                               | 57,543                 | 103,365           |
| Total  | \$57,543               | 103,391           |
| Other Information:                               |                        |                   |
| Accumulated benefit obligation                   | \$257,412              | 265,899           |
| Weighted-Average Liability Assumptions:          |                        |                   |
| Discount Rate                                    | 4.66                   | % 4.42            |
| Rate of compensation increase                    | 4.00                   | % 4.00            |

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The following table shows the cost of the Retirement Income Plan and the life insurance benefit ("Retirement Life Plan") for the quarterly and nine month periods ended September 30, 2013 and September 30, 2012:

| (\$ in thousands)  | Retirement Income Plan<br>Quarter ended September 30,        |           | Retirement Life Plan<br>Quarter ended September 30,        |       |
|--|--|-----------|--|-------|
|  | 2013   | 2012      | 2013   | 2012  |
| Components of Net Periodic Benefit Cost and Other Amounts Recognized in OCI: |  |           |  |       |
| Net Periodic Benefit Cost:   |  |           |  |       |
| Service cost   | \$1,857  | 2,154     | —  | —     |
| Interest cost  | 3,053  | 3,230     | 69   | 73    |
| Expected return on plan assets   | (3,986   | ) (3,547  | ) —  | —     |
| Amortization of unrecognized prior service cost                              | —  | 38        | —  | —     |
| Amortization of unrecognized net actuarial loss                              | 772  | 1,383     | 18   | 8     |
| Total net periodic cost  | \$1,696  | 3,258     | 87   | 81    |
| Other Changes in Plan Assets and Benefit Obligations Recognized in OCI:      |  |           |  |       |
| Reversal of amortization of net actuarial loss                               | \$(772   | ) (1,383  | ) (18  | ) (8  |
| Reversal of amortization of prior service cost                               | —  | (38       | ) —  | —     |
| Total recognized in OCI  | \$(772   | ) (1,421  | ) (18  | ) (8  |
| Total recognized in net periodic benefit cost and OCI                        | \$924  | 1,837     | 69   | 73    |
|  |  |           |  |       |
| (\$ in thousands)  | Retirement Income Plan<br>Nine Months ended<br>September 30, |           | Retirement Life Plan<br>Nine Months ended<br>September 30, |       |
|  | 2013   | 2012      | 2013   | 2012  |
| Components of Net Periodic Benefit Cost and Other Amounts Recognized in OCI: |  |           |  |       |
| Net Periodic Benefit Cost:   |  |           |  |       |
| Service cost   | \$6,163  | 6,462     | —  | —     |
| Interest cost  | 9,407  | 9,690     | 208  | 221   |
| Expected return on plan assets   | (11,819  | ) (10,641 | ) —  | —     |
| Amortization of unrecognized prior service cost                              | 10   | 113       | —  | —     |
| Amortization of unrecognized net actuarial loss                              | 3,366  | 4,149     | 53   | 23    |
| Curtailment expense  | 16   | —         | —  | —     |
| Total net periodic cost  | \$7,143  | 9,773     | 261  | 244   |
| Other Changes in Plan Assets and Benefit Obligations Recognized in OCI:      |  |           |  |       |
| Net actuarial gain due to curtailment  | \$(44,000  | ) —       | —  | —     |
| Reversal of amortization of net actuarial loss                               | (3,366   | ) (4,149  | ) (53  | ) (23 |
| Reversal of amortization of prior service cost                               | (10  | ) (113    | ) —  | —     |
| Curtailment expense  | (16  | ) —       | —  | —     |
| Total recognized in OCI  | \$(47,392  | ) (4,262  | ) (53  | ) (23 |

|   |           |         |     |     |
|---|-----------|---------|-----|-----|
| Total recognized in net periodic benefit cost and OCI | \$(40,249 | ) 5,511 | 208 | 221 |
|---|-----------|---------|-----|-----|

The amortization of prior service cost related to the Retirement Income Plan is determined using a straight-line amortization of the cost over the average remaining service period of employees expected to receive benefits under the Retirement Income Plan.

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The estimated net actuarial loss for the Retirement Income Plan that will be amortized from AOCI into net periodic benefit cost during the 2013 fiscal year is \$4.1 million.

|                                       | Retirement Income Plan               |        | Retirement Life Plan                 |        |
|---------------------------------------|--------------------------------------|--------|--------------------------------------|--------|
|                                       | Nine Months ended September 30, 2013 |        | Nine Months ended September 30, 2012 |        |
| Weighted-Average Expense Assumptions: |                                      |        |                                      |        |
| Discount rate                         | 4.66                                 | % 5.16 | 4.42                                 | % 5.16 |
| Expected return on plan assets        | 7.40                                 | 7.75   | —                                    | —      |
| Rate of compensation increase         | 4.00                                 | 4.00   | —                                    | —      |

The following table presents future benefit payments expected under the Retirement Income Plan:

| (\$ in thousands)                            | Retirement Income Plan |
|--|------------------------|
| Benefits Expected to be Paid in Future Years |                        |
| Fiscal Years:                                |                        |
| 2013   | \$7,586                |
| 2014   | 8,384                  |
| 2015   | 9,148                  |
| 2016   | 9,942                  |
| 2017   | 10,810                 |
| 2018-2022                                    | 67,447                 |

For additional information regarding our retirement plans, refer to Note 15. "Retirement Plans" included in Item 8. "Financial Statements and Supplementary Data." of our 2012 Annual Report.

## NOTE 11. Comprehensive Income

The components of comprehensive income, both gross and net of tax, for Third Quarter and Nine Months 2013 and 2012 are as follows:

| Third Quarter 2013<br>(\$ in thousands)            | Gross    | Tax      | Net      |   |
|--|----------|----------|----------|---|
| Net income   | \$44,485 | 11,832   | 32,653   |   |
| Components of OCI:                                 |          |          |          |   |
| Unrealized losses on investment securities:        |          |          |          |   |
| Unrealized gains during the period                 | 9,820    | 3,437    | 6,383    |   |
| Amounts reclassified into net income:              |          |          |          |   |
| HTM securities                                     | (472     | ) (165   | ) (307   | ) |
| Non-credit OTTI                                    | 1        | —        | 1        |   |
| Realized gains on AFS securities                   | (13,516  | ) (4,731 | ) (8,785 | ) |
| Net unrealized losses                              | (4,167   | ) (1,459 | ) (2,708 | ) |
| Defined benefit pension and post-retirement plans: |          |          |          |   |
| Amounts reclassified into net income:              |          |          |          |   |
| Net actuarial loss                                 | 790      | 277      | 513      |   |
| Defined benefit pension and post-retirement plans  | 790      | 277      | 513      |   |
| Other comprehensive loss                           | (3,377   | ) (1,182 | ) (2,195 | ) |
| Comprehensive income                               | \$41,108 | 10,650   | 30,458   |   |



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## Third Quarter 2012

(\$ in thousands)

|  | Gross    | Tax    | Net    |
|--|----------|--------|--------|
| Net income   | \$20,314 | 2,040  | 18,274 |
| Components of OCI:                                 |          |        |        |
| Unrealized gains on investment securities:         |          |        |        |
| Unrealized holding gains during the period         | 36,620   | 12,817 | 23,803 |
| Non-credit OTTI recognized in OCI                  | 2,023    | 708    | 1,315  |
| Amounts reclassified into net income:              |          |        |        |
| HTM securities                                     | (336     | ) (117 | ) (219 |
| Non-credit OTTI                                    | 9        | 3      | 6      |
| Realized losses on AFS securities                  | 1,037    | 363    | 674    |
| Net unrealized gains                               | 39,353   | 13,774 | 25,579 |
| Defined benefit pension and post-retirement plans: |          |        |        |
| Amounts reclassified into net income:              |          |        |        |
| Net actuarial loss                                 | 1,391    | 487    | 904    |
| Prior service cost                                 | 38       | 14     | 24     |
| Defined benefit pension and post-retirement plans  | 1,429    | 501    | 928    |
| Other comprehensive income                         | 40,782   | 14,275 | 26,507 |
| Comprehensive income                               | \$61,096 | 16,315 | 44,781 |

## Nine Months 2013

(\$ in thousands)

|  | Gross     | Tax       | Net       |
|--|-----------|-----------|-----------|
| Net income   | \$108,019 | 26,936    | 81,083    |
| Components of OCI:                                 |           |           |           |
| Unrealized losses on investment securities:        |           |           |           |
| Unrealized holding losses during the period        | (77,810   | ) (27,234 | ) (50,576 |
| Non-credit OTTI recognized in OCI                  | 77        | 27        | 50        |
| Amounts reclassified into net income:              |           |           |           |
| HTM securities                                     | (1,803    | ) (631    | ) (1,172  |
| Non-credit OTTI                                    | 14        | 5         | 9         |
| Realized gains on AFS securities                   | (24,780   | ) (8,673  | ) (16,107 |
| Net unrealized losses                              | (104,302  | ) (36,506 | ) (67,796 |
| Defined benefit pension and post-retirement plans: |           |           |           |
| Net actuarial gain                                 | 44,000    | 15,400    | 28,600    |
| Amounts reclassified into net income:              |           |           |           |
| Net actuarial loss                                 | 3,419     | 1,197     | 2,222     |
| Prior service cost                                 | 10        | 4         | 6         |
| Curtailed expense                                  | 16        | 5         | 11        |
| Defined benefit pension and post-retirement plans  | 47,445    | 16,606    | 30,839    |
| Other comprehensive loss                           | (56,857   | ) (19,900 | ) (36,957 |
| Comprehensive income                               | \$51,162  | 7,036     | 44,126    |



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Nine Months 2012

(\$ in thousands)

|  | Gross     | Tax      | Net      |
|--|-----------|----------|----------|
| Net income   | \$42,813  | 6,158    | 36,655   |
| Components of OCI:                                 |           |          |          |
| Unrealized gains on investment securities:         |           |          |          |
| Unrealized holding gains during the period         | 64,273    | 22,496   | 41,777   |
| Non-credit OTTI recognized in OCI                  | 2,241     | 784      | 1,457    |
| Amounts reclassified into net income:              |           |          |          |
| HTM securities                                     | (1,901    | ) (665   | ) (1,236 |
| Non-credit OTTI                                    | 272       | 95       | 177      |
| Realized gains on AFS securities                   | (3,451    | ) (1,208 | ) (2,243 |
| Net unrealized gains                               | 61,434    | 21,502   | 39,932   |
| Defined benefit pension and post-retirement plans: |           |          |          |
| Amounts reclassified into net income:              |           |          |          |
| Net actuarial loss                                 | 4,172     | 1,460    | 2,712    |
| Prior service cost                                 | 113       | 40       | 73       |
| Defined benefit pension and post-retirement plans  | 4,285     | 1,500    | 2,785    |
| Other comprehensive income                         | 65,719    | 23,002   | 42,717   |
| Comprehensive income                               | \$108,532 | 29,160   | 79,372   |

The balances of, and changes in, each component of AOCI (net of taxes) as of September 30, 2013 are as follows:

| September 30, 2013<br>(\$ in thousands) | Net Unrealized (Loss) Gain on Investment Securities |                |              |                         | Defined Benefit<br>Pension and<br>Post-Retirement<br>Plans | Total AOCI |
|---|---|----------------|--------------|-------------------------|--|------------|
|   | OTTI<br>Related                                     | HTM<br>Related | All<br>Other | Investments<br>Subtotal |  |            |
| Balance, December 31, 2012              | \$(1,658  | ) 2,594        | 121,391      | 122,327                 | (68,287  | ) 54,040   |
| OCI before reclassifications            | 50  | (103           | ) (50,473    | ) (50,526               | ) 28,600   | (21,926    |
| Amounts reclassified from AOCI          | 9   | (1,172         | ) (16,107    | ) (17,270               | ) 2,239  | (15,031    |
| Net current period OCI                  | 59  | (1,275         | ) (66,580    | ) (67,796               | ) 30,839   | (36,957    |
| Balance, September 30, 2013             | \$(1,599  | ) 1,319        | 54,811       | 54,531                  | (37,448  | ) 17,083   |

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The reclassifications out of AOCI for Third Quarter and Nine Months 2013 are as follows:

| (\$ in thousands)   | Amount Reclassified from AOCI    |                                      | Affected Line Item in the Unaudited Consolidated Statement of Income  |
|---|----------------------------------|--------------------------------------|---|
|   | Quarter ended September 30, 2013 | Nine Months ended September 30, 2013 |   |
| <b>OTTI related</b>   |                                  |                                      |   |
| Amortization of non-credit OTTI losses on HTM securities      | \$1                              | 14                                   | Net investment income earned  |
|   | 1                                | 14                                   | Income (loss) from continuing operations, before federal income tax   |
|   | —                                | (5                                   | ) Total federal income tax expense (benefit)                          |
|   | 1                                | 9                                    | ) Net income  |
| <b>HTM related</b>  |                                  |                                      |   |
| Unrealized gains and losses on HTM disposals                  | (19                              | ) (170                               | ) Net realized investment gains                                       |
| Amortization of net unrealized gains on HTM securities        | (453                             | ) (1,633                             | ) Net investment income earned  |
|   | (472                             | ) (1,803                             | ) Income (loss) from continuing operations, before federal income tax |
|   | 165                              | 631                                  | Total federal income tax expense (benefit)                            |
|   | (307                             | ) (1,172                             | ) Net income  |
| Realized gains and losses on AFS                              |                                  |                                      |   |
| Realized gains and losses on AFS disposals                    | (13,516                          | ) (24,780                            | ) Net realized investments gains                                      |
|   | (13,516                          | ) (24,780                            | ) Income (loss) from continuing operations, before federal income tax |
|   | 4,731                            | 8,673                                | Total federal income tax expense (benefit)                            |
|   | (8,785                           | ) (16,107                            | ) Net income  |
| <b>Defined benefit pension and post-retirement life plans</b> |                                  |                                      |   |
| Net actuarial loss  | 159                              | 717                                  | Loss and loss expense incurred  |
|   | 631                              | 2,702                                | Policy acquisition costs  |
|   | 790                              | 3,419                                | Income (loss) from continuing operations, before federal income tax   |
| <b>Prior service cost</b>                                     |                                  |                                      |   |
|   | —                                | 7                                    | Loss and loss expense incurred  |
|   | —                                | 3                                    | Policy acquisition costs  |
|   | —                                | 10                                   | Income (loss) from continuing operations, before federal income tax   |
| <b>Curtailement expense</b>                                   |                                  |                                      |   |
|   | —                                | 16                                   | Policy acquisition costs  |
|   | —                                | 16                                   | Income (loss) from continuing operations, before federal income tax   |
|   | 790                              | 3,445                                |   |

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|  |          |             |   |
|--|----------|-------------|---|
| Total defined benefit pension and post-retirement life |          |             | Income (loss) from continuing operations, before federal income tax |
|  | (277     | ) (1,206    | ) Total federal income tax expense                                  |
|  | 513      | 2,239       | (benefit)   |
|  |          |             | Net income  |
| Total reclassifications for the period                 | \$(8,578 | ) \$(15,031 | ) Net income  |

Note 12. Discontinued Operations

In the fourth quarter of 2009, we sold 100% of our interest in Selective HR for proceeds to be received over a 10-year period. These proceeds were based on the ability of the purchaser to retain and generate new worksite lives through the independent agents who distribute the products. We settled the remaining receivable for an aggregate of \$1.0 million, which was received in two installments during the second quarter of 2013, in full and final settlement of the contingent purchase price. An impairment of \$1.5 million was recorded in the first quarter of 2013 and is included in "Loss on disposal of discontinued operations, net of tax" in the Unaudited Consolidated Statements of Income.

