SELECTIVE INSURANCE GROUP INC
Form 10-Q
November 02, 2007

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended: September 30, 2007

or

o **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: 0-8641

SELECTIVE INSURANCE GROUP, INC.

(Exact name of registrant as specified in its charter)

New Jersey	22-2168890
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
40 Wantage Avenue Branchville, New Jersey	07890
(Address of Principal Executive Offices)	(Zip Code)

(973) 948-3000

(Registrant s Telephone Number, Including Area Code)

(Former name, former address and former fiscal year, if changed since last report)

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

Yes þ No o

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

Yes o No þ

As of September 30, 2007, there were 53,079,052 shares of common stock, par value $2.00, outstanding.

SELECTIVE INSURANCE GROUP, INC.

Table of Contents

	Page No
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements	
Consolidated Balance Sheets as of September 30, 2007 (Unaudited) and December 31, 2006	1
Unaudited Consolidated Statements of Income for the Quarter and Nine Months Ended September 30, 2007 and 2006	2
Unaudited Consolidated Statements of Stockholders Equity for the Nine Months Ended September 30, 2007 and 2006	3
Unaudited Consolidated Statements of Cash Flow for the Nine Months Ended September 30, 2007 and 2006	4
Notes to Unaudited Interim Consolidated Financial Statements	5
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	
Forward Looking Statements	14
Introduction	14
Critical Accounting Policies and Estimates	14
Highlights of Third Quarter 2007 and Nine Months 2007 Results	15
Results of Operations and Related Information by Segment	16
Financial Condition, Liquidity and Capital Resources	31
Off-Balance Sheet Arrangements	33
Contractual Obligations and Contingent Liabilities and Commitments	33
Ratings	34
Federal Income Taxes	34
Item 3. Quantitative and Qualitative Disclosures About Market Risk	35
Item 4. Controls and Procedures	35
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	35
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	36
Item 6. Exhibits	36

Exhibit 10.1
Exhibit 11
Exhibit 31.1
Exhibit 31.2
Exhibit 32.1
Exhibit 32.2

Table of Contents

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

SELECTIVE INSURANCE GROUP, INC. **CONSOLIDATED BALANCE SHEETS** (in thousands, except share amounts)		**Unaudited** **September 30, 2007**	**December 31, 2006**
ASSETS			
Investments:			
Fixed maturity securities, held-to-maturity at amortized cost (fair value of: $9,073 - 2007; $10,073 - 2006)	**$**	**8,917**	9,822
Fixed maturity securities, available-for-sale at fair value (amortized cost of: $2,917,726 - 2007; $2,916,884 - 2006)		**2,929,916**	2,937,100
Equity securities, available-for-sale at fair value (cost of: $159,498 - 2007; $157,864 - 2006)		**293,681**	307,376
Short-term investments (at cost which approximates fair value)		**228,523**	197,019
Other investments		**168,755**	144,785
Total investments		**3,629,792**	3,596,102
Cash and cash equivalents		**2,862**	6,443
Interest and dividends due or accrued		**32,747**	34,846
Premiums receivable, net of allowance for uncollectible accounts of: $4,082 - 2007; $3,229 - 2006		**552,169**	458,452
Other trade receivables, net of allowance for uncollectible accounts of: $179 - 2007; $255 - 2006		**21,542**	21,388
Reinsurance recoverable on paid losses and loss expenses		**4,251**	4,693
Reinsurance recoverable on unpaid losses and loss expenses		**212,831**	199,738
Prepaid reinsurance premiums		**84,698**	69,935
Current federal income tax		**18,703**	468
Deferred federal income tax		**20,260**	15,445
Property and equipment at cost, net of accumulated depreciation and amortization of: $114,221 - 2007; $103,660 - 2006		**58,365**	59,004
Deferred policy acquisition costs		**235,159**	218,103
Goodwill		**33,637**	33,637
Other assets		**79,576**	49,451
Total assets	**$**	**4,986,592**	4,767,705
LIABILITIES AND STOCKHOLDERS EQUITY			
Liabilities:			
Reserve for losses	**$**	**2,105,965**	1,959,485
Reserve for loss expenses		**356,632**	329,285
Unearned premiums		**903,310**	791,540
Senior convertible notes		**46,577**	57,413
Notes payable		**286,145**	304,424
Commissions payable		**56,199**	54,814
Accrued salaries and benefits		**82,977**	94,560
Other liabilities		**106,163**	98,957

Total liabilities	**3,943,968**	3,690,478
Stockholders Equity:		
Preferred stock of $0 par value per share: Authorized shares: 5,000,000; no shares issued or outstanding Common stock of $2 par value per share: Authorized shares: 360,000,000		
Issued: 93,248,805 - 2007; 91,562,266 - 2006	**186,498**	183,124
Additional paid-in capital	**185,828**	153,246
Retained earnings	**1,076,642**	986,017
Accumulated other comprehensive income	**87,221**	100,601
Treasury stock at cost (shares: 40,169,753 - 2007; 34,289,974 - 2006)	**(493,565)**	(345,761)
Total stockholders equity (Note 9)	**1,042,624**	1,077,227
Commitments and contingencies (Note 10)		
Total liabilities and stockholders equity	**$ 4,986,592**	4,767,705

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

Table of Contents

SELECTIVE INSURANCE GROUP, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts)	Quarter ended September 30, 2007	2006	Nine Months ended September 30, 2007	2006
Revenues:				
Net premiums written	**$ 409,523**	401,426	**$ 1,231,631**	1,229,036
Net increase in unearned premiums and prepaid reinsurance premiums	**(31,263)**	(23,854)	**(97,007)**	(106,552)
Net premiums earned	**378,260**	377,572	**1,134,624**	1,122,484
Net investment income earned	**43,674**	38,891	**124,179**	112,283
Net realized gains	**2,814**	3,948	**27,205**	25,802
Diversified Insurance Services revenue	**29,331**	29,284	**89,186**	84,111
Other income	**1,390**	1,091	**4,423**	4,233
Total revenues	**455,469**	450,786	**1,379,617**	1,348,913
Expenses:				
Losses incurred	**204,304**	199,296	**616,235**	589,578
Loss expenses incurred	**42,455**	41,757	**128,053**	126,738
Policy acquisition costs	**125,630**	122,859	**373,249**	357,780
Dividends to policyholders	**1,440**	1,776	**3,949**	4,074
Interest expense	**5,832**	4,619	**18,155**	15,042
Diversified Insurance Services expenses	**24,670**	23,296	**74,089**	70,441
Other expenses	**4,424**	6,500	**22,187**	23,005
Total expenses	**408,755**	400,103	**1,235,917**	1,186,658
Income before federal income tax	**46,714**	50,683	**143,700**	162,255
Federal income tax expense (benefit):				
Current	**234**	18,031	**30,571**	52,844
Deferred	**9,361**	(5,404)	**2,871**	(10,620)
Total federal income tax expense	**9,595**	12,627	**33,442**	42,224
Net income	**$ 37,119**	38,056	**110,258**	120,031
Earnings per share:				
Basic net income	**$ 0.72**	0.69	**2.10**	2.19
Diluted net income	**$ 0.66**	0.63	**1.92**	1.94

Dividends to stockholders	**$ 0.12**	0.11	**0.36**	0.33

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

Table of Contents

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

($ in thousands, except per share amounts)	Nine Months Ended September 30, 2007		2006	
Common stock:				
Beginning of year	$ **183,124**		173,085	
Dividend reinvestment plan (shares: 58,082 - 2007; 48,512 - 2006)	**116**		97	
Convertible debentures (shares: 849,349 - 2007; 3,999,128 - 2006)	**1,699**		7,998	
Stock purchase and compensation plans (shares: 779,108 - 2007; 737,884 - 2006)	**1,559**		1,476	
End of period	**186,498**		182,656	
Additional paid-in capital:				
Beginning of year	**153,246**		71,638	
Dividend reinvestment plan	**1,276**		1,200	
Convertible debentures	**9,843**		49,357	
Stock purchase and compensation plans	**21,463**		21,367	
End of period	**185,828**		143,562	
Retained earnings:				
Beginning of year	**986,017**		847,687	
Net income	**110,258**	**110,258**	120,031	120,031
Cash dividends to stockholders ($0.36 per share - 2007; $0.33 per share - 2006)	**(19,633)**		(18,944)	
End of period	**1,076,642**		948,774	
Accumulated other comprehensive income:				
Beginning of year	**100,601**		118,121	
Other comprehensive (loss) income:				
Decrease in unrealized gains on investment securities, net of deferred income tax effect of: $(7,376) - 2007; $(4,183) - 2006	**(13,699)**	**(13,699)**	(7,769)	(7,769)
Defined benefit pension plans, net of deferred income tax effect of: $172 - 2007	**319**	**319**		
End of period	**87,221**		110,352	
Comprehensive income		**96,878**		112,262

Treasury stock:		
Beginning of year	**(345,761)**	(229,407)
Acquisition of treasury stock (shares: 5,879,779 - 2007; 4,000,610 - 2006)	**(147,804)**	(107,174)
End of period	**(493,565)**	(336,581)
Total stockholders equity	$ **1,042,624**	1,048,763

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.

Table of Contents

SELECTIVE INSURANCE GROUP, INC. **UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOW** *(in thousands)*	**Nine Months ended September 30,**	
	2007	**2006**
Operating Activities		
Net income	**$ 110,258**	120,031
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**21,391**	18,792
Share-based compensation expense	**16,166**	11,166
Net realized gains	**(27,205)**	(25,802)
Deferred tax	**2,871**	(10,620)
Debt conversion expense		2,117
Changes in assets and liabilities:		
Increase in reserves for losses and loss expenses, net of reinsurance recoverable on unpaid losses and loss expenses	**160,852**	182,574
Increase in unearned premiums, net of prepaid reinsurance and advance premiums	**97,549**	106,093
Increase in current federal income tax recoverable	**(18,235)**	(2,632)
Increase in premiums receivable	**(93,717)**	(85,070)
Increase in other trade receivables	**(154)**	(1,942)
Increase in deferred policy acquisition costs	**(17,056)**	(26,451)
Decrease (increase) in interest and dividends due or accrued	**1,250**	(628)
Decrease in reinsurance recoverable on paid losses and loss expenses	**442**	2,550
Decrease in accrued salaries and benefits	**(13,229)**	(554)
(Decrease) increase in accrued insurance expenses	**(377)**	3,389
Other-net	**2,330**	(1,831)
Net adjustments	**132,878**	171,151
Net cash provided by operating activities	**243,136**	291,182
Investing Activities		
Purchase of fixed maturity securities, available-for-sale	**(377,021)**	(639,337)
Purchase of equity securities, available-for-sale	**(127,392)**	(39,569)
Purchase of other investments	**(51,197)**	(58,427)
Purchase of short-term investments	**(1,622,327)**	(1,925,906)
Net proceeds from sale of subsidiary		376
Sale of fixed maturity securities, available-for-sale	**102,660**	293,691
Redemption and maturities of fixed maturity securities, held-to-maturity	**915**	2,908
Redemption and maturities of fixed maturity securities, available-for-sale	**264,528**	147,739
Sale of equity securities, available-for-sale	**126,395**	77,489
Proceeds from other investments	**31,815**	2,040
Sale of short-term investments	**1,590,804**	1,917,377
Purchase of property and equipment	**(10,427)**	(14,251)

Net cash used in investing activities	**(71,247)**	(235,870)
Financing Activities		
Dividends to stockholders	**(17,912)**	(17,311)
Acquisition of treasury stock	**(147,804)**	(107,174)
Proceeds from issuance of notes payable, net of issuance costs		96,787
Principal payment of notes payable	**(18,300)**	(18,300)
Borrowings under line of credit agreement	**6,000**	
Repayment of borrowings under line of credit agreement	**(6,000)**	
Proceeds from stock purchase and compensation plans	**5,784**	7,901
Cash retained for tax deductibility of the increase in value of equity instruments	**2,762**	3,440
Cash paid in connection with debt conversion		(2,117)
Net cash used in financing activities	**(175,470)**	(36,774)
Net (decrease) increase in cash and cash equivalents	**(3,581)**	18,538
Cash and cash equivalents at beginning of year	**6,443**	2,983
Cash and cash equivalents at end of period	**$ 2,862**	21,521
Supplemental Disclosures of Cash Flows Information		
Cash paid during the period for:		
Interest	**$ 15,714**	12,088
Federal income tax	**46,525**	52,035
Non-cash financing activity:		
Conversion of convertible debentures	**11,059**	58,534

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

Table of Contents

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. Organization

Selective Insurance Group, Inc., through its subsidiaries, (collectively known as Selective) offers property and casualty insurance products and diversified insurance services and products. Selective Insurance Group, Inc. was incorporated in New Jersey in 1977 and its main offices are located in Branchville, New Jersey. Selective Insurance Group, Inc. s Common Stock is publicly traded on the NASDAQ Global Select Market under the symbol, SIGI. Selective classifies its business into three operating segments:

Insurance Operations, which sells property and casualty insurance products and services primarily in 21 states in the Eastern and Midwestern United States;

Investments; and

Diversified Insurance Services, which provides human resource administration outsourcing products and services, and federal flood insurance administrative services.

NOTE 2. Basis of Presentation

These interim unaudited consolidated financial statements (Financial Statements) have been prepared in conformity with (i) accounting principles generally accepted in the United States of America (GAAP) and (ii) the rules and regulations of the United States Securities and Exchange Commission (SEC) regarding interim financial reporting. The preparation of the Financial Statements in conformity with GAAP requires management 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 Selective Insurance Group, Inc. and its subsidiaries are eliminated in consolidation.

These Financial Statements reflect all adjustments that, in the opinion of management, are normal, recurring and necessary for a fair presentation of Selective s results of operations and financial condition. These Financial Statements cover the quarters ended September 30, 2007 (Third Quarter 2007) and September 30, 2006 (Third Quarter 2006) and the nine-month periods ended September 30, 2007 (Nine Months 2007) and September 30, 2006 (Nine Months 2006). These Financial Statements do not include all of the information and disclosures required by GAAP and the SEC for audited financial statements. Results of operations for any interim period are not necessarily indicative of results for a full year. Consequently, these Financial Statements should be read in conjunction with the consolidated financial statements contained in Selective s Annual Report on Form 10-K for the year ended December 31, 2006 (2006 Annual Report).