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Note 13. Litigation

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

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

Note 14. Commitments and Contingencies

At September 30, 2013, we had contractual obligations that expire at various dates through 2026 to invest up to an additional \$58.9 million in alternative and other investments. There is no certainty that all of such additional investments will be required.

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

Forward-Looking Statements

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

Introduction

We classify our business into three operating segments:

- Standard Insurance Operations - comprised of both commercial lines ("Commercial Lines") and personal lines ("Personal Lines") insurance products and services that are sold in the standard marketplace;

- Excess and Surplus ("E&S") Insurance Operations - comprised of Commercial Lines insurance products and services that are unavailable in the standard market due to market conditions or characteristics of the insured that are caused by the insured's claim history or the characteristics of their business; and

- Investments - invests the premiums collected by our Standard and E&S Insurance Operations, as well as amounts generated through our capital management strategies, which may include the issuance of debt and equity securities. Our Standard Insurance Operations products and services are sold through nine subsidiaries that write Commercial Lines and Personal Lines business, some of which write flood business through the National Flood Insurance Program's ("NFIP") write-your-own ("WYO") program. Two of these subsidiaries, Selective Casualty Insurance Company ("SCIC") and Selective Fire and Casualty Insurance Company ("SFCIC"), were created in 2012. These subsidiaries began writing direct premium in 2013 and have been included in our reinsurance pooling agreement as of July 1, 2012.

Our E&S Insurance Operations products and services are sold through a subsidiary that was acquired in December 2011. This subsidiary, Mesa Underwriters Specialty Insurance Company ("MUSIC"), provides us with a nationally-authorized non-admitted platform to write commercial and personal E&S lines business. For additional information regarding our E&S acquisitions, refer to Note 12. "Business Combinations" in Item 8. "Financial Statements and Supplementary Data." contained in our Annual Report on Form 10-K for the year ended December 31, 2012 ("2012 Annual Report").

Our ten insurance subsidiaries are collectively referred to as the "Insurance Subsidiaries".

The purpose of Management's Discussion and Analysis ("MD&A") is to provide an understanding of the consolidated results of operations and financial condition and known trends and uncertainties that may have a material impact in future periods. Consequently, investors should read the MD&A in conjunction with the consolidated financial statements in our 2012 Annual Report.

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

- Critical Accounting Policies and Estimates;

Financial Highlights of Results for the third quarters ended September 30, 2013 ("Third Quarter 2013") and September 30, 2012 ("Third Quarter 2012") and the nine-month periods ended September 30, 2013 ("Nine Months 2013") and September 30, 2012 ("Nine Months 2012");

Results of Operations and Related Information by Segment;

Federal Income Taxes;

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

Ratings;

Off-Balance Sheet Arrangements; and

Contractual Obligations, Contingent Liabilities, and Commitments.

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## Critical Accounting Policies and Estimates

These unaudited interim consolidated financial statements include amounts based on our informed estimates and judgments for those transactions that are not yet complete. Such estimates and judgments affect the reported amounts in the consolidated financial statements. Those estimates and judgments most critical to the preparation of the consolidated financial statements involve the following: (i) reserves for loss and loss expenses; (ii) deferred policy acquisition costs; (iii) pension and post-retirement benefit plan actuarial assumptions; (iv) other-than-temporary investment impairments; and (v) reinsurance. These estimates and judgments require the use of assumptions about matters that are highly uncertain and, therefore, are subject to change as facts and circumstances develop. If different estimates and judgments had been applied, materially different amounts might have been reported in the financial statements. For additional information regarding our critical accounting policies, refer to our 2012 Annual Report, pages 44 through 53. However, for changes related to actuarial assumptions used in the measurement of the Retirement Income Plan for Selective Insurance Company of America and the Supplemental Excess Retirement Plan (jointly referred to as the "Retirement Income Plan"), see Note 10. "Retirement Plans" of this Form 10-Q.

Financial Highlights of Results for Third Quarter 2013 and Nine Months 2013<sup>1</sup>

| (\$ and<br>shares in thousands, except per share<br>amounts) | Quarter ended September 30, |         |                          | Nine Months ended September<br>30, |           |                          |  |
|--|-----------------------------|---------|--------------------------|------------------------------------|-----------|--------------------------|--|
|  | 2013                        | 2012    | Change<br>% or<br>Points | 2013                               | 2012      | Change<br>% or<br>Points |  |
| Generally Accepted Accounting Principles ("GAAP") measures:  |                             |         |                          |                                    |           |                          |  |
| Revenues   | \$486,813                   | 436,872 | 11 %                     | 1,415,707                          | 1,285,127 | 10 %                     |  |
| Pre-tax net investment income                                | 32,457                      | 30,650  | 6                        | 99,330                             | 97,284    | 2                        |  |
| Pre-tax net income   | 44,485                      | 20,314  | 119                      | 108,019                            | 42,813    | 152                      |  |
| Net income   | 32,653                      | 18,274  | 79                       | 81,083                             | 36,655    | 121                      |  |
| Diluted net income per share                                 | 0.57                        | 0.33    | 73                       | 1.43                               | 0.66      | 117                      |  |
| Diluted weighted-average<br>outstanding shares               | 56,900                      | 55,862  | 2                        | 56,719                             | 55,717    | 2                        |  |
| GAAP combined ratio  | 97.7                        | % 99.8  | (2.1 ) pts               | 97.9                               | 102.3     | (4.4 ) pts               |  |
| Statutory combined ratio <sup>2</sup>                        | 96.3                        | % 98.4  | (2.1 )                   | 96.9                               | 101.2     | (4.3 )                   |  |
| Return on average equity                                     | 11.7                        | % 6.6   | 5.1                      | 9.8                                | 4.5       | 5.3                      |  |
| Non-GAAP measures:   |                             |         |                          |                                    |           |                          |  |
| Operating income <sup>3</sup>                                | \$23,922                    | 18,982  | 26 %                     | \$67,819                           | 34,414    | 97 %                     |  |
| Diluted operating income per share <sup>3</sup>              | 0.42                        | 0.34    | 24                       | 1.20                               | 0.62      | 94                       |  |
| Operating return on average equity <sup>3</sup>              | 8.6                         | % 6.9   | 1.7 pts                  | 8.2                                | 4.2       | 4.0 pts                  |  |

<sup>1</sup> Refer to the Glossary of Terms attached to our 2012 Annual Report as Exhibit 99.1 for definitions of terms used in this Form 10-Q.

<sup>2</sup> Nine Months 2013 includes 0.4 points related to the Retirement Income Plan amendments that curtail the accrual of additional benefits for all eligible employees participating in the plans after March 31, 2016.

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

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

Quarter ended September 30,

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|   |          |        | Nine Months ended September<br>30, |        |
|---|----------|--------|------------------------------------|--------|
| (\$ in thousands, except per share amounts)                         | 2013     | 2012   | 2013                               | 2012   |
| Operating income  | \$23,922 | 18,982 | 67,819                             | 34,414 |
| Net realized gains (losses), net of tax                             | 8,731    | (708   | ) 14,261                           | 2,241  |
| Loss on disposal of discontinued operations, net of tax             | —        | —      | (997                               | ) —    |
| Net income  | \$32,653 | 18,274 | 81,083                             | 36,655 |
| Diluted operating income per share                                  | \$0.42   | 0.34   | 1.20                               | 0.62   |
| Diluted net realized gains (losses) per share                       | 0.15     | (0.01  | ) 0.25                             | 0.04   |
| Diluted net loss from disposal of discontinued operations per share | —        | —      | (0.02                              | ) —    |
| Diluted net income per share  | \$0.57   | 0.33   | 1.43                               | 0.66   |

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Over the long term, we target a return on average equity that is three points higher than our historic cost of capital of approximately 9%, excluding the impact of realized gains and losses, which is referred to as operating return on equity. Our operating return on average equity was 8.6% in Third Quarter 2013 compared to 6.9% in Third Quarter 2012. For Nine Months 2013 and Nine Months 2012, our operating return on average equity was 8.2% and 4.2%, respectively. Our operating return on average equity contribution by component is as follows:

| Operating Return on Average Equity | Quarter ended September 30, |        | Nine Months ended September 30, |        |
|------------------------------------|-----------------------------|--------|---------------------------------|--------|
|                                    | 2013                        | 2012   | 2013                            | 2012   |
| Insurance Operations               | 2.4                         | % 0.2  | 2.1                             | (2.2 ) |
| Investments                        | 8.8                         | 8.5    | 9.0                             | 9.0    |
| Other                              | (2.6 )                      | (1.8 ) | (2.9 )                          | (2.6 ) |
| Total                              | 8.6                         | 6.9    | 8.2                             | 4.2    |

Improvements in our operating return on average equity generated from our Insurance Subsidiaries reflect increases in underwriting profitability of \$9.3 million in the quarter and \$54.3 million in the year-to-date period. These fluctuations were driven primarily by: (i) higher underwriting profitability in our Standard Insurance Operations of \$3.6 million and \$40.7 million, respectively, reflecting the impact of earning renewal pure price increases, which exceeded loss costs trends over the past year; and (ii) improvements in our E&S Insurance Operations of \$5.7 million and \$13.5 million, respectively. E&S operations were primarily affected by: (i) earned premiums that now reflect the full operations of this business following the acquisition in 2011; (ii) renewal pure price increases; and (iii) a decrease in initial start-up expenditures.

Our investment segment's contribution to operating return on equity was relatively consistent both in Third Quarter and Nine Months 2013 compared to the same periods last year. Higher income from our alternative investments was partially offset by lower income on our fixed maturity securities portfolio. This portfolio has been negatively impacted by the interest rate environment, which has lowered reinvestment yields when comparing periods.

The operating return on average equity generated by our Insurance Subsidiaries and our Investments segment was partially offset by: (i) long-term compensation to our employees, which increases as our stock price improves; (ii) interest expense on our issued debt; and (iii) the first quarter of 2013 write-off of unamortized debt costs related to the redemption of our 7.5% Junior Subordinated Notes.

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The following table provides a quantitative foundation for analyzing our overall Insurance Subsidiaries underwriting results:

| All Lines<br>(\$ in thousands)            | Quarter ended September 30, |         |                          | Nine Months ended September 30, |           |                          |
|---|-----------------------------|---------|--------------------------|---------------------------------|-----------|--------------------------|
|   | 2013                        | 2012    | Change<br>% or<br>Points | 2013                            | 2012      | Change<br>% or<br>Points |
| <b>GAAP Insurance Operations Results:</b> |                             |         |                          |                                 |           |                          |
| Net premiums written ("NPW")              | \$492,748                   | 450,518 | 9 %                      | 1,405,049                       | 1,296,253 | 8 %                      |
| Net premiums earned ("NPE")               | 437,568                     | 406,225 | 8                        | 1,284,760                       | 1,177,266 | 9                        |
| <b>Less:</b>                              |                             |         |                          |                                 |           |                          |
| Loss and loss expense incurred            | 283,317                     | 272,251 | 4                        | 832,760                         | 813,060   | 2                        |
| Net underwriting expenses incurred        | 142,774                     | 132,428 | 8                        | 421,812                         | 388,841   | 8                        |
| Dividends to policyholders                | 1,326                       | 685     | 94                       | 3,393                           | 2,829     | 20                       |
| Underwriting gain (loss)                  | \$10,151                    | 861     | 1,079 %                  | 26,795                          | (27,464)  | 198 %                    |
| <b>GAAP Ratios:</b>                       |                             |         |                          |                                 |           |                          |
| Loss and loss expense ratio               | 64.7                        | % 67.0  | (2.3 ) pts               | 64.8                            | 69.1      | (4.3 ) pts               |
| Underwriting expense ratio                | 32.7                        | 32.6    | 0.1                      | 32.8                            | 33.0      | (0.2 )                   |
| Dividends to policyholders ratio          | 0.3                         | 0.2     | 0.1                      | 0.3                             | 0.2       | 0.1                      |
| Combined ratio                            | 97.7                        | 99.8    | (2.1 )                   | 97.9                            | 102.3     | (4.4 )                   |
| <b>Statutory Ratios:</b>                  |                             |         |                          |                                 |           |                          |
| Loss and loss expense ratio               | 64.7                        | 66.9    | (2.2 )                   | 64.8                            | 69.0      | (4.2 )                   |
| Underwriting expense ratio                | 31.3                        | 31.3    | —                        | 31.8                            | 32.0      | (0.2 )                   |
| Dividends to policyholders ratio          | 0.3                         | 0.2     | 0.1                      | 0.3                             | 0.2       | 0.1                      |
| Combined ratio                            | 96.3                        | % 98.4  | (2.1 ) pts               | 96.9                            | 101.2     | (4.3 ) pts               |

The growth in NPW for our Insurance Subsidiaries in Third Quarter 2013 and Nine Months 2013 compared to the prior year periods reflects the following in our Standard Insurance Operations: (i) renewal pure price increases; (ii) strong retention; and (iii) new business.

NPE increases in Third Quarter 2013 and Nine Months 2013 were consistent with the fluctuations in NPW for the twelve-month period ended September 30, 2013 compared to the twelve-month period ended September 30, 2012.

The combined ratio improved for both the quarterly and year-to-date periods. This improvement was driven by renewal pure price increases that are exceeding loss trends in our Standard Insurance Operations. In addition, the improvement in the combined ratios in Third Quarter 2013 and Nine Months 2013 was also driven by the following in our E&S Insurance Operations: (i) earned premiums that now reflect the full operations of this business; (ii) underwriting improvements, including renewal pure price increases; and (iii) a decrease in initial start-up expenditures and acquisition costs.

**Outlook**

In their 2012 year-end review, A.M. Best and Company ("A.M. Best") projected an industry combined ratio of 101.2% for 2013. However, continued improvements in the pricing environment, coupled with modest exposure growth from the slowly improving economy, and underwriting actions taken to insulate balance sheets against further impact from the challenging investment environment, produced an underwriting profit for the industry through the first six months of 2013 with a combined ratio of 96.5%.

Reflecting the improved results, Selective now expects to generate a 2013 full year statutory combined ratio of approximately 95.5%, excluding 2.5 points of catastrophe losses, a net improvement of one point from previously issued guidance. This assumes no prior year casualty reserve development in the fourth quarter. In addition,

investment income will be approximately \$95 - \$100 million, after tax, and weighted average shares at year end 2013 are anticipated to be approximately 57 million.