NOTE 3. Statement of Cash Flow

At December 31, 2006, Selective changed its definition of cash equivalents for presentation in the Statements of Cash Flow. Accordingly, the Nine Months 2006 Statement of Cash Flow has been restated to conform with this policy change. In addition, certain amounts in the Statement of Cash Flow for Nine Months 2006 have been reclassified to conform to reclassifications made to the balance sheet in the prior year. These reclassifications resulted in immaterial changes to individual line items in the operating activities and investing activities sections of the Statements of Cash Flow, but had no impact on total cash flows from operating activities. Neither the policy change nor the reclassifications had any effect on Selective s net income or stockholders equity. For additional information, refer to Item 8. Financial Statements and Supplementary Data, Note 2 of Selective s 2006 Annual Report.

Table of Contents

NOTE 4. Adoption of Accounting Pronouncements

On January 1, 2007, Selective adopted Financial Accounting Standards No. 155, *Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140* (FAS 155). Under the guidance contained in FAS 155, companies are required to evaluate interests in securitized financial assets to identify whether such interests are freestanding derivatives or hybrid financial instruments that contain an embedded derivative. During the fourth quarter of 2006, the Financial Accounting Standards Board (FASB) recommended a narrow scope exception for securitized interests if: (i) the securitized interest itself has no embedded derivative (including interest rate related derivatives) that would be required to be accounted for separately other than an embedded derivative that results solely from the embedded call options in the underlying financial assets; and (ii) the investor does not control the right to accelerate the settlement. The adoption of FAS 155 did not have a material impact on the results of operations or financial condition of Selective during Third Quarter 2007 and Nine Months 2007.

On January 1, 2007, Selective adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 calls for a two-step process to evaluate tax positions based on the recognition, derecognition, and measurement of benefits related to income taxes. The process begins with an initial assessment of whether a tax position, based on its technical merits and applicability to the facts and circumstances, will more-likely-than-not be sustained upon examination, including related appeals or litigation. The more-likely-than-not threshold is defined as having greater than a 50% chance of being realized upon settlement. Tax positions that are more-likely-than-not sustainable are then measured to determine how much of the benefit should be recorded in the financial statements. This determination is made by considering the probabilities of the amounts that could be realized upon effective settlement. Each tax position is evaluated individually and must continue to meet the threshold in each subsequent reporting period or the benefit will be derecognized. A position that initially failed to meet the more-likely-than-not threshold should be recognized in a subsequent period if: (i) a change in facts and circumstances results in the position s ability to meet the threshold; (ii) the issue is settled with the taxing authority; or (iii) the statute of limitations expires. FIN 48 is effective for fiscal years beginning after December 15, 2006. Selective has analyzed its tax positions in all federal and state jurisdictions in which it is required to file income tax returns for all open tax years. The open tax years for the federal returns are 2003 though 2006. The Internal Revenue Service completed a limited scope examination of tax year 2003 and 2004 that resulted in a favorable adjustment. Selective did not have any unrecognized tax benefits as of January 1, 2007. Selective believes its tax positions will be sustained on audit and does not anticipate any adjustments that will result in a material change to its financial position. As a result, there was no material change in Selective s liability for unrecognized tax benefits.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosure about fair value measurements. It applies to other pronouncements that require or permit fair value, however, it does not require any new fair value measurements. FAS 157 is effective for fiscal years beginning after November 15, 2007. Selective is currently evaluating the impact that the adoption of FAS 157 may have on its financial statements.

In February 2007, the FASB issued Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (FAS 159), which provides companies with an option to report selected financial assets and liabilities at fair value (fair value option). FAS 159 requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of a company s choice to use fair value on its earnings. FAS 159 also requires companies to display the fair value of those assets and liabilities for which a company has chosen to use fair value on the face of the balance sheet. Selective is currently evaluating the impact that the adoption of the FAS 159 fair value option may have on its financial statements.

Table of Contents

NOTE 5. Reinsurance

The following table contains a listing of direct, assumed, and ceded reinsurance amounts by income statement caption. For more information concerning reinsurance, refer to Note 7, Reinsurance in Item 8. Financial Statements and Supplementary Data in Selective s 2006 Annual Report.

	Unaudited, Quarter ended September 30,		Unaudited, Nine Months ended September 30,	
($ in thousands)	**2007**	**2006**	**2007**	**2006**
Premiums written:				
Direct	$ **448,541**	429,061	$ **1,356,914**	1,314,505
Assumed	**17,826**	21,064	**25,632**	32,116
Ceded	**(56,844)**	(48,699)	**(150,915)**	(117,585)
Net	$ **409,523**	401,426	$ **1,231,631**	1,229,036
Premiums earned:				
Direct	$ **417,939**	407,608	$ **1,246,291**	1,207,353
Assumed	**8,305**	10,077	**24,485**	29,515
Ceded	**(47,984)**	(40,113)	**(136,152)**	(114,384)
Net	$ **378,260**	377,572	$ **1,134,624**	1,122,484
Losses and loss expenses incurred:				
Direct	$ **253,291**	275,698	$ **807,041**	768,543
Assumed	**6,025**	6,857	**18,390**	22,321
Ceded	**(12,557)**	(41,502)	**(81,143)**	(74,548)
Net	$ **246,759**	241,053	$ **744,288**	716,316

The ceded premiums and losses included in the above table related to Selective s flood operations are as follows:

	Unaudited, Quarter ended September 30,		Unaudited, Nine Months ended September 30,	
($ in thousands)	**2007**	**2006**	**2007**	**2006**
Ceded premiums written	$ **(40,110)**	(34,483)	$ **(110,211)**	(90,629)
Ceded premiums earned	**(33,859)**	(27,626)	**(96,895)**	(76,990)
Ceded losses and loss expenses incurred	**(2,871)**	(33,384)	**(47,445)**	(51,606)

Table of Contents

NOTE 6. Segment Information

Selective has classified its operations into three segments, the disaggregated results of which are reported to, and used by, senior management to manage Selective s operations:

Insurance Operations, which are evaluated based on statutory underwriting results (net premiums earned, incurred losses and loss expenses, policyholders dividends, policy acquisition costs, and other underwriting expenses) and statutory combined ratios;

Investments, which are evaluated based on net investment income and net realized gains and losses; and

Diversified Insurance Services (federal flood insurance administrative services and human resource administration outsourcing products and services), which, because they are not dependent on insurance underwriting cycles, are evaluated based on several measures including, but not limited to, results of operations in accordance with GAAP, with a focus on our return on revenue (net income divided by revenues).

The Insurance Operations and Diversified Insurance Services segments share a common marketing and distribution system and create new opportunities for independent insurance agents to bring value-added services and products to their customers. Selective s commercial and personal lines property and casualty insurance products, flood insurance, and human resource administration outsourcing products are principally sold through independent insurance agents. Selective and its subsidiaries also provide services to each other in the normal course of business. These transactions, which are eliminated in all consolidated statements, totaled $4.5 million in Third Quarter 2007 and $13.4 million in Nine Months 2007 compared with $4.7 million in Third Quarter 2006 and $14.5 million in Nine Months 2006. In computing the results of each segment, Selective does not make adjustments for interest expense, net general corporate expenses, or federal income taxes. Selective also does not maintain separate investment portfolios for the segments and, therefore, does not allocate assets to the segments.