In addition, we expect our E&S Insurance Operations to produce a combined ratio between 100% and 102% for 2013, and be at profitability levels similar to our Standard Insurance Operations in 2014. We also expect to achieve an overall statutory combined ratio of 92% by year-end 2014, excluding three points of expected catastrophe losses. Our Insurance Subsidiaries reported a statutory combined ratio, excluding catastrophe losses, of 93.6% for Third Quarter 2013 and 94.3% for Nine Months 2013.

A key component of meeting our combined ratio targets is our ability to generate Commercial Lines renewal pure price increases in excess of our predicted loss trends. Although A.M. Best is maintaining its negative outlook for the commercial lines market, it does anticipate that sustained pricing momentum will continue in 2013. We achieved renewal pure price

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increases of 7.6% for standard Commercial Lines and 8.0% for standard Personal Lines in Nine Months 2013. While these increases demonstrate the overall strength of the relationships that we have with our independent retail agents, even in difficult economic and competitive times, we are expecting overall price increases in 2014 will be between 6% and 7.5%.

Although interest rates on the 10-year U.S. Treasury Note rose by 85 basis points during Nine Months 2013, they are still low by historical standards. The continued low interest rate environment has several significant impacts on our business, some of which are beneficial and some of which present a challenge to us. The benefits include lower inflation rates that suppress loss trends, as well as reduce our cost of capital. However, the low interest rate environment presents a significant challenge in generating after-tax returns on our investment portfolio, as fixed maturity securities mature and money is re-invested at lower rates. Even if current interest rate levels were to increase by 50 basis points per year for the next few years, book yields on our overall portfolio would continue to underperform 2012 book yield levels until approximately 2017.

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## Results of Operations and Related Information by Segment

## Insurance Operations

## Standard Insurance Operations

Our Standard Insurance Operations segment, which represents 93% of our combined insurance operations NPW, sells insurance products and services primarily in 22 states in the Eastern and Midwestern U.S. and the District of Columbia, through approximately 1,100 independent retail insurance agencies. This segment consists of two components: (i) Commercial Lines, which markets primarily to businesses and represents approximately 82% of the segment's NPW; and (ii) Personal Lines, including our flood business, which markets primarily to individuals and represents approximately 18% of the segment's NPW.

| (\$ in thousands)                        | Quarter ended September 30, |         |                    | Nine Months ended September 30, |           |                    |  |  |
|--|-----------------------------|---------|--------------------|---------------------------------|-----------|--------------------|--|--|
|  | 2013                        | 2012    | Change % or Points | 2013                            | 2012      | Change % or Points |  |  |
| GAAP Insurance Operations Results:       |                             |         |                    |                                 |           |                    |  |  |
| NPW                                      | \$457,173                   | 420,754 | 9 %                | 1,308,428                       | 1,212,355 | 8 %                |  |  |
| NPE                                      | 405,676                     | 381,498 | 6                  | 1,192,762                       | 1,126,849 | 6                  |  |  |
| Less:                                    |                             |         |                    |                                 |           |                    |  |  |
| Loss and loss expense incurred           | 262,697                     | 251,694 | 4                  | 771,948                         | 772,430   | —                  |  |  |
| Net underwriting expenses incurred       | 131,515                     | 122,550 | 7                  | 388,440                         | 363,353   | 7                  |  |  |
| Dividends to policyholders               | 1,326                       | 685     | 94                 | 3,393                           | 2,829     | 20                 |  |  |
| Underwriting gain (loss)                 | \$10,138                    | 6,569   | 54 %               | 28,981                          | (11,763)  | 346 %              |  |  |
| GAAP Ratios:                             |                             |         |                    |                                 |           |                    |  |  |
| Loss and loss expense ratio              | 64.8                        | % 66.0  | (1.2 ) pts         | 64.7                            | 68.5      | (3.8 ) pts         |  |  |
| Underwriting expense ratio               | 32.4                        | 32.1    | 0.3                | 32.6                            | 32.2      | 0.4                |  |  |
| Dividends to policyholders ratio         | 0.3                         | 0.2     | 0.1                | 0.3                             | 0.3       | —                  |  |  |
| Combined ratio                           | 97.5                        | 98.3    | (0.8 )             | 97.6                            | 101.0     | (3.4 )             |  |  |
| Statutory Ratios:                        |                             |         |                    |                                 |           |                    |  |  |
| Loss and loss expense ratio <sup>1</sup> | 64.7                        | 65.9    | (1.2 )             | 64.7                            | 68.6      | (3.9 )             |  |  |
| Underwriting expense ratio <sup>1</sup>  | 31.0                        | 30.8    | 0.2                | 31.6                            | 31.2      | 0.4                |  |  |
| Dividends to policyholders ratio         | 0.3                         | 0.2     | 0.1                | 0.3                             | 0.3       | —                  |  |  |
| Combined ratio <sup>1</sup>              | 96.0                        | % 96.9  | (0.9 ) pts         | 96.6                            | 100.1     | (3.5 ) pts         |  |  |

Nine Months 2013 includes 0.2 points in the loss and loss expense ratio, 0.3 points in the underwriting expense ratio, and 0.5 points in the combined ratio related to the Retirement Income Plan amendments recorded in the first quarter of 2013 that curtail the accrual of additional benefits for all eligible employees participating in the plans after March 31, 2016.

The improvements in NPW in Third Quarter and Nine Months 2013 compared to Third Quarter and Nine Months 2012 are primarily the result of the following:

| (\$ in millions)          | Quarter ended September 30, 2013 |           | Quarter ended September 30, 2012 |           |
|---------------------------|----------------------------------|-----------|----------------------------------|-----------|
|                           | Renewal Pure Price Increase      | Retention | Renewal Pure Price Increase      | Retention |
| Standard Commercial Lines | 7.9                              | % 83      | % 6.6                            | 83        |
| Standard Personal Lines   | 7.5                              | 86        | 6.9                              | 87        |

  

| (\$ in millions)          | Nine Months ended September 30, 2013 |           | Nine Months ended September 30, 2012 |           |
|---------------------------|--------------------------------------|-----------|--------------------------------------|-----------|
|                           | Renewal Pure Price Increase          | Retention | Renewal Pure Price Increase          | Retention |
| Standard Commercial Lines | 7.6                                  | % 82      | % 6.0                                | 82        |
| Standard Personal Lines   | 8.0                                  | 86        | 6.1                                  | 86        |

In addition, new business was up \$15.8 million, or 23%, in Third Quarter 2013 and \$25.3 million, or 11%, in Nine Months 2013 mainly driven by our standard Commercial Lines operations.

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NPE increases in Third Quarter and Nine Months 2013 were consistent with the fluctuations in NPW for the twelve-month period ended September 30, 2013 as compared to the twelve-month period ended September 30, 2012.

The GAAP loss and loss expense ratio improved 1.2 points in Third Quarter 2013 and 3.8 points in Nine Months 2013 compared to the same periods a year ago. The improvement in the ratio reflects the earning of Standard Insurance Operations renewal pure price increases that averaged 6.3% in 2012 and 7.7% in Nine Months 2013, both of which exceed our projected loss trend of 3%. In addition, the following variances are included in the GAAP loss and loss expense ratio:

| (\$ in millions)                                  | Quarter ended September 30, 2013 |                                       |     | Quarter ended September 30, 2012 |                                       |                 |
|---|----------------------------------|---------------------------------------|-----|----------------------------------|---------------------------------------|-----------------|
|   | Loss and Loss Expense Incurred   | Impact on Loss and Loss Expense Ratio | pts | Loss and Loss Expense Incurred   | Impact on Loss and Loss Expense Ratio | Change in Ratio |
| Catastrophe losses                                | \$10.9                           | 2.7                                   | pts | 8.6                              | 2.3                                   | pts 0.4         |
| Non-catastrophe property losses                   | 54.8                             | 13.5                                  |     | 53.3                             | 14.0                                  | (0.5 )          |
| Favorable prior year casualty reserve development | 3.5                              | 0.8                                   |     | 7.0                              | 1.8                                   | 1.0             |

| (\$ in millions)                                  | Nine Months ended September 30, 2013 |                                       |     | Nine Months ended September 30, 2012 |                                       |                 |
|---|--------------------------------------|---------------------------------------|-----|--------------------------------------|---------------------------------------|-----------------|
|   | Loss and Loss Expense Incurred       | Impact on Loss and Loss Expense Ratio | pts | Loss and Loss Expense Incurred       | Impact on Loss and Loss Expense Ratio | Change in Ratio |
| Catastrophe losses                                | \$29.3                               | 2.5                                   | pts | 45.5                                 | 4.0                                   | pts (1.5 )      |
| Non-catastrophe property losses                   | 165.7                                | 13.9                                  |     | 161.8                                | 14.4                                  | (0.5 )          |
| Favorable prior year casualty reserve development | 9.5                                  | 0.8                                   |     | 15.0                                 | 1.3                                   | 0.5             |

The breakdown of favorable prior year casualty reserve development by line of business for the periods indicated is as follows:

| Favorable/(Unfavorable) Prior Year Casualty Reserve Development (\$ in millions) | Quarter ended September 30, |         | Nine Months ended September 30, |          |      |
|--|-----------------------------|---------|---------------------------------|----------|------|
|  | 2013                        | 2012    | 2013                            | 2012     |      |
| General liability  | \$3.0                       | —       | 12.0                            | —        |      |
| Commercial automobile  | —                           | 2.0     | —                               | 4.5      |      |
| Workers compensation   | (3.5 )                      | —       | (14.0 )                         | —        |      |
| Businessowners' policies   | 2.0                         | 2.5     | 8.0                             | 6.0      |      |
| Homeowners   | 1.0                         | 2.0     | 2.5                             | 5.0      |      |
| Personal automobile  | 1.0                         | 0.5     | 1.0                             | (0.5 )   |      |
| Total favorable prior year casualty reserve development                          | \$3.5                       | 7.0     | 9.5                             | 15.0     |      |
| Favorable impact on loss ratio   | 0.8                         | pts 1.8 | pts. 0.8                        | pts. 1.3 | pts. |

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## Review of Underwriting Results by Line of Business

## Standard Commercial Lines

| (\$ in thousands)                             | Quarter ended September 30, |         |                          | Nine Months ended September 30, |           |                          | Change<br>% or<br>Points | Change<br>% or<br>Points |
|---|-----------------------------|---------|--------------------------|---------------------------------|-----------|--------------------------|--------------------------|--------------------------|
|   | 2013                        | 2012    | Change<br>% or<br>Points | 2013                            | 2012      | Change<br>% or<br>Points |                          |                          |
| GAAP Insurance Operations Results:            |                             |         |                          |                                 |           |                          |                          |                          |
| NPW   | \$376,373                   | 341,318 | 10                       | %                               | 1,080,213 | 990,568                  | 9                        | %                        |
| NPE   | 330,962                     | 309,693 | 7                        |                                 | 971,464   | 916,479                  | 6                        |                          |
| Less:   |                             |         |                          |                                 |           |                          |                          |                          |
| Loss and loss expense incurred                | 209,771                     | 206,974 | 1                        |                                 | 614,226   | 622,102                  | (1)                      | )                        |
| Net underwriting expenses incurred            | 111,089                     | 102,685 | 8                        |                                 | 329,224   | 306,214                  | 8                        |                          |
| Dividends to policyholders                    | 1,326                       | 685     | 94                       |                                 | 3,393     | 2,829                    | 20                       |                          |
| Underwriting gain (loss)                      | \$8,776                     | (651)   | ) 1,448                  | %                               | 24,621    | (14,666)                 | ) 268                    | %                        |
| GAAP Ratios:                                  |                             |         |                          |                                 |           |                          |                          |                          |
| Loss and loss expense ratio                   | 63.4                        | % 66.8  | (3.4                     | )pts                            | 63.2      | 67.9                     | (4.7                     | )pts                     |
| Underwriting expense ratio                    | 33.5                        | 33.2    | 0.3                      |                                 | 34.0      | 33.4                     | 0.6                      |                          |
| Dividends to policyholders ratio              | 0.4                         | 0.2     | 0.2                      |                                 | 0.3       | 0.3                      | —                        |                          |
| Combined ratio                                | 97.3                        | 100.2   | (2.9                     | )                               | 97.5      | 101.6                    | (4.1                     | )                        |
| Statutory Ratios:                             |                             |         |                          |                                 |           |                          |                          |                          |
| Loss and loss expense ratio <sup>1</sup>      | 63.3                        | 66.7    | (3.4                     | )                               | 63.2      | 67.9                     | (4.7                     | )                        |
| Underwriting expense ratio <sup>1</sup>       | 31.9                        | 31.9    | —                        |                                 | 32.7      | 32.3                     | 0.4                      |                          |
| Dividends to policyholders ratio <sup>1</sup> | 0.4                         | 0.2     | 0.2                      |                                 | 0.3       | 0.3                      | —                        |                          |
| Combined ratio                                | 95.6                        | % 98.8  | (3.2                     | )pts                            | 96.2      | 100.5                    | (4.3                     | )pts                     |

Nine Months 2013 includes 0.1 points in the loss and loss expense ratio, 0.4 points in the underwriting expense ratio, and 0.5 points in the combined ratio related to the Retirement Income Plan amendments recorded in the first quarter of 2013 that curtail the accrual of additional benefits for all eligible employees participating in the plans after March 31, 2016.

The increase in NPW in Third Quarter and Nine Months 2013 compared to Third Quarter and Nine Months 2012 is primarily the result of the following:

| (\$ in millions)             | Quarter ended September 30, |      | Nine Months ended September 30, |       |
|------------------------------|-----------------------------|------|---------------------------------|-------|
|                              | 2013                        | 2012 | 2013                            | 2012  |
| Retention                    | 83                          | % 83 | 82                              | 82    |
| Renewal pure price increases | 7.9                         | 6.6  | 7.6                             | 6.0   |
| New business                 | \$74.9                      | 56.1 | 217.3                           | 184.6 |

NPE increases in Third Quarter and Nine Months 2013 were consistent with the fluctuations in NPW for the twelve-month period ended September 30, 2013 compared to the twelve-month period ended September 30, 2012.



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The GAAP loss and loss expense ratio improved by 3.4 points in Third Quarter 2013 and 4.7 points in Nine Months 2013 compared to the same periods a year ago. The improvement in the ratio reflects the earning of standard Commercial Lines renewal pure price increases that averaged 6.2% in 2012 and 7.6% in Nine Months 2013, both of which exceed our projected loss trend of approximately 3%. The following variances also impacted the GAAP loss and loss expense ratio as follows:

| (\$ in millions)                                  | Third Quarter 2013 |                      | Third Quarter 2012 |                      | Change in Ratio |
|---|--------------------|----------------------|--------------------|----------------------|-----------------|
|   | Losses Incurred    | Impact on Loss Ratio | Losses Incurred    | Impact on Loss Ratio |                 |
| Catastrophe losses                                | \$2.2              | 0.7                  | 6.8                | 2.2                  | (1.5) pts       |
| Non-catastrophe property losses                   | 34.9               | 10.5                 | 34.1               | 11.0                 | (0.5) pts       |
| Favorable prior year casualty reserve development | 1.5                | 0.4                  | 4.5                | 1.6                  | 1.2             |

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| (\$ in millions)                                  | Nine Months 2013 |                      |     | Nine Months 2012 |                      |     | Change in |      |
|---|------------------|----------------------|-----|------------------|----------------------|-----|-----------|------|
|   | Losses Incurred  | Impact on Loss Ratio |     | Losses Incurred  | Impact on Loss Ratio |     | Ratio     |      |
| Catastrophe losses                                | \$12.1           | 1.2                  | pts | 29.1             | 3.2                  | pts | (2.0      | )pts |
| Non-catastrophe property losses                   | 99.7             | 10.3                 |     | 102.5            | 11.2                 |     | (0.9      | )    |
| Favorable prior year casualty reserve development | 6.0              | 0.6                  |     | 10.5             | 1.2                  |     | 0.6       |      |

The following is a discussion of our most significant standard Commercial Lines of business:

## General Liability

| (\$ in thousands)                                  | Quarter ended September 30, |         |                    | Nine Months ended September 30, |         |                    | Change |     |
|--|-----------------------------|---------|--------------------|---------------------------------|---------|--------------------|--------|-----|
|  | 2013                        | 2012    | Change % or Points | 2013                            | 2012    | Change % or Points |        |     |
| Statutory NPW                                      | \$115,866                   | 106,020 | 9 %                | 335,503                         | 305,870 | 10 %               |        |     |
| Direct new business                                | 20,169                      | 16,737  | 21                 | 60,809                          | 53,050  | 15                 |        |     |
| Retention  | 82                          | % 83    | (1) pts            | 81                              | 81      | —                  |        | pts |
| Renewal pure price increases                       | 9.3                         | % 7.2   | 2.1                | 8.8                             | 6.8     | 2.0                |        |     |
| Statutory NPE                                      | 100,925                     | 93,763  | 8 %                | 298,394                         | 276,538 | 8 %                |        |     |
| Statutory combined ratio                           | 96.2                        | % 100.4 | (4.2) pts          | 95.7                            | 101.0   | (5.3) pts          |        |     |
| % of total statutory standard Commercial Lines NPW | 31                          | % 31    |                    | 31                              | 31      |                    |        |     |

The growth in NPW and NPE for our general liability business in both Third Quarter and Nine Months 2013 reflect: (i) renewal pure price increases; (ii) strong retention; and (iii) higher new business.

The statutory combined ratio improvement for both Third Quarter and Nine Months 2013 was due to: (i) the impact of favorable prior year casualty reserve development of \$3.0 million, or 3.0 points, and \$12.0 million, or 4.0 points, in Third Quarter and Nine Months 2013, respectively, compared to no prior year casualty reserve development in Third Quarter and Nine Months 2012; and (ii) the impact of earned renewal pure price increases that have exceeded loss cost trends. Partially offsetting these items was the impact of the Retirement Income Plan curtailment charge of \$1.4 million, which increased the overall combined ratio by 0.4 points for Nine Months 2013.

## Commercial Automobile

| (\$ in thousands)            | Quarter ended September 30, |        |                    | Nine Months ended September 30, |         |                    | Change |     |
|------------------------------|-----------------------------|--------|--------------------|---------------------------------|---------|--------------------|--------|-----|
|                              | 2013                        | 2012   | Change % or Points | 2013                            | 2012    | Change % or Points |        |     |
| Statutory NPW                | \$91,715                    | 80,725 | 14 %               | 257,841                         | 231,475 | 11 %               |        |     |
| Direct new business          | 16,420                      | 12,040 | 36                 | 47,490                          | 39,466  | 20                 |        |     |
| Retention                    | 83                          | % 84   | (1.0) pts          | 82                              | 82      | —                  |        | pts |
| Renewal pure price increases | 8.0                         | % 5.6  | 2.4                | 7.4                             | 4.9     | 2.5                |        |     |
| Statutory NPE                | 79,138                      | 72,758 | 9 %                | 230,191                         | 214,782 | 7 %                |        |     |
|                              | 97.1                        | % 95.7 | 1.4 pts            | 96.8                            | 96.1    | 0.7 pts            |        |     |

Statutory combined  
ratio

% of total statutory

standard Commercial

24

% 24

24

23

Lines NPW

The growth in NPW and NPE for our commercial automobile business in both Third Quarter and Nine Months 2013 reflect: (i) renewal pure price increases; (ii) strong retention; and (iii) higher new business.

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The fluctuations in the statutory combined ratios for Third Quarter and Nine Months 2013 were impacted by the following:

| (\$ in millions)                                  | Quarter ended September 30, 2013 |                             |                                       | Quarter ended September 30, 2012 |                                       |     | Change in Ratio |
|---|----------------------------------|-----------------------------|---------------------------------------|----------------------------------|---------------------------------------|-----|-----------------|
|   | Loss and Expense Incurred        | Loss and Loss Expense Ratio | Impact on Loss and Loss Expense Ratio | Loss and Expense Incurred        | Impact on Loss and Loss Expense Ratio |     |                 |
| Catastrophe losses                                | \$0.1                            | 0.1                         | pts                                   | 0.7                              | 0.9                                   | pts | (0.8 )          |
| Favorable prior year casualty reserve development | —                                | —                           |                                       | 2.0                              | 2.7                                   |     | 2.7             |

  

| (\$ in millions)                                  | Nine Months ended September 30, 2013 |                             |                                       | Nine Months ended September 30, 2012 |                                       |     | Change in Ratio |
|---|--------------------------------------|-----------------------------|---------------------------------------|--------------------------------------|---------------------------------------|-----|-----------------|
|   | Loss and Expense Incurred            | Loss and Loss Expense Ratio | Impact on Loss and Loss Expense Ratio | Loss and Expense Incurred            | Impact on Loss and Loss Expense Ratio |     |                 |
| Catastrophe losses                                | \$(0.9                               | )(0.4                       | )pts                                  | 2.2                                  | 1.0                                   | pts | (1.4 )          |
| Favorable prior year casualty reserve development | —                                    | —                           |                                       | 4.5                                  | 2.1                                   |     | 2.1             |

In addition, Nine Months 2013 included \$1.0 million, or 0.4 points, related to the Retirement Income Plan curtailment charge.

## Workers Compensation

| (\$ in thousands)                                  | Quarter ended September 30, |         |      | Change % or Points | Nine Months ended September 30, |         |      | Change % or Points |
|--|-----------------------------|---------|------|--------------------|---------------------------------|---------|------|--------------------|
|  | 2013                        | 2012    |      |                    | 2013                            | 2012    |      |                    |
| Statutory NPW                                      | \$70,461                    | 66,320  | 6    | %                  | 214,455                         | 206,272 | 4    | %                  |
| Direct new business                                | 14,459                      | 8,535   | 69   |                    | 43,151                          | 33,905  | 27   |                    |
| Retention  | 82                          | % 83    | (1   | )pts               | 82                              | 81      | 1    | pts                |
| Renewal pure price increases                       | 7.9                         | % 8.5   | (0.6 | )                  | 7.8                             | 8.0     | (0.2 | )                  |
| Statutory NPE                                      | 66,510                      | 65,592  | 1    | %                  | 197,449                         | 198,064 | —    | %                  |
| Statutory combined ratio                           | 118.2                       | % 115.9 | 2.3  | pts                | 118.4                           | 113.1   | 5.3  | pts                |
| % of total statutory standard Commercial Lines NPW | 19                          | % 19    |      |                    | 20                              | 21      |      |                    |

NPW increased by 6% in Third Quarter and 4% in Nine Months 2013, respectively, compared to Third Quarter and Nine Months 2012, driven by higher renewal pure price increases.

The workers compensation book of business represents 20% of our total statutory standard Commercial Lines net premium written for Nine Months 2013, which is a decrease from 24% at the end of 2008. While we continue to view workers compensation in the context of an overall account, we remain very focused on improving this competitive

line of business through underwriting, where we achieved renewal pure price increases of 7.9% for Third Quarter 2013 and 7.8% for Nine Months 2013. We are applying all the underwriting tools we have to move pricing higher and write the best risks. We also have a number of claims initiatives aimed at proactively managing return-to-work programs and higher severity claims.

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The increase in the statutory combined ratios for both periods was primarily attributable to the impact of prior year casualty reserve development as follows:

Third Quarter 2013 was unfavorable by \$3.5 million, or 5.3 points, driven primarily by development in several accident years from 2008 and prior; and \$14.0 million, or 7.2 points, unfavorable development in Nine Months 2013 driven primarily by development in several accident years from 2008 and prior and on the 2012 accident year.

Third Quarter and Nine Months 2012 reflect no prior year casualty reserve development.

In addition, the Retirement Income Plan curtailment increased the workers compensation statutory combined ratio by 0.6 points in Nine Months 2013.

Commercial Property

| (\$ in thousands)                                  | Quarter ended September 30, |        |                    | Nine Months ended September 30, |         |                    |     |  |
|--|-----------------------------|--------|--------------------|---------------------------------|---------|--------------------|-----|--|
|  | 2013                        | 2012   | Change % or Points | 2013                            | 2012    | Change % or Points |     |  |
| Statutory NPW                                      | \$69,578                    | 62,259 | 12 %               | 186,531                         | 168,481 | 11 %               |     |  |
| Direct new business                                | 16,966                      | 12,577 | 35                 | 45,747                          | 38,624  | 18                 |     |  |
| Retention  | 82                          | % 83   | (1) pts            | 81                              | 81      | —                  | pts |  |
| Renewal pure price increases                       | 5.8                         | % 4.9  | 0.9                | 5.6                             | 4.2     | 1.4                |     |  |
| Statutory NPE                                      | 57,004                      | 52,197 | 9 %                | 165,356                         | 151,945 | 9 %                |     |  |
| Statutory combined ratio                           | 67.0                        | % 81.3 | (14.3) pts         | 77.8                            | 93.7    | (15.9) pts         |     |  |
| % of total statutory standard Commercial Lines NPW | 18                          | % 18   |                    | 17                              | 17      |                    |     |  |

NPW and NPE increased in both Third Quarter and Nine Months 2013 compared to the same prior year periods primarily due to: (i) improvement in new business; (ii) renewal pure price increases; and (iii) strong retention.

The improvement in the statutory combined ratio in Third Quarter and Nine Months 2013 compared to the same prior year periods was due to:

| (\$ in millions)                | Third Quarter 2013 |                      |     | Third Quarter 2012 |                      |     | Change in |      |
|---------------------------------|--------------------|----------------------|-----|--------------------|----------------------|-----|-----------|------|
|                                 | Losses Incurred    | Impact on Loss Ratio |     | Losses Incurred    | Impact on Loss Ratio |     | Ratio     |      |
| Catastrophe losses              | \$0.9              | 1.6                  | pts | 2.2                | 4.2                  | pts | (2.6)     | )pts |
| Non-catastrophe property losses | 14.8               | 25.9                 |     | 19.3               | 37.0                 |     | (11.1)    | )    |
| (\$ in millions)                | Nine Months 2013   |                      |     | Nine Months 2012   |                      |     | Change in |      |
|                                 | Losses Incurred    | Impact on Loss Ratio |     | Losses Incurred    | Impact on Loss Ratio |     | Ratio     |      |
| Catastrophe losses              | \$10.4             | 6.3                  | pts | 18.0               | 11.8                 | pts | (5.5)     | )pts |
| Non-catastrophe property losses | 48.7               | 29.5                 |     | 60.2               | 39.6                 |     | (10.1)    | )    |

Additionally, the statutory combined ratio was increased by 0.5 points during Nine Months 2013 due to the Retirement Income Plan curtailment charge.



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## Standard Personal Lines

| (\$ in thousands)                        | Quarter ended September 30, |        |                    | Nine Months ended September 30, |         |                    |  |  |
|--|-----------------------------|--------|--------------------|---------------------------------|---------|--------------------|--|--|
|  | 2013                        | 2012   | Change % or Points | 2013                            | 2012    | Change % or Points |  |  |
| GAAP Insurance Operations Results:       |                             |        |                    |                                 |         |                    |  |  |
| NPW                                      | \$80,800                    | 79,436 | 2 %                | 228,215                         | 221,787 | 3 %                |  |  |
| NPE                                      | 74,714                      | 71,805 | 4                  | 221,298                         | 210,370 | 5                  |  |  |
| Less:                                    |                             |        |                    |                                 |         |                    |  |  |
| Loss and loss expense incurred           | 52,926                      | 44,720 | 18                 | 157,722                         | 150,328 | 5                  |  |  |
| Net underwriting expenses incurred       | 20,426                      | 19,865 | 3                  | 59,216                          | 57,139  | 4                  |  |  |
| Underwriting gain                        | \$1,362                     | 7,220  | (81 ) %            | 4,360                           | 2,903   | 50 %               |  |  |
| GAAP Ratios:                             |                             |        |                    |                                 |         |                    |  |  |
| Loss and loss expense ratio              | 70.8                        | % 62.3 | 8.5 pts            | 71.3                            | 71.5    | (0.2 ) pts         |  |  |
| Underwriting expense ratio               | 27.4                        | 27.6   | (0.2 )             | 26.7                            | 27.1    | (0.4 )             |  |  |
| Combined ratio                           | 98.2                        | 89.9   | 8.3                | 98.0                            | 98.6    | (0.6 )             |  |  |
| Statutory Ratios:                        |                             |        |                    |                                 |         |                    |  |  |
| Loss and loss expense ratio <sup>1</sup> | 70.9                        | 62.3   | 8.6                | 71.4                            | 71.5    | (0.1 )             |  |  |
| Underwriting expense ratio <sup>1</sup>  | 26.7                        | 26.5   | 0.2                | 26.2                            | 26.9    | (0.7 )             |  |  |
| Combined ratio <sup>1</sup>              | 97.6                        | % 88.8 | 8.8 pts            | 97.6 %                          | 98.4    | (0.8 ) pts         |  |  |

Nine Months 2013 includes 0.1 points in the loss and loss expense ratio, 0.3 points in the underwriting expense ratio, and 0.4 points in the combined ratio related to the Retirement Income Plan amendments recorded in the first quarter of 2013 that curtail the accrual of additional benefits for all eligible employees participating in the plans after March 31, 2016.

The improvements in NPW are primarily the result of the following:

| (\$ in millions)            | Quarter ended September 30, |      | Nine Months ended September 30, |      |
|-----------------------------|-----------------------------|------|---------------------------------|------|
|                             | 2013                        | 2012 | 2013                            | 2012 |
| Retention                   | 86                          | % 87 | 86                              | 86   |
| Renewal pure price increase | 7.5                         | 6.9  | 8.0                             | 6.1  |

NPE increases in Third Quarter 2012 and Nine Months 2013, compared to the same periods last year, are consistent with the fluctuations in NPW for the twelve-month period ended September 30, 2013 as compared to the twelve-month period ended September 30, 2012.