Table of Contents

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

Revenue by segment ($ in thousands)	Unaudited, Quarter ended September 30, 2007	2006	Unaudited, Nine Months ended September 30, 2007	2006
Insurance Operations:				
Commercial automobile net premiums earned	$ **79,709**	80,646	**237,311**	241,212
Workers compensation net premiums earned	**80,037**	80,232	**243,386**	233,541
General liability net premiums earned	**101,785**	100,459	**306,848**	301,515
Commercial property net premiums earned	**48,293**	46,079	**141,657**	135,513
Business owners policy net premiums earned	**13,106**	12,307	**38,981**	35,890
Bonds net premiums earned	**4,880**	4,493	**14,257**	12,776
Other net premiums earned	**171**	177	**518**	535
Total commercial lines net premiums earned	**327,981**	324,393	**982,958**	960,982
Personal automobile net premiums earned	**32,594**	36,285	**99,637**	111,635
Homeowners net premiums earned	**15,612**	14,947	**46,127**	44,170
Other net premiums earned	**2,073**	1,947	**5,902**	5,697
Total personal lines net premiums earned	**50,279**	53,179	**151,666**	161,502
Total net premiums earned	**378,260**	377,572	**1,134,624**	1,122,484
Miscellaneous income	**1,390**	1,090	**4,361**	4,229
Total insurance operations revenues	**379,650**	378,662	**1,138,985**	1,126,713
Investments:				
Net investment income	**43,674**	38,891	**124,179**	112,283
Net realized gain on investments	**2,814**	3,948	**27,205**	25,802
Total investment revenues	**46,488**	42,839	**151,384**	138,085
Diversified Insurance Services:				
Human resource administration outsourcing	**14,048**	15,370	**45,771**	48,270
Flood insurance	**13,023**	12,410	**37,089**	31,874
Other	**2,260**	1,504	**6,326**	3,967
Total diversified insurance services revenues	**29,331**	29,284	**89,186**	84,111
Total all segments	**455,469**	450,785	**1,379,555**	1,348,909
Other income		1	**62**	4
Total revenues	$ **455,469**	450,786	**1,379,617**	1,348,913

	Unaudited,	Unaudited,

Income before federal income tax		**Quarter ended September 30,**		**Nine Months ended September 30,**	
($ in thousands)		**2007**	**2006**	**2007**	**2006**
Insurance Operations:					
Commercial lines underwriting	$	**8,950**	12,655	**28,537**	48,723
Personal lines underwriting		**(3,828)**	(153)	**(13,844)**	(2,208)
Underwriting income, before federal income tax		**5,122**	12,502	**14,693**	46,515
GAAP combined ratio		**98.6%**	96.7	**98.7%**	95.9
Statutory combined ratio		**96.2%**	94.9	**96.3%**	94.5
Investments:					
Net investment income		**43,674**	38,891	**124,179**	112,283
Net realized gain on investments		**2,814**	3,948	**27,205**	25,802
Total investment income, before federal income tax		**46,488**	42,839	**151,384**	138,085
Diversified Insurance Services:					
Income before federal income tax		**4,661**	5,988	**15,097**	13,670
Total all segments		**56,271**	61,329	**181,174**	198,270
Interest expense		**(5,832)**	(4,619)	**(18,155)**	(15,042)
General corporate expenses		**(3,725)**	(6,027)	**(19,319)**	(20,973)
Income before federal income tax	**$**	**46,714**	50,683	**143,700**	162,255

Table of Contents

NOTE 7. Retirement Plans

The following tables show the costs of the Retirement Income Plan for Selective Insurance Company of America (Retirement Income Plan) and the retirement life insurance component (Retirement Life Plan) of the Welfare Benefits Plan for Employees of Selective Insurance Company of America. For more information concerning these plans, refer to Note 16, Retirement Plans in Item 8. Financial Statements and Supplementary Data in the 2006 Annual Report.

	Retirement Income Plan Unaudited, Quarter ended September 30,		Retirement Life Plan Unaudited, Quarter ended September 30,	
($ in thousands)	**2007**	**2006**	**2007**	**2006**
Components of Net Periodic Benefit Cost:				
Service cost	**$ 1,864**	1,988	**80**	71
Interest cost	**2,241**	2,014	**124**	149
Expected return on plan assets	**(2,773)**	(2,503)		
Amortization of unrecognized prior service cost	**38**	38	**(9)**	(8)
Amortization of unrecognized net loss	**175**	431		19
Net periodic cost	**$ 1,545**	1,968	**195**	231

	Retirement Income Plan Unaudited, Nine Months ended September 30,		Retirement Life Plan Unaudited, Nine Months ended September 30,	
($ in thousands)	**2007**	**2006**	**2007**	**2006**
Components of Net Periodic Benefit Cost:				
Service cost	**$ 5,440**	5,509	**242**	254
Interest cost	**6,609**	6,046	**374**	354
Expected return on plan assets	**(8,193)**	(7,315)		
Amortization of unrecognized prior service cost	**114**	113	**(25)**	(24)
Amortization of unrecognized net loss	**402**	1,261		19
Special termination benefit	**900**		**100**	
Net periodic cost	**$ 5,272**	5,614	**691**	603

In the second quarter of 2007, Selective restructured its personal lines department. As part of this restructuring, an early retirement enhancement option was offered to eligible employees. The present value of the enhancement to be made in conjunction with this early retirement option is equal to $0.9 million for pension benefits and $0.1 million for the Retirement Life Plan. These amounts are reflected as expense in the results for Nine Months 2007.

As indicated in its 2006 Annual Report, Selective had originally anticipated contributing $4.2 million to the Retirement Income Plan in 2007. That estimate has been revised to $8.2 million, of which $7.2 million has been paid as of September 30, 2007. The increase in the level of contributions is primarily the result of capital calls that were made related to other investment commitments associated with alternative investment holdings within the Retirement Income Plan.

Table of Contents

NOTE 8. Comprehensive Income

The components of comprehensive income, both gross and net of tax, for Third Quarter 2007 and Third Quarter 2006 are as follows:

Third Quarter 2007

(in thousands)	**Gross**	**Tax**	**Net**
Net income	**$ 46,714**	**9,595**	**37,119**
Components of other comprehensive income:			
Unrealized gains on securities:			
Unrealized holding gains during the period	**23,430**	**8,201**	**15,229**
Previous unrealized gains currently realized in net income	**(2,814)**	**(985)**	**(1,829)**
Net unrealized gains	**20,616**	**7,216**	**13,400**
Net prior service cost arising during period	**29**	**10**	**19**
Net gain arising during period	**175**	**61**	**114**
Defined benefit pension plans, net	**204**	**71**	**133**
Comprehensive income	**$ 67,534**	**16,882**	**50,652**

Third Quarter 2006

(in thousands)	Gross	Tax	Net
Net income	$ 50,683	12,627	38,056
Components of other comprehensive income:			
Unrealized holding gains during the period	57,673	20,186	37,487
Previous unrealized gains currently realized in net income	(3,948)	(1,382)	(2,566)
Net unrealized gains	53,725	18,804	34,921
Comprehensive income	$ 104,408	31,431	72,977