The variance in the loss and loss expense ratios was driven by premiums outpacing loss costs in Third Quarter and Nine Months 2013 compared to Third Quarter and Nine Months 2012, as well as the following:

| (\$ in millions)                | Third Quarter 2013             |                                       | Third Quarter 2012             |                                       | Change in Ratio |
|---------------------------------|--------------------------------|---------------------------------------|--------------------------------|---------------------------------------|-----------------|
|                                 | Loss and Loss Expense Incurred | Impact on Loss and Loss Expense Ratio | Loss and Loss Expense Incurred | Impact on Loss and Loss Expense Ratio |                 |
| Catastrophe losses <sup>1</sup> | \$8.7                          | 11.7 pts                              | 1.8                            | 2.6 pts                               | 9.1 pts         |
| Non-catastrophe property losses | 19.9                           | 26.6                                  | 19.2                           | 26.8                                  | (0.2 )          |



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|   |      |   |      |   |      |   |      |   |      |   |
|---|------|---|------|---|------|---|------|---|------|---|
| Flood claims handling fees                        | (1.1 | ) | (1.4 | ) | (1.1 | ) | (1.5 | ) | (0.1 | ) |
| Favorable prior year casualty reserve development | 2.0  |   | 2.7  |   | 2.5  |   | 3.5  |   | 0.8  |   |

<sup>1</sup> Third Quarter 2013 catastrophe losses include \$7.5 million, or 10.0 points, related to severe thunderstorms in the Midwest that occurred in August 2013.

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| (\$ in millions)                                  | Nine Months 2013               |                                       |     | Nine Months 2012               |                                       |     | Change in Ratio |      |
|---|--------------------------------|---------------------------------------|-----|--------------------------------|---------------------------------------|-----|-----------------|------|
|   | Loss and Loss Expense Incurred | Impact on Loss and Loss Expense Ratio | pts | Loss and Loss Expense Incurred | Impact on Loss and Loss Expense Ratio | pts |                 |      |
| Catastrophe losses                                | \$17.1                         | 7.7                                   | pts | 16.4                           | 7.8                                   | pts | (0.1            | )pts |
| Non-catastrophe property losses                   | 66.0                           | 29.8                                  |     | 59.4                           | 28.2                                  |     | 1.6             |      |
| Flood claims handling fees                        | (3.9                           | )(1.7                                 | )   | (2.0                           | )(1.0                                 | )   | (0.7            | )    |
| Favorable prior year casualty reserve development | 3.5                            | 1.7                                   |     | 4.5                            | 2.2                                   |     | 0.5             |      |

The improvements in the underwriting expense ratios were driven by higher direct premiums written in our flood business that, coupled with an increase in the flood expense allowance for issuing and servicing these policies, increased our expense allowance earned from our participation in the NFIP. On a statutory basis, the favorable flood impact was more than offset by higher supplemental commissions to agents in the quarter, and was partially offset by the first quarter of 2013 Retirement Income Plan curtailment expense in the year-to-date period.

## E&amp;S Insurance Operations

Our E&S Insurance Operations segment, which represents 7% of our combined insurance operations NPW, sells Commercial Lines insurance products and services in all 50 states and the District of Columbia through approximately 100 wholesale general agents. Insurance policies in this segment typically cover business risks with unique characteristics, such as the nature of the business or its claim history, that are difficult to profitably insure in the standard commercial lines market. E&S insurers have more flexibility in coverage terms and rates compared to standard market insurers, generally resulting in policies with higher rates, and terms and conditions that are customized for specific risks.

| (\$ in thousands)                         | Quarter ended September 30, |         |                    | Nine Months ended September 30, |           |                    | Change % or Points |      |
|---|-----------------------------|---------|--------------------|---------------------------------|-----------|--------------------|--------------------|------|
|   | 2013                        | 2012    | Change % or Points | 2013                            | 2012      | Change % or Points |                    |      |
| <b>GAAP Insurance Operations Results:</b> |                             |         |                    |                                 |           |                    |                    |      |
| NPW                                       | \$35,575                    | 29,764  | 20 %               | 96,621                          | 83,898    | 15 %               |                    |      |
| NPE                                       | 31,892                      | 24,727  | 29                 | 91,998                          | 50,417    | 82                 |                    |      |
| <b>Less:</b>                              |                             |         |                    |                                 |           |                    |                    |      |
| Loss and loss expense incurred            | 20,620                      | 20,557  | —                  | 60,812                          | 40,630    | 50                 |                    |      |
| Net underwriting expenses incurred        | 11,259                      | 9,878   | 14                 | 33,372                          | 25,488    | 31                 |                    |      |
| Underwriting gain (loss)                  | \$13                        | (5,708  | ) 100 %            | (2,186                          | ) (15,701 | ) 86 %             |                    |      |
| <b>GAAP Ratios:</b>                       |                             |         |                    |                                 |           |                    |                    |      |
| Loss and loss expense ratio               | 64.7                        | % 83.1  | (18.4              | )pts                            | 66.1      | 80.6               | (14.5              | )pts |
| Underwriting expense ratio                | 35.3                        | 40.0    | (4.7               | )                               | 36.3      | 50.5               | (14.2              | )    |
| Combined ratio                            | 100.0                       | 123.1   | (23.1              | )                               | 102.4     | 131.1              | (28.7              | )    |
| <b>Statutory Ratios:</b>                  |                             |         |                    |                                 |           |                    |                    |      |
| Loss and loss expense ratio               | 64.7                        | 83.0    | (18.3              | )                               | 66.2      | 79.3               | (13.1              | )    |
| Underwriting expense ratio                | 35.8                        | 38.6    | (2.8               | )                               | 35.7      | 41.0               | (5.3               | )    |
| Combined ratio                            | 100.5                       | % 121.6 | (21.1              | )pts                            | 101.9     | 120.3              | (18.4              | )pts |



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Our E&S business is a small operation whose combined ratios are significantly impacted by premium growth as well as volatility in loss and loss expenses and underwriting expenses. The improvement in the combined ratios in Third Quarter 2013 and Nine Months 2013 was driven by a reduction in acquisition and integration costs from 2012 as well as significant underwriting actions to improve profitability. Partially offsetting the above was unfavorable prior year casualty reserve development of approximately \$2.5 million in Nine Months 2013. There was no prior year casualty reserve development in Third Quarter 2013 or at any time in Nine Months 2012.

Although year-over-year and quarter-to-quarter comparisons of this business are difficult considering the volatility caused by the items discussed above, results are tracking in line with our expectations to achieve between a 100% and 102% combined ratio for 2013.

Reinsurance

We have successfully completed negotiations of our July 1, 2013 Standard Insurance Operations excess of loss treaties with highlights as follows:

Property Excess of Loss

The property excess of loss treaty ("Property Treaty") was renewed with substantially the same terms as the expiring treaty providing for the following per risk coverage of \$38.0 million in excess of a \$2.0 million retention:

- The per occurrence cap on the total program is \$84.0 million.

- The first layer continues to have unlimited reinstatements. The annual aggregate limit for the second layer, which is \$30.0 million in excess of \$10.0 million, is consistent with the prior year treaty at \$120.0 million.

- Consistent with the prior year treaty, the Property Treaty excludes nuclear, biological, chemical, and radiological terrorism losses.

Casualty Excess of Loss

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

- The first through sixth layers provide coverage for 100% of up to \$88.0 million in excess of a \$2.0 million retention.

- Consistent with the prior year treaty, the Casualty Treaty excludes nuclear, biological, chemical, and radiological terrorism losses.

- Annual aggregate terrorism limits remain the same as the prior year treaty at \$201.0 million.

Investments

Our investment philosophy includes certain return and risk objectives for the fixed maturity, equity, and other investment portfolios. Although yield and income generation remain the key drivers to our investment strategy, our overall philosophy is to invest with a long-term horizon along with predominantly a "buy-and-hold" approach. 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. Within the equity portfolio, the high dividend yield strategy is designed to generate consistent dividend income while maintaining an expected tracking error to the Standard & Poor's Rating Services ("S&P") 500 Index. Additional equity strategies are focused on meeting or exceeding strategy specific benchmarks of public equity indices. The return objective of the other investment portfolio, which includes alternative investments, is to meet or exceed the S&P 500 Index.

Total Invested Assets

| (\$ in thousands)     | September 30, December 31, |           | Change | % |
|-----------------------|----------------------------|-----------|--------|---|
|                       | 2013                       | 2012      |        |   |
| Total invested assets | \$ 4,516,060               | 4,330,019 | 4      | % |

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|                              |        |         |     |   |
|------------------------------|--------|---------|-----|---|
| Unrealized gain – before tax | 83,894 | 188,197 | (55 | ) |
| Unrealized gain – after tax  | 54,531 | 122,328 | (55 | ) |

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The increase in our investment portfolio compared to year-end 2012 was driven primarily by: (i) strong operating cash flows of \$238 million; and (ii) net proceeds from our debt issuance in February 2013. These increases were partially offset by a \$104.3 million pre-tax decrease in unrealized gains, primarily from a decrease in the market value of our fixed maturity securities portfolio, driven by the rise in interest rates during Nine Months 2013. During Nine Months 2013, interest rates on the 10-year U.S. Treasury Note rose by 85 basis points. The cash generated from our insurance operations segments, as well as net amounts generated from our capital management strategies executed in the first quarter of 2013, were used to invest primarily in corporate bonds, structured securities, and municipal bonds within our fixed maturity securities portfolio.

We structure our portfolio conservatively with a focus on: (i) asset diversification; (ii) investment quality; (iii) liquidity, particularly to meet the cash obligations of our insurance operations segments; (iv) consideration of taxes; and (v) preservation of capital. We believe that we have a high quality and liquid investment portfolio. The breakdown of our investment portfolio is as follows:

|                                    | September 30,<br>2013 | December 31,<br>2012 |
|------------------------------------|-----------------------|----------------------|
| U.S. government obligations        | 4                     | % 6                  |
| Foreign government obligations     | 1                     | 1                    |
| State and municipal obligations    | 29                    | 31                   |
| Corporate securities               | 38                    | 34                   |
| Mortgage-backed securities ("MBS") | 15                    | 14                   |
| Asset-backed securities ("ABS")    | 3                     | 3                    |
| Total fixed maturity securities    | 90                    | 89                   |
| Equity securities                  | 4                     | 3                    |
| Short-term investments             | 4                     | 5                    |
| Other investments                  | 2                     | 3                    |
| Total                              | 100                   | % 100                |

**Fixed Maturity Securities**

The average duration of the fixed maturity securities portfolio as of September 30, 2013 was 3.5 years, including short-term investments, compared to the Insurance Subsidiaries' liability duration of approximately 3.9 years. The current duration of the fixed maturity securities portfolio is within our historical range, and is monitored and managed to maximize yield while managing interest rate risk at an acceptable level. We are experiencing continued pressure on the yields within our fixed maturity securities portfolio, as higher yielding bonds that are either maturing or have been sold are being replaced with lower yielding bonds that are currently available in the marketplace. We manage liquidity with a laddered maturity structure and an appropriate level of short-term investments to avoid liquidation of available-for-sale ("AFS") fixed maturity securities in the ordinary course of business. We typically have a long investment time horizon, and every purchase or sale is made with the intent of maximizing risk adjusted investment returns in the current market environment while balancing capital preservation.

Our fixed maturity securities portfolio had a weighted average credit rating of "AA-" as of September 30, 2013. The following table presents the credit ratings of our fixed maturity securities portfolio:

| Fixed Maturity Security Rating | September 30,<br>2013 | December 31,<br>2012 |
|--------------------------------|-----------------------|----------------------|
| Aaa/AAA                        | 15                    | % 16                 |
| Aa/AA                          | 45                    | 47                   |
| A/A                            | 27                    | 25                   |

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|                |     |       |
|----------------|-----|-------|
| Baa/BBB        | 12  | 10    |
| Ba/BB or below | 1   | 2     |
| Total          | 100 | % 100 |

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The following table summarizes the fair value, unrealized gain (loss) balances, and the weighted average credit qualities of our AFS fixed maturity securities at September 30, 2013 and December 31, 2012:

| (\$ in millions)  | September 30, 2013 |                        |                                 | December 31, 2012 |                        |                                 |
|---|--------------------|------------------------|---------------------------------|-------------------|------------------------|---------------------------------|
|   | Fair Value         | Unrealized Gain (Loss) | Weighted Average Credit Quality | Fair Value        | Unrealized Gain (Loss) | Weighted Average Credit Quality |
| <b>AFS Fixed Maturity Portfolio:</b>  |                    |                        |                                 |                   |                        |                                 |
| U.S. government obligations   | \$ 180.8           | 11.6                   | AA+                             | 259.1             | 17.2                   | AA+                             |
| Foreign government obligations  | 29.7               | 0.9                    | AA-                             | 30.2              | 1.4                    | AA-                             |
| State and municipal obligations   | 929.5              | 11.1                   | AA                              | 818.0             | 44.1                   | AA                              |
| Corporate securities  | 1,663.1            | 33.5                   | A                               | 1,450.3           | 81.3                   | A                               |
| MBS   | 679.5              | 2.0                    | AA+                             | 609.8             | 19.0                   | AA                              |
| ABS   | 150.8              | 0.6                    | AAA                             | 128.6             | 2.3                    | AAA                             |
| Total AFS fixed maturity portfolio  | \$3,633.4          | 59.7                   | AA-                             | 3,296.0           | 165.3                  | AA-                             |
| <b>State and Municipal Obligations:</b>                                     |                    |                        |                                 |                   |                        |                                 |
| General obligations   | \$438.6            | 5.8                    | AA+                             | 352.3             | 20.5                   | AA+                             |
| Special revenue obligations   | 490.9              | 5.3                    | AA                              | 465.7             | 23.6                   | AA                              |
| Total state and municipal obligations                                       | \$929.5            | 11.1                   | AA                              | 818.0             | 44.1                   | AA                              |
| <b>Corporate Securities:</b>  |                    |                        |                                 |                   |                        |                                 |
| Financial   | \$522.7            | 13.0                   | A                               | 438.0             | 23.2                   | A                               |
| Industrials   | 112.2              | 4.1                    | A-                              | 104.2             | 7.4                    | A-                              |
| Utilities   | 143.5              | 1.0                    | A-                              | 124.2             | 6.6                    | BBB+                            |
| Consumer discretionary  | 189.4              | 3.6                    | A-                              | 134.7             | 8.3                    | BBB+                            |
| Consumer staples  | 164.2              | 4.3                    | A                               | 163.6             | 8.6                    | A                               |
| Healthcare  | 170.8              | 4.0                    | A                               | 178.2             | 11.0                   | A+                              |
| Materials   | 94.9               | 1.4                    | BBB+                            | 71.9              | 4.6                    | A-                              |
| Energy  | 88.0               | 1.2                    | A-                              | 77.4              | 4.3                    | A-                              |
| Information technology  | 105.6              | (0.2)                  | A+                              | 100.1             | 3.2                    | A                               |
| Telecommunications services   | 64.3               | 0.6                    | BBB+                            | 46.7              | 2.8                    | BBB+                            |
| Other   | 7.5                | 0.5                    | AA+                             | 11.3              | 1.3                    | AA+                             |
| Total corporate securities  | \$1,663.1          | 33.5                   | A                               | 1,450.3           | 81.3                   | A                               |
| <b>MBS:</b>   |                    |                        |                                 |                   |                        |                                 |
| Government guaranteed agency commercial mortgage-backed securities ("CMBS") | \$35.5             | 1.0                    | AA+                             | 48.9              | 2.3                    | AA+                             |
| Other agency CMBS   | 9.1                | (0.3)                  | AA+                             | 1.2               | —                      | AA+                             |
| Non-agency CMBS   | 107.4              | (1.2)                  | AA                              | 87.1              | 1.1                    | AA-                             |
| Government guaranteed agency residential MBS ("RMBS")                       | 61.4               | 1.8                    | AA+                             | 91.0              | 3.3                    | AA+                             |
| Other agency RMBS   | 418.9              | 0.1                    | AA+                             | 331.3             | 11.3                   | AA+                             |
| Non-agency RMBS   | 42.0               | 0.5                    | A-                              | 44.3              | 0.9                    | A-                              |
| Alternative-A ("Alt-A") RMBS  | 5.2                | 0.1                    | A+                              | 6.0               | 0.1                    | AA-                             |
| Total MBS   | \$679.5            | 2.0                    | AA+                             | 609.8             | 19.0                   | AA                              |
| <b>ABS:</b>   |                    |                        |                                 |                   |                        |                                 |