The components of comprehensive income, both gross and net of tax, for Nine Months 2007 and Nine Months 2006 are as follows:

Nine Months 2007

(in thousands)	**Gross**	**Tax**	**Net**
Net income	**$ 143,700**	**33,442**	**110,258**
Components of other comprehensive income:			
Unrealized gains on securities:			
Unrealized holding gains during the period	**6,130**	**2,146**	**3,984**
Previous unrealized gains currently realized in net income	**(27,205)**	**(9,522)**	**(17,683)**
Net unrealized losses	**(21,075)**	**(7,376)**	**(13,699)**

Net prior service cost arising during period	**89**	**31**	**58**
Net gain arising during period	**402**	**141**	**261**
Defined benefit pension plans, net	**491**	**172**	**319**
Comprehensive income	**$ 123,116**	**26,238**	**96,878**

Nine Months 2006

(in thousands)	Gross	Tax	Net
Net income	$ 162,255	42,224	120,031
Components of other comprehensive income:			
Unrealized holding gains during the period	13,850	4,848	9,002
Previous unrealized gains currently realized in net income	(25,802)	(9,031)	(16,771)
Net unrealized losses	(11,952)	(4,183)	(7,769)
Comprehensive income	$ 150,303	38,041	112,262

Table of Contents

As of December 31, 2006, Selective adopted Statement of Financial Accounting Standard No. 158, *Employer s Accounting for Defined Benefit Pensions and Other Postretirement Benefits* (FAS 158). Selective recorded the impact of adopting FAS 158 in accumulated other comprehensive income (AOCI), a separate component of stockholders equity, resulting in a decrease in equity of $13.7 million, after tax. Selective included this decrease in AOCI as a component of comprehensive income, which is separately presented in the 2006 Consolidated Statement of Stockholders Equity. Subsequent to the filing of our 2006 Annual Report, Selective identified that, although the impact of adopting FAS 158 was properly included as a decrease to AOCI, it should not have been reflected as a component of comprehensive income. The impact of appropriately excluding the FAS 158 adjustment increases comprehensive income from $146.1 million, as presented, to $159.8 million, as adjusted.

NOTE 9. Stockholders Equity

On January 30, 2007, the Board of Directors of Selective Insurance Group, Inc. declared a two-for-one stock split of Selective Insurance Group, Inc. s common stock, par value $2.00 per share (Common Stock), in the form of a share dividend of one additional share of Common Stock for each outstanding share of Common Stock (the Share Dividend). The Share Dividend was paid on February 20, 2007 to stockholders of record as of the close of business on February 13, 2007. The effect of the Share Dividend has been recognized retroactively in all share and per share data, as well as the capital stock account balances, in the accompanying consolidated financial statements, notes to consolidated financial statements and supplemental financial data.

On March 8, 2007, Selective Insurance Group, Inc. entered into a written trading plan under Rule 10b5-1 under the Securities Exchange Act of 1934 (Trading Plan) with a broker to facilitate the purchase of its Common Stock. Rule 10b5-1 allows a company to purchase its shares at times when it ordinarily would not be in the market because of self-imposed trading blackout periods, such as the time preceding its quarterly earnings releases. On April 24, 2007, the Board of Directors extended the then existing share repurchase program through December 31, 2007. During the six-month period ending June 30, 2007, Selective Insurance Group, Inc. completed the 10 million share authorization that was existing at the time by repurchasing approximately 5.2 million shares of its Common Stock at a total cost of $133.4 million.

On July 24, 2007, the Board of Directors of Selective Insurance Group, Inc. authorized a new share repurchase program for up to 4 million shares, which expires on July 26, 2009. During Third Quarter 2007, Selective Insurance Group, Inc. repurchased approximately 0.5 million shares under this authorization at a total cost of $9.9 million. In total, during Nine Months 2007, Selective Insurance Group, Inc. repurchased approximately 5.7 million shares of its Common Stock at a total cost of $143.3 million under its previous and current stock repurchase programs.

On October 23, 2007, the Board of Directors of Selective Insurance Group, Inc. authorized, for stockholders of record as of November 15, 2007, a dividend of $0.13 per share to be paid on December 3, 2007. This is an 8% increase compared to the dividend declared in Third Quarter 2007.

NOTE 10. Commitments and Contingencies

Other investments, as shown on the consolidated balance sheet, were $168.8 million as of September 30, 2007 and $144.8 million as of December 31, 2006. At December 31, 2006, Selective had additional other investment commitments of up to $110.5 million, of which $14.8 million was paid during Third Quarter 2007 and $44.2 million during Nine Months 2007. At September 30, 2007, Selective had contractual obligations that expire at various dates through 2022 to further invest up to $151.9 million in these other investments. There is no certainty that any such additional investments will be required.

NOTE 11. Litigation

In the ordinary course of conducting business, Selective and its subsidiaries are named as defendants in various legal proceedings. Most of these proceedings are claims litigation involving Selective s seven insurance subsidiaries (the 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. Selective accounts for such activity through the establishment of unpaid loss and loss adjustment expense reserves. Selective s management expects 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 Selective s consolidated financial condition, results of operations, or cash flows.

Table of Contents

The 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 state class actions seeking certification of a state or national class. Such putative class actions have alleged, for example, improper reimbursement of medical providers paid under workers compensation and personal and commercial automobile insurance policies. The Insurance Subsidiaries are also from time-to-time involved 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. Selective believes that it has valid defenses to these cases, and settled one such case in Third Quarter 2007 that had been filed in Fulton County, Georgia, Fields, et al. v. Selective Insurance Company of South Carolina, et al. Selective s management expects that the ultimate liability, if any, with respect to such lawsuits, after consideration of provisions made for estimated losses, will not be material to Selective s 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 Selective s consolidated results of operations or cash flows in particular quarterly or annual periods.

NOTE 12. Subsequent Events

In October 2007, 27,500 of Selective Insurance Group, Inc. s outstanding 1.6155% Senior Convertible Notes due 2032 (the Notes) were presented for conversion. Selective Insurance Group, Inc. delivered (i) cash for the principal amount of these Notes and accrued and unpaid interest, and (ii) shares of its Common Stock for the remaining portion of the conversion. This transaction will impact our diluted weighted average share calculation by a net reduction of approximately 480,000 shares, but will not have a material impact on diluted earnings per share in 2007.

On October 25, 2007, Selective Insurance Group, Inc. announced that it has called for redemption on November 30, 2007 of one-half of its outstanding Notes. The record date for the redemption is November 5, 2007. The Notes called for redemption will be redeemed at $380.12 Note issue price plus $4.62 call premium for a redemption price of $384.74 per $1,000 Note, plus accumulated and unpaid cash interest up to, but not including, November 30, 2007. Selective Insurance Group, Inc. plans to settle any voluntary conversions that are presented before the November 30, 2007 redemption date in the same manner as described above. This transaction will result in a net reduction of up to 1.2 million shares, depending on the number of bonds converted and the average share price during the conversion period. The expected reduction to Selective s diluted weighted average share calculation resulting from this transaction will have a minimal impact in 2007.