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|                               |          |     |     |       |     |     |
|-------------------------------|----------|-----|-----|-------|-----|-----|
| ABS                           | \$ 150.0 | 0.5 | AAA | 127.2 | 2.0 | AAA |
| Alt-A ABS <sup>2</sup>        | —        | —   | —   | 0.8   | 0.2 | D   |
| Sub-prime ABS <sup>1, 2</sup> | 0.8      | 0.1 | CCC | 0.6   | 0.1 | D   |
| Total ABS                     | 150.8    | 0.6 | AAA | 128.6 | 2.3 | AAA |

<sup>1</sup>We define sub-prime exposure as exposure to direct and indirect investments in non-agency residential mortgages with average FICO<sup>®</sup> scores below 650.

<sup>2</sup>Alt-A ABS and subprime ABS each consist of one security whose issuer is currently expected by rating agencies to default on its obligations.

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The following tables provide information regarding our held-to-maturity ("HTM") fixed maturity securities and their credit qualities at September 30, 2013 and December 31, 2012:

September 30, 2013

| (\$ in millions)                        | Fair Value | Carry Value | Unrecognized Holding Gain (Loss) | Unrealized Gain (Loss) in Accumulated Other Comprehensive Income ("AOCI") | Total Unrealized/Unrecognized Gain (Loss) | Weighted Average Credit Quality |
|---|------------|-------------|----------------------------------|---|---|---------------------------------|
| <b>HTM Fixed Maturity Portfolio:</b>    |            |             |                                  |   |   |                                 |
| Foreign government obligations          | \$5.6      | 5.5         | 0.1                              | 0.2   | 0.3                                       | AA+                             |
| State and municipal obligations         | 395.6      | 376.3       | 19.3                             | 4.1   | 23.4                                      | AA                              |
| Corporate securities                    | 31.8       | 28.8        | 3.0                              | (0.5)   | 2.5                                       | A                               |
| MBS                                     | 9.6        | 6.3         | 3.3                              | (1.0)   | 2.3                                       | AA                              |
| ABS                                     | 5.9        | 5.1         | 0.8                              | (0.8)   | —   | A+                              |
| Total HTM fixed maturity portfolio      | \$448.5    | 422.0       | 26.5                             | 2.0   | 28.5                                      | AA                              |
| <b>State and Municipal Obligations:</b> |            |             |                                  |   |   |                                 |
| General obligations                     | \$124.2    | 118.7       | 5.5                              | 2.3   | 7.8                                       | AA                              |
| Special revenue obligations             | 271.4      | 257.6       | 13.8                             | 1.8   | 15.6                                      | AA                              |
| Total state and municipal obligations   | \$395.6    | 376.3       | 19.3                             | 4.1   | 23.4                                      | AA                              |
| <b>Corporate Securities:</b>            |            |             |                                  |   |   |                                 |
| Financial                               | \$7.4      | 6.8         | 0.6                              | (0.2)   | 0.4                                       | BBB+                            |
| Industrials                             | 7.9        | 6.8         | 1.1                              | (0.2)   | 0.9                                       | A                               |
| Utilities                               | 14.6       | 13.3        | 1.3                              | (0.1)   | 1.2                                       | A+                              |
| Consumer discretionary                  | 1.9        | 1.9         | —                                | —   | —   | AA                              |
| Total corporate securities              | \$31.8     | 28.8        | 3.0                              | (0.5)   | 2.5                                       | A                               |
| <b>MBS:</b>                             |            |             |                                  |   |   |                                 |
| Non-agency CMBS                         | \$9.6      | 6.3         | 3.3                              | (1.0)   | 2.3                                       | AA                              |
| Total MBS                               | \$9.6      | 6.3         | 3.3                              | (1.0)   | 2.3                                       | AA                              |
| <b>ABS:</b>                             |            |             |                                  |   |   |                                 |
| ABS                                     | \$3.4      | 3.3         | 0.1                              | (0.1)   | —   | BBB+                            |
| Alt-A ABS                               | 2.5        | 1.8         | 0.7                              | (0.7)   | —   | AAA                             |
| Total ABS                               | \$5.9      | 5.1         | 0.8                              | (0.8)   | —   | A+                              |

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December 31, 2012

| (\$ in millions)                        | Fair Value | Carry Value | Unrecognized Holding Gain (Loss) | Unrealized Gain (Loss) in AOCI | Total Unrealized/Unrecognized Gain (Loss) | Weighted Average Credit Quality |
|---|------------|-------------|----------------------------------|--------------------------------|---|---------------------------------|
| <b>HTM Portfolio:</b>                   |            |             |                                  |                                |   |                                 |
| Foreign government obligations          | \$5.9      | 5.5         | 0.4                              | 0.2                            | 0.6                                       | AA+                             |
| State and municipal obligations         | 526.9      | 498.0       | 28.9                             | 6.8                            | 35.7                                      | AA                              |
| Corporate securities                    | 42.1       | 37.5        | 4.6                              | (0.8)                          | ) 3.8                                     | A                               |
| MBS                                     | 12.7       | 7.2         | 5.5                              | (1.2)                          | ) 4.3                                     | AA-                             |
| ABS                                     | 7.1        | 5.9         | 1.2                              | (1.1)                          | ) 0.1                                     | A                               |
| Total HTM portfolio                     | \$594.7    | 554.1       | 40.6                             | 3.9                            | 44.5                                      | AA                              |
| <b>State and Municipal Obligations:</b> |            |             |                                  |                                |   |                                 |
| General obligations                     | \$174.4    | 166.0       | 8.4                              | 3.8                            | 12.2                                      | AA                              |
| Special revenue obligations             | 352.5      | 332.0       | 20.5                             | 3.0                            | 23.5                                      | AA                              |
| Total state and municipal obligations   | \$526.9    | 498.0       | 28.9                             | 6.8                            | 35.7                                      | AA                              |
| <b>Corporate Securities:</b>            |            |             |                                  |                                |   |                                 |
| Financial                               | \$9.6      | 8.3         | 1.3                              | (0.7)                          | ) 0.6                                     | BBB+                            |
| Industrials                             | 11.9       | 10.4        | 1.5                              | (0.2)                          | ) 1.3                                     | A+                              |
| Utilities                               | 15.1       | 13.4        | 1.7                              | —                              | 1.7                                       | A+                              |
| Consumer discretionary                  | 3.5        | 3.4         | 0.1                              | 0.1                            | 0.2                                       | AA                              |
| Materials                               | 2.0        | 2.0         | —                                | —                              | —   | BBB                             |
| Total corporate securities              | \$42.1     | 37.5        | 4.6                              | (0.8)                          | ) 3.8                                     | A                               |
| <b>MBS:</b>                             |            |             |                                  |                                |   |                                 |
| Non-agency CMBS                         | \$12.7     | 7.2         | 5.5                              | (1.2)                          | ) 4.3                                     | AA-                             |
| Total MBS                               | \$12.7     | 7.2         | 5.5                              | (1.2)                          | ) 4.3                                     | AA-                             |
| <b>ABS:</b>                             |            |             |                                  |                                |   |                                 |
| ABS                                     | \$4.7      | 4.2         | 0.5                              | (0.3)                          | ) 0.2                                     | BBB+                            |
| Alt-A ABS                               | 2.4        | 1.7         | 0.7                              | (0.8)                          | ) (0.1)                                   | ) AAA                           |
| Total ABS                               | \$7.1      | 5.9         | 1.2                              | (1.1)                          | ) 0.1                                     | A                               |

A portion of our AFS and HTM municipal bonds contain insurance enhancements. The following table provides information regarding these insurance-enhanced securities as of September 30, 2013:

**Insurers of Municipal Bond Securities**

| (\$ in thousands)   | Fair Value | Ratings with Insurance | Ratings without Insurance |
|---|------------|------------------------|---------------------------|
| National Public Finance Guarantee Corporation, a subsidiary of MBIA, Inc. | \$157,628  | AA-                    | AA-                       |
| Assured Guaranty  | 146,494    | AA                     | AA-                       |
| Ambac Financial Group, Inc.   | 70,884     | AA                     | AA                        |
| Other   | 11,183     | AA                     | A+                        |
| Total   | \$386,189  | AA-                    | AA-                       |



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The following table details the top 10 state exposures of the municipal bond portion of our fixed maturity securities portfolio at September 30, 2013:

## State Exposures of Municipal Bonds

| (\$ in thousands)                       | General Obligation |         | Special Revenue | Fair Value | Weighted Average Credit Quality |
|---|--------------------|---------|-----------------|------------|---------------------------------|
|   | Local              | State   |                 |            |                                 |
| Texas                                   | \$69,301           | 1,079   | 41,701          | 112,081    | AA+                             |
| Washington                              | 34,877             | 6,717   | 51,569          | 93,163     | AA                              |
| New York                                | 9,735              | —       | 68,579          | 78,314     | AA+                             |
| Florida                                 | —                  | 15,139  | 52,909          | 68,048     | AA-                             |
| Arizona                                 | 7,923              | —       | 53,279          | 61,202     | AA                              |
| Colorado                                | 31,824             | —       | 16,741          | 48,565     | AA-                             |
| Missouri                                | 16,349             | 10,065  | 18,846          | 45,260     | AA+                             |
| California                              | 3,299              | —       | 41,168          | 44,467     | AA-                             |
| North Carolina                          | 13,133             | 5,924   | 23,328          | 42,385     | AA                              |
| Ohio                                    | 9,436              | 9,440   | 19,831          | 38,707     | AA                              |
| Other                                   | 153,772            | 123,668 | 308,656         | 586,096    | AA                              |
|   | 349,649            | 172,032 | 696,607         | 1,218,288  | AA                              |
| Pre-refunded/escrowed to maturity bonds | 51,207             | 4,250   | 51,397          | 106,854    | AA+                             |
| Total                                   | \$400,856          | 176,282 | 748,004         | 1,325,142  | AA                              |

There has been concern regarding the stress on state and local governments emanating from declining revenues, large unfunded liabilities, and entrenched cost structures. We are comfortable with the quality, composition, and diversification of our \$1.3 billion municipal bond portfolio. Our municipal bond portfolio is very high quality with an average AA rating and is well laddered with 44% maturing within three years, and another 15% maturing between three and five years. The weightings of the municipal bond portfolio are: (i) 57% of high-quality revenue bonds that have dedicated revenue streams; (ii) 30% of local general obligation bonds; and (iii) 13% of state general obligation bonds. In addition, approximately 8% of the municipal bond portfolio has been pre-refunded, meaning assets have been placed in trust to fund the debt service and maturity of the bonds. Our largest state exposure is to Texas, at 8% excluding the impact of pre-refunded bonds. Of the \$69 million in local Texas general obligation bonds, \$23 million represents investments in Texas Permanent School Fund bonds, which are considered to have lower risk.

The sector composition and credit quality of our special revenue bonds did not significantly change from December 31, 2012. For details regarding our special revenue bond sectors and additional information regarding credit risk associated with our portfolio, see Item 7A. "Quantitative and Qualitative Disclosures About Market Risk." of our 2012 Annual Report.

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

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Our top Eurozone exposures as of September 30, 2013 were as follows:

September 30, 2013

| (\$ in millions) | Corporate Securities | Foreign Government Securities | Equity Securities | Total Exposure |
|------------------|----------------------|-------------------------------|-------------------|----------------|
| Country:         |                      |                               |                   |                |
| Netherlands      | \$ 15.7              | —                             | —                 | 15.7           |
| Luxembourg       | 8.4                  | —                             | —                 | 8.4            |
| Germany          | —                    | 5.6                           | —                 | 5.6            |
| Ireland          | —                    | —                             | 2.2               | 2.2            |
| France           | 2.6                  | —                             | —                 | 2.6            |
| Total            | \$26.7               | 5.6                           | 2.2               | 34.5           |

Uncertainty about the ability of certain sovereign issuers to fully repay their debt triggered significant turbulence in global financial markets in 2012 but has abated in 2013. The sovereign debt crisis has been particularly concentrated in the Eurozone, and a number of member countries have been repeatedly downgraded by the major ratings agencies. As of September 30, 2013, we had no direct exposure to issuers domiciled in Italy, Greece, Portugal, or Spain, four of the more economically troubled nations in the Eurozone. We do not own any derivative exposures such as credit default swaps. Outside of the effect foreign economies have on the underlying investments, we have minimal exposure to Euro depreciation or appreciation.

#### Equity Securities

Our equity securities portfolio was 4% of invested assets as of September 30, 2013, up slightly from year-end 2012. During Nine Months 2013, we rebalanced our high dividend yield strategy holdings within this portfolio, generating purchases of \$109.5 million and sales which had an original cost of \$85.4 million. Also contributing to the increase in this portfolio's value were unrealized gains, which increased by \$3.2 million in Nine Months 2013.