Table of Contents

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, Selective and its management discuss and make statements regarding their intentions, beliefs, current expectations, and projections regarding Selective 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. Selective and its management caution prospective investors that such forward-looking statements are not guarantees of future performance. Risks and uncertainties are inherent in Selective s 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 in the 2006 Annual Report. 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. Selective and its management 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

Selective Insurance Group, Inc. offers property and casualty insurance products and diversified insurance services through its various subsidiaries (collectively known as Selective, we, or our). Selective classifies its businesses into three operating segments: (i) Insurance Operations, (ii) Investments, and (iii) Diversified Insurance Services.

The purpose of the Management s Discussion and Analysis (MD&A) is to provide an understanding of the consolidated results of operations and financial condition, and known trends and uncertainties that may have a material impact in future periods. Consequently, investors should read the MD&A in conjunction with Selective s consolidated financial statements in the 2006 Annual Report. For reading ease, we have written the MD&A in the first person plural.

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

Critical Accounting Policies and Estimates;

Highlights of Third Quarter 2007 and Nine Months 2007 Results;

Results of Operations and Related Information by Segment;

Financial Condition, Liquidity, and Capital Resources;

Off-Balance Sheet Arrangements;

Contractual Obligations and Contingent Liabilities and Commitments;

Ratings; and

Federal Income Taxes.

Critical Accounting Policies and Estimates

These unaudited interim consolidated financial statements include amounts based on informed estimates and judgments of management for those transactions that are not yet complete. Such estimates and judgments affect the reported amounts in the financial statements. Those estimates and judgments that were most critical to the preparation of the financial statements involved the following: (i) reserves for losses and loss expenses; (ii) deferred policy

acquisition costs; (iii) pension and postretirement benefit plan actuarial assumptions; and (iv) other-than-temporary investment impairments. 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. Our 2006 Annual Report, pages 33 through 40, provides a discussion of each of these critical accounting policies.

Table of Contents

Highlights of Third Quarter 2007 and Nine Months 2007 Results

Financial Highlights	**Unaudited Quarter ended September 30,**		**Change % or**	**Unaudited Nine Months ended September 30,**		**Change % or**
($ in thousands, except per share amounts)	**2007**	**2006**	**Points**	**2007**	**2006**	**Points**
Revenues	$ **455,469**	450,786	1%	$ **1,379,617**	1,348,913	2%
Net income	**37,119**	38,056	(2)	**110,258**	120,031	(8)
Diluted net income per share	**0.66**	0.63	5	**1.92**	1.94	(1)
Diluted weighted-average outstanding shares	**56,434**	61,660	(8)%	**58,017**	62,814	(8)%
GAAP combined ratio	**98.6**%	96.7	1.9pts	**98.7**%	95.9	2.8pts
Statutory combined ratio	**96.2**%	94.9	1.3	**96.3**%	94.5	1.8
Annualized return on average equity	**14.5**%	14.8	(0.3)pts	**13.9**%	15.8	(1.9)pts

Revenues increased in Third Quarter 2007 and Nine Months 2007 compared to the same periods in the prior year primarily due to growth in net investment income earned and net premiums earned (NPE).

Net investment income earned in Third Quarter 2007 increased 12% over Third Quarter 2006 and contributed $4.8 million to the $4.7 million revenue growth in the quarter compared to the year ago quarter. On a year-to-date basis, net investment income earned increased 11% compared to Nine Months 2006 and contributed $11.9 million to the $30.7 million revenue growth in Nine Months 2007 compared to Nine Months 2006. Increased net investment income is primarily attributable to higher investment yields on our growing fixed maturity securities portfolio and income increases on our other investment portfolio. The increase in our investment portfolio is the result of operating cash flows of $393.1 million for the year ended December 31, 2006 and net proceeds of $96.8 million from our $100.0 million junior subordinated notes offering in Third Quarter 2006. These increases were partially offset by stock repurchases of 4.1 million shares under our authorized stock repurchase program at a total cost of $110.1 million for the full year 2006. Total operating cash flows of $243.1 million during Nine Months 2007 were partially offset by 5.7 million shares repurchased under our stock repurchase programs during 2007 at a total cost of $143.3 million.

NPE growth contributed $0.7 million to the $4.7 million revenue growth for Third Quarter 2007 compared to Third Quarter 2006 and $12.1 million to the $30.7 million revenue growth in Nine Months 2007 as compared to Nine Months 2006. The following factors contributed to the growth of NPE in both the quarter and year-to-date periods:

- Direct new business written, excluding flood, for the twelve-month period ending September 30, 2007 of $335.6 million as compared to $322.9 million for the twelve-month period ending September 30, 2006.

- Commercial lines renewal price increases, including exposure, which averaged 2.2% for full year 2006 and have remained flat in Third Quarter 2007 and Nine Months 2007.

The above items were partially offset by (i) decreases in the commercial lines endorsement premium activity of $5.8 million to $2.3 million in Third Quarter 2007 and $10.3 million to $9.7 million in Nine Months 2007 as compared to the prior year periods as a result of changes in the economy, especially in the construction area; (ii) reductions in audit premium activity of $4.8 million to $(1.7) million in Third Quarter 2007 and of $6.7 million to $1.2 million in Nine Months 2007 also as a result of economic changes; and (iii) decreases in NPE on our New Jersey personal automobile book of business attributable to the loss of a portion of our book that was repriced at higher pricing levels through our MATRIX pricing system and subsequently did not renew. Our New Jersey personal automobile book of business experienced an 11% reduction in the number of cars we insured at September 30, 2007 compared to September 30, 2006 and overall personal lines NPE was down 6% in both Third Quarter and Nine

Months 2007 to $50.3 million and $151.7 million, respectively.

Table of Contents

Net income decreased in Third Quarter and Nine Months 2007 compared to the same periods in the prior year, due to increases in our GAAP combined ratio, resulting from lower pricing and increased property losses, partially offset by profitability improvements in our workers compensation line of business and increases in net favorable prior year loss and loss expense development within our casualty lines of business.

These reductions to net income were partially offset by: (i) net investment income earned increases in both the quarter and year-to-date periods as noted above; and (ii) decreases in federal income tax expense in Third Quarter 2007 and Nine Months 2007 compared to Third Quarter 2006 and Nine Months 2006, primarily attributable to lower underwriting income in our Insurance Operations segment, as explained above.

Results of Operations and Related Information by Segment

Insurance Operations

Our Insurance Operations segment writes property and casualty insurance business through seven insurance subsidiaries (the Insurance Subsidiaries). Our Insurance Operations segment sells property and casualty insurance products and services primarily in 21 states in the Eastern and Midwestern United States through 861 independent insurance agencies. Our Insurance Operations segment consists of two components: (i) commercial lines (Commercial Lines), which markets primarily to businesses, and represents approximately 87% of net premiums written (NPW), and (ii) personal lines (Personal Lines), which markets primarily to individuals and represents approximately 13% of NPW. The underwriting performance of these lines is generally measured by four different statutory ratios: (i) loss and loss expense ratio; (ii) underwriting expense ratio; (iii) dividend ratio; and (iv) combined ratio. For further details regarding these ratios see the discussion in the Insurance Operations Results section of Item 1. Business of the 2006 Annual Report.

Table of Contents

Summary of Insurance Operations

All Lines ($ in thousands)	Unaudited Quarter ended September 30, 2007	2006	Change % or Points	Unaudited Nine Months ended September 30, 2007	2006	Change % or Points
GAAP Insurance Operations Results:						
NPW	$ **409,523**	401,426	2%	**1,231,631**	1,229,036	%
NPE	**378,260**	377,572		**1,134,624**	1,122,484	1
Less:						
Losses and loss expenses incurred	**246,759**	241,053	2	**744,288**	716,316	4
Net underwriting expenses incurred	**124,939**	122,241	2	**371,694**	355,579	5
Dividends to policyholders	**1,440**	1,776	(19)	**3,949**	4,074	(3)
Underwriting income	$ **5,122**	12,502	(59)%	**14,693**	46,515	(68)%
GAAP Ratios:						
Loss and loss expense ratio	**65.2**%	63.8	1.4pts	**65.6**%	63.8	1.8pts
Underwriting expense ratio	**33.0**%	32.4	0.6	**32.8**%	31.7	1.1
Dividends to policyholders ratio	**0.4**%	0.5	(0.1)	**0.3**%	0.4	(0.1)
Combined ratio	**98.6**%	96.7	1.9	**98.7**%	95.9	2.8
Statutory Ratios: [1]						
Loss and loss expense ratio	**64.9**%	63.6	1.3	**65.1**%	63.6	1.5
Underwriting expense ratio	**30.9**%	30.8	0.1	**30.9**%	30.5	0.4
Dividends to policyholders ratio	**0.4**%	0.5	(0.1)	**0.3**%	0.4	(0.1)
Combined ratio	**96.2**%	94.9	1.3pts	**96.3**%	94.5	1.8pts

[1] The statutory ratios include the flood line of business, which is included in the Diversified Insurance Services segment on a GAAP basis and therefore excluded from the GAAP ratios. The total statutory combined ratio excluding flood is 96.8% for Third Quarter 2007 and 97.0% for Nine Months 2007 compared to 95.9% for Third Quarter 2006 and 95.2% for Nine Months 2006.

NPW increased 2% to $409.5 million in Third Quarter 2007 compared to Third Quarter 2006 and increased slightly in Nine Months 2007 compared to Nine Months 2006. Excluding the impact from the cancellation of the New Jersey Homeowners Quota Share Treaty (Quota Share Treaty), which increased Nine Months 2006 NPW by $11.3 million, NPW increased 1%, or $13.9 million, in Nine Months 2007 compared to Nine Months 2006. Premium growth resulting from increases in direct new business written of 17% to $92.6 million for Third Quarter 2007 and 10% to $269.7 million for Nine Months 2007 was partially offset by:

Commercial Lines renewal pricing, including exposure, that remained flat in both Third Quarter 2007 and Nine Months 2007, while increasing 1.7% in Third Quarter 2006 and 2.5% in Nine Months 2006,

reflecting an increasingly competitive and volatile commercial lines marketplace.

A decline in NPW for our New Jersey personal automobile business of $3.2 million to $19.5 million for Third Quarter 2007 and $12.2 million to $61.2 million for Nine Months 2007. This decrease was driven by a reduction in the number of New Jersey personal automobiles that we insure, primarily as a result of repricing at higher levels through our MATRIX pricing system.

NPE increased slightly in Third Quarter 2007 and Nine Months 2007 compared to the same periods last year reflecting increases in NPW over the last 12 months.

The 1.4-point increase in the GAAP loss and loss expense ratio in Third Quarter 2007 compared to Third Quarter 2006 and the 1.8-point increase in Nine Months 2007 compared to Nine Months 2006 were primarily attributable to lower pricing on our Commercial and Personal Lines business, as well as increases in property losses in Third Quarter 2007 and Nine Months 2007 compared to the prior year periods. The increases in property losses were driven by higher non-catastrophe losses for Third Quarter and Nine Months 2007 compared to the prior year periods. These increases to the GAAP loss and loss expense ratio were partially offset by (i) improved profitability in our workers compensation line of business, and (ii) net favorable prior year loss and loss expense development within our casualty lines of business of approximately $5 million in Third Quarter 2007 and approximately $12 million in Nine Months 2007, compared to approximately $4 million in Third Quarter and Nine Months 2006.

Table of Contents

The increases in the GAAP underwriting expense ratio in Third Quarter and Nine Months 2007 compared to Third Quarter and Nine Months 2006 were primarily attributable to increases in underwriting expenses that outpaced premium growth in the comparable periods, which is reflected in a higher statutory underwriting expense ratio of 30.9% for Nine Months 2007 compared to 30.5% for Nine Months 2006. Increased labor expenses drove the increase in expense dollars for Third Quarter and Nine Months 2007.

Insurance Operations Outlook

Historically, the results of the property and casualty insurance industry have experienced significant fluctuations due to high levels of competition, economic conditions, interest rates, loss cost trends, and other factors. During Nine Months 2007, the industry has experienced low levels of catastrophe losses and a softening market characterized by accelerated competition, leading to pricing deterioration in the primary insurance market that was worse than originally anticipated. We expect this trend to continue throughout the remainder of the year and into 2008. The average forecast, according to the A.M. Best Review/Preview dated April 23, 2007, calls for commercial lines NPW to be relatively flat for 2007 compared to 1.6% growth in 2006. The 2007 NPW forecast is ranked the second slowest rate of growth for property and casualty insurers since 1998. Accelerated competition in the marketplace, coupled with low premium growth rates, has also led to an increased interest in merger and acquisition activity within the industry. Even in this competitive market, we believe we will be able to continue to profitably grow our business based on strong agency relationships and our unique field-based model. To this end, we have developed market-planning tools that are allowing us to strategically appoint additional independent agencies as well as agency management specialists (AMSs) in under-penetrated territories, with classes of business that we know historically have been profitable. Through the end of Third Quarter 2007, the Insurance Subsidiaries total agency count increased to 861, up from 772 at year-end, serviced by approximately 100 field-based AMSs who make hands-on underwriting decisions in agents offices on a daily basis. The high-touch component of our model is backed by technology that allows agents and the Insurance Subsidiaries field teams and agents to input business seamlessly into our systems, while also allowing them to select and price accounts at optimal levels through predictive modeling. Technology that allows for the seamless placement of business into our systems includes our One & Done small business system and our xSELerate straight-through processing system. Premiums of $267,000 per workday were processed through our One & Done small business system in Third Quarter 2007, up 69% from Third Quarter 2006. Additionally, we continue to pursue our organic growth strategy. Effective July 1, 2007, we have entered our 21st primary state, Massachusetts, for Commercial Lines only. We also have plans to expand Personal Lines into Rhode Island, Minnesota, and Iowa, later this year, states that are already within our existing Commercial Lines footprint.

In addition to pricing deterioration, future profitability may also be impacted by the following:

(i) Higher loss trends, which are characterized by changes in frequency and severity. When renewal pure price increases are declining and loss costs trend higher, a market cycle shift occurs. General inflation and, notably, medical inflation, can drive loss costs up, leading to higher industry-wide statutory combined ratios. We believe it is critical to have a clearly defined plan to improve risk selection and mitigate higher frequency and severity trends during market cycles. Some of the tools we use to lower frequency and severity are knowledge management, predictive modeling, safety management, managed care, and enhanced claims review. Although it is uncertain at this time whether our initiatives will offset macro pricing and loss trends, we have outperformed the industry s loss and loss adjustment expense ratio by 7.1 points, on average, over the past 10 years.