#### Other Investments

As of September 30, 2013, other investments represented 2% of our total invested assets. The following table outlines a summary of our other investment portfolio by strategy and the remaining commitment amount associated with each strategy:

| Other Investments<br>(\$ in thousands) | Carrying Value        |                      | Remaining<br>Commitment<br>September<br>30, 2013 |
|--|-----------------------|----------------------|--|
|  | September 30,<br>2013 | December 31,<br>2012 |  |
| Alternative Investments:               |                       |                      |  |
| Secondary private equity               | \$25,954              | 28,032               | 7,703  |
| Private equity                         | 18,951                | 18,344               | 10,502   |
| Energy/power generation                | 17,049                | 18,640               | 7,076  |
| Mezzanine financing                    | 12,921                | 12,692               | 18,796   |
| Real estate                            | 12,385                | 11,751               | 10,205   |
| Distressed debt                        | 11,911                | 12,728               | 2,964  |
| Venture capital                        | 7,018                 | 7,477                | 400  |
| Total alternative investments          | 106,189               | 109,664              | 57,646   |
| Other securities                       | 1,884                 | 4,412                | 1,289  |
| Total other investments                | \$108,073             | 114,076              | 58,935   |

In addition to the capital that we have already invested to date, we are contractually obligated to invest up to an additional \$58.9 million in our other investments portfolio through commitments that currently expire at various dates through 2026. During the second quarter of 2013, we contracted for one new alternative investment within the private equity strategy. This investment, which has characteristics consistent with our other private equity strategy investments, has a commitment of \$7.0 million, of which \$0.9 million has been paid as of September 30, 2013. For a description of our seven alternative investment strategies outlined above, as well as redemption, restrictions, and fund liquidations, refer to Note 5. "Investments" in Item 8. "Financial Statements and Supplementary Data." of our 2012 Annual Report. In addition, for information on current year activity, refer to Note 5. "Investments" in Item 1. "Financial Statements" of this Form 10-Q.

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## Net Investment Income

The components of net investment income earned for the indicated periods were as follows:

| (\$ in thousands)                                   | Quarter ended September 30, |          | Nine Months ended September 30, |           |
|---|-----------------------------|----------|---------------------------------|-----------|
|   | 2013                        | 2012     | 2013                            | 2012      |
| Fixed maturity securities                           | \$30,569                    | 30,839   | 90,956                          | 93,948    |
| Equity securities                                   | 1,341                       | 1,268    | 4,422                           | 3,785     |
| Short-term investments                              | 21                          | 36       | 102                             | 103       |
| Other investments                                   | 2,639                       | 497      | 10,110                          | 5,460     |
| Miscellaneous income                                | —                           | 41       | —                               | 105       |
| Investment expenses                                 | (2,113                      | ) (2,031 | ) (6,260                        | ) (6,117  |
| Net investment income earned – before tax           | 32,457                      | 30,650   | 99,330                          | 97,284    |
| Net investment income tax expense                   | (7,947                      | ) (7,156 | ) (24,281                       | ) (23,305 |
| Net investment income earned – after tax            | \$24,510                    | 23,494   | 75,049                          | 73,979    |
| Effective tax rate                                  | 24.5                        | % 23.3   | 24.4                            | 24.0      |
| Annual after-tax yield on fixed maturity securities |                             |          | 2.3                             | 2.5       |
| Annual after-tax yield on investment portfolio      |                             |          | 2.3                             | 2.3       |

Net investment income before tax increased in both Third Quarter and Nine Months 2013 compared to the same periods last year primarily due to higher income from our alternative investments. Partially offsetting this increase in Nine Months 2013 was a decrease in fixed maturity securities income due to lower investment yields than in the prior year period.

## Realized Gains and Losses

## Realized Gains and Losses (excluding OTTI)

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

| (\$ in thousands)                         | Quarter ended September 30, |        | Nine Months ended September 30, |        |
|---|-----------------------------|--------|---------------------------------|--------|
|   | 2013                        | 2012   | 2013                            | 2012   |
| HTM fixed maturity securities             |                             |        |                                 |        |
| Gains                                     | \$32                        | 40     | 35                              | 195    |
| Losses                                    | (37                         | ) (90  | ) (86                           | ) (196 |
| AFS fixed maturity securities             |                             |        |                                 |        |
| Gains                                     | 662                         | 2,168  | 2,580                           | 2,941  |
| Losses                                    | (31                         | ) (262 | ) (330                          | ) (379 |
| AFS equity securities                     |                             |        |                                 |        |
| Gains                                     | 13,801                      | —      | 24,272                          | 4,775  |
| Losses                                    | (236                        | ) —    | (407                            | ) (428 |
| Short-term investments                    |                             |        |                                 |        |
| Gains                                     | —                           | —      | —                               | —      |
| Losses                                    | —                           | —      | —                               | (2     |
| Other Investments                         |                             |        |                                 |        |
| Gains                                     | —                           | —      | —                               | 1      |
| Losses                                    | (80                         | ) —    | (940                            | ) —    |
| Total other net realized investment gains | 14,111                      | 1,856  | 25,124                          | 6,907  |



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|   |          |   |        |   |        |   |        |   |
|---|----------|---|--------|---|--------|---|--------|---|
| Total OTTI charges recognized in earnings | (680     | ) | (2,944 | ) | (3,184 | ) | (3,459 | ) |
| Total net realized gains (losses)         | \$13,431 |   | (1,088 | ) | 21,940 |   | 3,448  |   |

Our general philosophy for sales of securities is to reduce our exposure to securities and sectors based on economic evaluations and when the fundamentals for that security or sector have deteriorated, or to opportunistically trade out of securities to other securities with better economic return characteristics. We typically have a long investment time horizon, and every purchase or sale is made with the intent of maximizing risk adjusted investment returns in the current market environment while balancing capital preservation.

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Certain equity securities were sold at a loss that were in a continuous loss position for less than three months prior to their sale. The fair value of these securities was \$3.0 million, with related net realized losses of \$0.2 million, in Third Quarter 2013 and \$6.0 million, with related net realized losses of \$0.4 million, in Nine Months 2013. There were no equity securities sold at a loss during Third Quarter 2012. In Nine Months 2012, we sold \$8.1 million of equity securities with related net realized losses of \$0.4 million.

In addition, we sold one fixed maturity security at a loss during Third Quarter 2012, which was in a continuous unrealized loss position for greater than 12 months, with a fair value as of the sale date of \$4.8 million and related net realized loss of \$0.2 million.

For additional discussion regarding realized gains and losses, see Note 5. "Investments" in Item 1. "Financial Statements" of this Form 10-Q.

## Other-than-Temporary Impairments

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

| (\$ in thousands)                         | Quarter ended September 30, |       | Nine Months ended September 30, |       |
|---|-----------------------------|-------|---------------------------------|-------|
|   | 2013                        | 2012  | 2013                            | 2012  |
| HTM fixed maturity securities:            |                             |       |                                 |       |
| ABS                                       | \$—                         | —     | 3                               | —     |
| Total HTM fixed maturity securities       | —                           | —     | 3                               | —     |
| AFS fixed maturity securities:            |                             |       |                                 |       |
| ABS                                       | —                           | 36    | —                               | 98    |
| CMBS                                      | —                           | 519   | —                               | 627   |
| RMBS                                      | —                           | —     | 8                               | 174   |
| Total AFS fixed maturity securities       | —                           | 555   | 8                               | 899   |
| Equity securities                         | 680                         | 2,389 | 1,326                           | 2,560 |
| Total AFS securities                      | 680                         | 2,944 | 1,334                           | 3,459 |
| Other investments                         | —                           | —     | 1,847                           | —     |
| Total OTTI charges recognized in earnings | \$680                       | 2,944 | 3,184                           | 3,459 |

We regularly review our entire investment portfolio for declines in fair value. If we believe that a decline in the value of a particular investment is other than temporary, we record it as an OTTI, through realized losses in earnings for the credit-related portion and through unrealized losses in other comprehensive income ("OCI") for the non-credit related portion. If there is a decline in fair value of an equity security that we do not intend to hold, or if we determine that the decline is other than temporary, we write down the cost of the investment to fair value and record the charge through earnings as a component of realized losses.

For discussion of our OTTI methodology, see Note 2. "Summary of Significant Accounting Policies" in Item 8. "Financial Statements and Supplementary Data." of our 2012 Annual Report.

## Unrealized/Unrecognized Losses

As reflected in the table below, our net unrealized/unrecognized loss positions increased by \$40.6 million as of September 30, 2013 compared to December 31, 2012 as follows:

(\$ in thousands)

| September 30, 2013 |                  |                              | December 31, 2012 |                  |                              |
|--------------------|------------------|------------------------------|-------------------|------------------|------------------------------|
| Number of Issues   | % of Market/Book | Unrealized/Unrecognized Loss | Number of Issues  | % of Market/Book | Unrealized/Unrecognized Loss |
| 501                | 80% - 99%        | \$43,295                     | 100               | 80% - 99%        | 2,701                        |

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|   |           |          |   |           |       |
|---|-----------|----------|---|-----------|-------|
| — | 60% - 79% | —        | 1 | 60% - 79% | 233   |
| 1 | 40% - 59% | 286      | — | 40% - 59% | —     |
| — | 20% - 39% | —        | — | 20% - 39% | —     |
| — | 0% - 19%  | —        | — | 0% - 19%  | —     |
|   |           | \$43,581 |   |           | 2,934 |

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We have reviewed the securities in the table above in accordance with our OTTI policy, which is discussed in Note 2. "Summary of Significant Accounting Policies" in Item 8. "Financial Statements and Supplementary Data." of our 2012 Annual Report. We have concluded that these securities were temporarily impaired as of September 30, 2013 and December 31, 2012. For additional information regarding the unrealized/unrecognized losses in our AFS and HTM portfolios, see Note 5. "Investments" in Item 1. "Financial Statements" of this Form 10-Q.

**Contractual Maturities**

The following table presents amortized cost and fair value information for our AFS fixed maturity securities that were in an unrealized loss position at September 30, 2013 by contractual maturity:

| (\$ in thousands)                      | Amortized<br>Cost | Fair<br>Value |
|--|-------------------|---------------|
| One year or less                       | \$14,576          | 14,352        |
| Due after one year through five years  | 343,058           | 337,618       |
| Due after five years through ten years | 889,527           | 854,503       |
| Due after ten years                    | 20,116            | 19,157        |
| Total                                  | \$1,267,277       | 1,225,630     |

The following table presents amortized cost and fair value information for our HTM fixed maturity securities that were in an unrealized/unrecognized loss position at September 30, 2013 by contractual maturity:

| (\$ in thousands)                     | Amortized<br>Cost | Fair<br>Value |
|---------------------------------------|-------------------|---------------|
| One year or less                      | \$739             | 731           |
| Due after one year through five years | 2,856             | 2,808         |
| Total                                 | \$3,595           | 3,539         |

**Federal Income Taxes**

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

| (\$ in million)                                       | Quarter ended September 30, |      | Nine Months ended September 30, |      |
|---|-----------------------------|------|---------------------------------|------|
|   | 2013                        | 2012 | 2013                            | 2012 |
| Federal income tax expense from continuing operations | \$11.8                      | 2.0  | 27.5                            | 6.2  |
| Effective tax rate                                    | 27                          | % 10 | 25                              | 14   |

The increase in federal income tax expense in Third Quarter and Nine Months 2013 compared to the same prior year periods was primarily due to an improvement in underwriting results as compared to last year. For a discussion of our underwriting results, see the "Results of Operations and Related Information by Segment" section above.

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

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

**Liquidity**

We manage liquidity with a focus on generating sufficient cash flows to meet the short-term and long-term cash requirements of our business operations. Our cash and short-term investment position of \$172 million at September 30, 2013 was comprised of \$23 million at Selective Insurance Group, Inc. (the "Parent") and \$149 million at the Insurance Subsidiaries. This amount was lower than our aggregate \$215 million cash and short-term investment position at December 31, 2012, as we were previously maintaining higher liquid assets to fund claim payments related

to Hurricane Sandy. As those payments continue to be made, cash and short-term assets have declined. Short-term investments are generally maintained in "AAA" rated money market funds approved by the National Association of Insurance Commissioners. During Nine Months 2013, the Parent continued to build a fixed maturity security investment portfolio containing high-quality, highly-liquid government and corporate fixed maturity securities to generate additional yield. This portfolio amounted to \$57 million at September 30, 2013, compared to \$41 million at December 31, 2012.

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Sources of cash for the Parent have historically consisted of dividends from the Insurance Subsidiaries, borrowings under lines of credit and loan agreements with certain Insurance Subsidiaries, and the issuance of stock and debt securities. We continue to monitor these sources, giving consideration to our long-term liquidity and capital preservation strategies.

We currently anticipate the Insurance Subsidiaries will pay approximately \$32 million in total dividends to the Parent in 2013. Cash dividends of \$25 million were paid through Nine Months 2013, which included approximately \$11 million that were deemed extraordinary under New Jersey insurance regulations. The Insurance Subsidiaries are expected to pay \$7 million in ordinary dividends throughout the remainder of 2013. As of December 31, 2012, our allowable ordinary maximum dividend was approximately \$106 million for 2013.

Any dividends to the Parent are subject to the approval and/or review of the insurance regulators in the respective domiciliary states and are generally payable only from earned surplus as reported in the statutory annual statements of those subsidiaries as of the preceding December 31. Although past dividends have historically been met with regulatory approval, there is no assurance that future dividends that may be declared will be approved. For additional information regarding dividend restrictions, refer to Note 20. "Statutory Financial Information, Capital Requirements, and Restrictions on Dividends and Transfers of Funds" in Item 8. "Financial Statements and Supplementary Data." of our 2012 Annual Report.

In the first quarter of 2013, we issued \$185 million of 5.875% Senior Notes due 2043. The Senior Notes pay interest on February 15, May 15, August 15, and November 15 of each year beginning on May 15, 2013, and on the date of maturity. The notes are callable by us on or after February 8, 2018, at a price equal to 100% of their principal amount, plus accrued and unpaid interest. A portion of the proceeds from this debt issuance was used to fully redeem the \$100 million aggregate principal amount of our 7.5% Junior Subordinated Notes due 2066. Of the remaining net proceeds, \$57.1 million was used to make capital contributions to the Insurance Subsidiaries while the balance was used for general corporate purposes. For additional information related to our outstanding debt, refer to Note 10. "Indebtedness" in Item 8. "Financial Statements and Supplementary Data." of our 2012 Annual Report.

The Parent had no private or public issuances of stock during Nine Months 2013. In Third Quarter 2013, the Parent renewed its \$30 million line of credit ("Line of Credit"). For additional information regarding the renewal, see the "Short-Term Borrowings" section below and Note 9. "Indebtedness" in Item 1. "Financial Statements" of this Form 10-Q. The Parent had no borrowings under this Line of Credit or the previous credit facility at September 30, 2013 or at any time during Nine Months 2013.

We have two Insurance Subsidiaries domiciled in Indiana ("Indiana Subsidiaries") that are members of the Federal Home Loan Bank of Indianapolis ("FHLBI"), Selective Insurance Company of South Carolina ("SICSC") and Selective Insurance Company of the Southeast ("SICSE"). Membership in the FHLBI provides these subsidiaries with access to additional liquidity. The Indiana Subsidiaries' aggregate investment of \$2.9 million provides them with the ability to borrow up to 20 times the total amount of the FHLBI common stock purchased, at comparatively low borrowing rates. All borrowings from the FHLBI are required to be secured by certain investments. For additional information regarding the required collateral, refer to Note 5. "Investments" in Item 1. "Financial Statements" of this Form 10-Q.

The Parent's Line of Credit agreement permits collateralized borrowings by the Indiana Subsidiaries from the FHLBI so long as the aggregate amount borrowed does not exceed 10% of the respective Indiana Subsidiary's admitted assets from the preceding calendar year. Admitted assets amounted to \$496.7 million for SICSC and \$380.5 million for SICSE as of December 31, 2012, for a borrowing capacity of approximately \$88 million. As our outstanding borrowing with the FHLBI is currently \$58 million, the Indiana Subsidiaries have the ability to borrow approximately \$30 million more until the Line of Credit borrowing limit is met, of which \$22 million could be loaned to the Parent under lending agreements approved by the Indiana Department of Insurance. Similar to the Line of Credit agreement, these lending agreements limit borrowings by the Parent from the Indiana Subsidiaries to 10% of the admitted assets

of the respective Indiana Subsidiary. For additional information regarding the Parent's Line of Credit, refer to the section below entitled "Short-term Borrowings."

The Insurance Subsidiaries also generate liquidity through insurance float, which is created by collecting premiums and earning investment income before losses are paid. The period of the float can extend over many years. Our investment portfolio consists of maturity dates that are laddered to continually provide a source of cash flows for claims payments in the ordinary course of business. The duration of the fixed maturity securities portfolio including short-term investments was 3.5 years as of September 30, 2013, while the liabilities of the Insurance Subsidiaries have a duration of 3.9 years. In addition, the Insurance Subsidiaries purchase reinsurance coverage for protection against any significantly large claims or catastrophes that may occur during the year.

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

Our ability to meet our interest and principal repayment obligations on our debt, as well as our ability to continue to pay dividends to our stockholders, is dependent on liquidity at the Parent coupled with the ability of the Insurance Subsidiaries to pay dividends, if necessary, and/or the availability of other sources of liquidity to the Parent. Upcoming principal payments include \$13 million in 2014 and \$45 million in 2016. Subsequent to 2016, our next principal repayment is due in 2034. Restrictions on the ability of the Insurance Subsidiaries to declare and pay dividends, without alternative liquidity options, could materially affect our ability to service debt and pay dividends on common stock.

**Short-term Borrowings**

Our Line of Credit with Wells Fargo Bank, National Association, as administrative agent, and Branch Banking and Trust Company (BB&T), was renewed effective September 26, 2013 with a borrowing capacity of \$30 million, which can be increased to \$50 million with the approval of both lending partners.

The Line of Credit provides the Parent with an additional source of short-term liquidity. The interest rate on our Line of Credit varies and is based on, among other factors, the Parent's debt ratings. The Line of Credit expires on September 26, 2017. There were no balances outstanding under this Line of Credit or the previous credit facility at September 30, 2013 or at any time during Nine Months 2013.

The Line of Credit agreement contains representations, warranties, and covenants that are customary for credit facilities of this type, including, without limitation, financial covenants under which we are obligated to maintain a minimum consolidated net worth, minimum combined statutory surplus, and maximum ratio of consolidated debt to total capitalization, as well as covenants limiting our ability to: (i) merge or liquidate; (ii) incur debt or liens; (iii) dispose of assets; (iv) make certain investments and acquisitions; and (v) engage in transactions with affiliates. The Line of Credit permits collateralized borrowings by the Indiana Subsidiaries from the FHLBI so long as the aggregate amount borrowed does not exceed 10% of the respective Indiana Subsidiary's admitted assets from the preceding calendar year.

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

|   | Required as of<br>September 30, 2013 | Actual as of<br>September 30, 2013 |
|---|--------------------------------------|------------------------------------|
| Consolidated net worth                    | \$785 million                        | \$1.1 billion                      |
| Statutory surplus                         | Not less than \$750<br>million       | \$1.2 billion                      |
| Debt-to-capitalization ratio <sup>1</sup> | Not to exceed 35%                    | 26.0%                              |
| A.M. Best financial strength rating       | Minimum of A-                        | A                                  |

<sup>1</sup> Calculated in accordance with the Line of Credit agreement.

**Capital Resources**

Capital resources provide protection for policyholders, furnish the financial strength to support the business of underwriting insurance risks, and facilitate continued business growth. At September 30, 2013, we had statutory surplus of \$1.2 billion, GAAP stockholders' equity of \$1.1 billion, and total debt of \$392.4 million, which equates to a debt-to-capital ratio of approximately 26%.



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

We continually monitor our cash requirements and the amount of capital resources that we maintain at the holding company and operating subsidiary levels. As part of our long-term capital strategy, we strive to maintain capital metrics, relative to the macroeconomic environment, that support our targeted financial strength. Based on our analysis and market conditions, we may take a variety of actions, including, but not limited to, contributing capital to the Insurance Subsidiaries in our insurance operations, issuing additional debt and/or equity securities, repurchasing shares of the Parent's common stock, and increasing stockholders' dividends.

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

Book value per share increased to \$20.16 as of September 30, 2013, from \$19.77 as of December 31, 2012, due to \$1.45 in net income coupled with a \$0.55 benefit related to the first quarter of 2013 pension revaluation and curtailment. These items were partially offset by a \$1.22 decrease in the unrealized gains on our investment portfolio driven by the rising interest rate environment, and \$0.39 in dividends to our shareholders.

### Ratings

We are rated by major rating agencies that issue opinions on our financial strength, operating performance, strategic position, and ability to meet policyholder obligations. We believe that our ability to write insurance business is most influenced by our rating from A.M. Best. In the second quarter of 2013, A.M. Best re-affirmed our rating of "A (Excellent)," their third highest of 13 financial strength ratings, with a "stable" outlook. The rating reflects our solid risk-adjusted capitalization, disciplined underwriting focus, increasing use of predictive modeling technology, strong independent retail agency relationships, and consistently stable loss reserves. We have been rated "A" or higher by A.M. Best for the past 83 years. A downgrade from A.M. Best to a rating below "A-" is an event of default under our Line of Credit and could affect our ability to write new business with customers and/or agents, some of whom are required (under various third-party agreements) to maintain insurance with a carrier that maintains a specified A.M. Best minimum rating.

Ratings by other major rating agencies are as follows:

Fitch Ratings ("Fitch") - Our "A+" rating was reaffirmed in the second quarter of 2013, citing our improved underwriting results, strong independent agency relationships, solid loss reserve position, and enhanced diversification through continued efforts to reduce our concentration in New Jersey. Our outlook was revised to negative reflecting increased levels of statutory and financial leverage, a moderate decline in the National Association of Insurance Commissioners ("NAIC") risk-based capital levels, and diminished operating earnings-based interest coverage relative to historical performance.

S&P - On July 11, 2013, S&P lowered our financial strength rating to "A-" from "A" under their recently revised rating criteria. The rating reflects our strong business risk profile and moderately strong financial risk profile, built on a strong competitive position in the regional small to midsize commercial insurance markets in Mid-Atlantic states and strong capital and earnings. The rating revision reflects S&P's view of our capital and earnings volatility relative to our peers. The outlook for the rating is stable citing the expectation that we will sustain our strong competitive position and business risk profile while maintaining a strong capital and earnings profile.

Moody's - Our "A2" financial strength rating was reaffirmed in the first quarter of 2013 by Moody's, which cited our strong regional franchise with established independent agency support, along with solid risk adjusted capitalization and strong invested asset quality. Our outlook was revised to negative, citing that our underwriting results have lagged similarly rated peers.

Our S&P, Moody's, and Fitch financial strength and associated credit ratings affect our ability to access capital markets. The interest rate on our Line of Credit varies and is based on, among other factors, the Parent's debt ratings. There can be no assurance that our ratings will continue for any given period of time or that they will not be changed. It is possible that positive or negative ratings actions by one or more of the rating agencies may occur in the future.

### Off-Balance Sheet Arrangements

At September 30, 2013 and December 31, 2012, we did not have any material relationships with unconsolidated entities or financial partnerships, such entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or for other contractually narrow or limited purposes. As such, we are not exposed to any material financing, liquidity, market, or credit risk that could arise if we had engaged in such relationships.



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## Contractual Obligations, Contingent Liabilities, and Commitments

Our future cash payments associated with loss and loss expense reserves, as well as contractual obligations pursuant to operating leases for office space and equipment, have not materially changed since December 31, 2012. Our future cash payments associated with contractual obligations pursuant to our notes payable as of September 30, 2013 are summarized below:

| Contractual Obligations<br>(\$ in millions) | Payment Due by Period |                     |              |              |                      |
|---|-----------------------|---------------------|--------------|--------------|----------------------|
|   | Total                 | Less than<br>1 year | 1-3<br>Years | 3-5<br>years | More than<br>5 years |
| Notes payable                               | \$393.0               | —                   | 13.0         | 45.0         | 335.0                |
| Interest on debt obligations                | 551.4                 | 22.1                | 43.7         | 42.5         | 443.1                |
| Total                                       | \$944.4               | 22.1                | 56.7         | 87.5         | 778.1                |

We expect to have the capacity to repay and/or refinance all of our contractual obligations as they come due.

At September 30, 2013, we had contractual obligations that expire at various dates through 2026 that may require us to invest up to an additional \$58.9 million in alternative and other investments. There is no certainty that any such additional investment will be required. We have issued no material guarantees on behalf of others and have no trading activities involving non-exchange traded contracts accounted for at fair value. We have no material transactions with related parties other than those disclosed in Note 17. "Related Party Transactions" included in Item 8. "Financial Statements and Supplementary Data." of our 2012 Annual Report.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in the information about market risk set forth in our 2012 Annual Report.

## ITEM 4. CONTROLS AND PROCEDURES

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended ("Exchange Act")), as of the end of the period covered by this report. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, our disclosure controls and procedures are: (i) effective in recording, processing, summarizing, and reporting information on a timely basis that we are required to disclose in the reports that we file or submit under the Exchange Act; and (ii) effective in ensuring that information that we are required to disclose in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. No changes in our internal control over financial reporting (as such term is defined in Rule 13a-15(f) of the Exchange Act) occurred during Third Quarter 2013 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

In May 2013, the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") released its updated Internal Control - Integrated Framework ("Framework"). The COSO framework is widely used by public companies to comply with the Sarbanes-Oxley Act of 2002. The effective date for companies to transition to the new Framework is December 15, 2014 when the original framework will no longer be available. The Company is currently utilizing the original Framework.

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## PART II - OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

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

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

## ITEM 1A. RISK FACTORS

Certain risk factors exist that can have a significant impact on our business, liquidity, capital resources, results of operations, financial condition, and debt ratings. The impact of these risk factors could also impact certain actions that we take as part of our long-term capital strategy, including but not limited to, contributing capital to 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. We operate in a continually changing business environment and new risk factors emerge from time to time. Consequently, we can neither predict such new risk factors nor assess the impact, if any, they might have on our business in the future. There have been no material changes from the risk factors disclosed in Item 1A. "Risk Factors." in our 2012 Annual Report other than as discussed below.

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"). Following the acquisition of MUSIC, the newly-acquired company was included in our Insurance Subsidiaries' intercompany pooling agreement. As a result, the financial strength ratings from A.M. Best and Fitch include MUSIC, while S&P and Moody's Investor Service have not yet taken any rating action on MUSIC. The financial strength ratings are as follows:

| NRSRO                    | Financial Strength Rating | Outlook  |
|--------------------------|---------------------------|----------|
| A.M. Best and Company    | "A"                       | Stable   |
| S&P                      | "A-"                      | Stable   |
| Moody's Investor Service | "A2"                      | Negative |
| Fitch                    | "A+"                      | Negative |

A significant rating downgrade, particularly from A.M. Best is an event of default under our Line of Credit and could 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. The Line of Credit requires our Insurance Subsidiaries to maintain an A.M. Best rating of at least "A-" (one level below our current rating) and a default could lead to acceleration of any outstanding principal. Such an event 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 our financial strength ratings could have a material adverse effect on our results of operations, liquidity, financial condition, financial strength, and debt ratings.

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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     | “bbb+”        | Stable                   |
| S&P                       | “BBB-”        | Stable                   |
| Moody's Investor Services | “Baa2”        | Negative                 |
| Fitch                     | “BBB+”        | Negative                 |

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 to access capital markets.

Because of the difficulties experienced by many financial institutions during the recent credit crisis, 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 their ratings that could adversely affect our business or the possible actions we may take in response to any such action.

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

The following table provides information regarding our purchases of our common stock in Third Quarter 2013:

| Period                 | Total Number of Shares Purchased <sup>1</sup> | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Programs | Maximum Number of Shares that May Yet Be Purchased Under the Announced Programs |
|------------------------|---|------------------------------|---|---|
| July 1 – 31, 2013      | —   | \$—                          | —   | —   |
| August 1 – 31, 2013    | 72  | 24.45                        | —   | —   |
| September 1 – 30, 2013 | 370   | 23.83                        | —   | —   |
| Total                  | 442   | \$23.93                      | —   | —   |

<sup>1</sup>During Third Quarter 2013, 442 shares were purchased from employees in connection with the vesting of restricted stock units. These repurchases were made to satisfy tax withholding obligations with respect to those employees. These shares were not purchased as part of any publicly announced program. The shares that were purchased in connection with the vesting of restricted stock units were purchased at fair market value as defined in the Selective Insurance Group, Inc. 2005 Omnibus Stock Plan As Amended and Restated Effective as of May 1, 2010.

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Item 6. EXHIBITS

(a) Exhibits:

Exhibit No.

|            |  |
|------------|--|
| * 10.1     | Credit Agreement among Selective Insurance Group, Inc., the Lenders Named Therein and Wells Fargo Bank, National Association, as Administrative Agent, dated as of September 26, 2013. |
| * 11       | Statement Re: Computation of Per Share Earnings.   |
| * 31.1     | Certification of Chief Executive Officer in accordance with Section 302 of the Sarbanes-Oxley Act of 2002.   |
| * 31.2     | Certification of Chief Financial Officer in accordance with Section 302 of the Sarbanes-Oxley Act of 2002.   |
| * 32.1     | Certification of Chief Executive Officer in accordance with Section 906 of the Sarbanes-Oxley Act of 2002.   |
| * 32.2     | Certification of Chief Financial Officer in accordance with Section 906 of the Sarbanes-Oxley Act of 2002.   |
| ** 101.INS | XBRL Instance Document.  |
| ** 101.SCH | XBRL Taxonomy Extension Schema Document.   |
| ** 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document.   |
| ** 101.LAB | XBRL Taxonomy Extension Label Linkbase Document.   |
| ** 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document.  |
| ** 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document.  |

\* Filed herewith.

\*\* Furnished and not filed herewith.



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SIGNATURES

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

SELECTIVE INSURANCE GROUP, INC.

Registrant

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

October 31, 2013

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

October 31, 2013