Table of Contents

(ii) The hardening of the reinsurance market as a result of changes in reinsurers models of catastrophic risk led to higher property catastrophe costs over the past few years as well as continued concern over the Terrorism Risk Insurance Act of 2002 (TRIA) and the long-term extension of this federal terror backstop. Bills are pending in the House and Senate to extend the terrorism insurance program. The program may not be extended and, if extended, it may contain substantial legislative changes and revisions, some of which may be favorable and some of which may be unfavorable for us. It is uncertain, at present, what the net impact to us may be if the legislation is passed.

Review of Underwriting Results by Line of Business

Commercial Lines Results

Commercial Lines	**Unaudited Quarter ended September 30,**		**Change % or**	**Unaudited Nine Months ended September 30,**		**Change % or**
($ in thousands)	**2007**	**2006**	**Points**	**2007**	**2006**	**Points**
GAAP Insurance Operations Results:						
NPW	$ **355,669**	347,731	2%	**1,077,394**	1,059,095	2%
NPE	**327,981**	324,393	1	**982,958**	960,982	2
Less:						
Losses and loss expenses incurred	**209,430**	205,321	2	**629,753**	605,365	4
Net underwriting expenses incurred	**108,161**	104,641	3	**320,719**	302,820	6
Dividends to policyholders	**1,440**	1,776	(19)	**3,949**	4,074	(3)
Underwriting income	$ **8,950**	12,655	(29)%	**28,537**	48,723	(41)%
GAAP Ratios:						
Loss and loss expense ratio	**63.9**%	63.3	0.6pts	**64.1**%	63.0	1.1pts
Underwriting expense ratio	**33.0**%	32.3	0.7	**32.6**%	31.5	1.1
Dividends to policyholders ratio	**0.4**%	0.5	(0.1)	**0.4**%	0.4	
Combined ratio	**97.3**%	96.1	1.2	**97.1**%	94.9	2.2
Statutory Ratios:						
Loss and loss expense ratio	**63.4**%	63.3	0.1	**63.7**%	62.9	0.8
Underwriting expense ratio	**31.6**%	31.3	0.3	**31.0**%	30.8	0.2
Dividends to policyholders ratio	**0.4**%	0.5	(0.1)	**0.4**%	0.4	
Combined ratio	**95.4**%	95.1	0.3pts	**95.1**%	94.1	1.0pts

NPW increased 2% in Third Quarter 2007 and Nine Months 2007 compared to the prior year periods. Premium growth, resulting from increases in direct new business written, of $11.3 million to $82.1 million for Third Quarter 2007 and $23.5 million to $241.5 million in Nine Months 2007, were partially offset by:

Decreases in endorsement and audit premium activity of $5.8 million and $4.8 million, respectively, in Third Quarter 2007 and $10.3 million and $6.7 million, respectively, in Nine Months 2007 as compared to the prior year periods; and

Competitive pressure on our renewal book of business, particularly on the high end of our middle market business. This competitive pressure is reflected in our renewal prices, including exposure, which remained flat in Third Quarter 2007 and Nine Months 2007 compared to increases of 1.7% in Third Quarter 2006 and 2.5% in Nine Months 2006.

NPE increased reflecting increases in NPW over the last 12 months.

Table of Contents

The GAAP loss and loss expense ratio increased 0.6 points in Third Quarter 2007 compared to Third Quarter 2006 and 1.1 points in Nine Months 2007 compared to Nine Months 2006, primarily due to lower pricing on our commercial book of business, as well as increased property losses. Included in total property losses were catastrophe losses that decreased $3.0 million, or 0.9 points, to $1.6 million in Third Quarter 2007 compared to Third Quarter 2006 and increased $0.7 million to $11.0 million in Nine Months 2007 compared to Nine Months 2006. The GAAP loss and loss expense ratio increases were partially offset by (i) improvements in workers compensation profitability reflecting the progress we have made in executing our strategies regarding this line; and (ii) net favorable prior year loss and loss expense development within our casualty lines of business.

For the quarter, net favorable prior year loss and loss expense development within our casualty lines of business amounted to approximately $5 million in Third Quarter 2007, or 1.6 points, compared to approximately $4 million in Third Quarter 2006, or 1.1 points. For the year-to-date period, net favorable prior year loss and loss expense development within our casualty lines of business amounted to approximately $12 million in Nine Months 2007, or 1.2 points, compared to approximately $4 million in Nine Months 2006, or 0.5 points.

The increase in the GAAP underwriting expense ratio in Third Quarter 2007 and Nine Months 2007 compared to the same periods last year was attributable to increases in underwriting expenses that outpaced premium growth. These underwriting expense increases were driven by higher labor costs.

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

General Liability

($ in thousands)	Unaudited Quarter ended September 30, 2007	2006	Change % or Points	Unaudited Nine Months ended September 30, 2007	2006	Change % or Points
Statutory NPW	**$ 105,901**	107,623	(2)%	**334,940**	335,243	%
Statutory NPE	**101,785**	100,459	1	**306,848**	301,515	2
Statutory combined ratio	**100.9%**	96.2	4.7pts	**98.6%**	94.8	3.8pts
% of total statutory commercial NPW	**30%**	31		**31%**	32	

Total policy counts in this line of business increased 11% in Third Quarter 2007 and 9% in Nine Months 2007 compared to Third Quarter 2006 and Nine Months 2006. New business premiums in this line of business increased 14% for Third Quarter 2007 and 10% for Nine Months 2007 compared to Third Quarter 2006 and Nine Months 2006. Evidence of the softening market is illustrated in our renewal pricing for this line which, including exposure, decreased 1.3% in Third Quarter 2007 and 0.8% in Nine Months 2007 compared to an increase of 0.7% in Third Quarter 2006 and 1.7% in Nine Months 2006. Continuing evidence of the softening market was illustrated by retention that decreased slightly to 74% in Third Quarter and 76% in Nine Months 2007 compared to 76% in Third Quarter and 77% in Nine Months 2006.

Pricing pressure, coupled with adverse statutory loss development of approximately $4 million in Third Quarter 2007 compared to approximately $3 million in Third Quarter 2006 and approximately $11 million in Nine Months 2007 compared to approximately $8 million in Nine Months 2006 continues to put pressure on profitability in this line of business. However, we continue to concentrate on our long-term strategy to improve profitability, which focuses on: (i) contractor growth in business segments with lower completed operations exposures; and (ii) contractor and subcontractor underwriting guidelines to minimize losses.

20

Table of Contents

Workers Compensation

($ in thousands)	Unaudited Quarter ended September 30, 2007	2006	Change % or Points	Unaudited Nine Months ended September 30, 2007	2006	Change % or Points
Statutory NPW	$ **88,977**	85,202	4%	**272,887**	263,200	4%
Statutory NPE	**80,049**	80,243		**243,422**	233,577	4
Statutory combined ratio	**99.5**%	105.1	(5.6)pts	**100.0**%	108.7	(8.7)pts
% of total statutory commercial NPW	**25**%	24		**25**%	25	

Our multi-faceted workers compensation strategy, which incorporates our knowledge management and predictive modeling initiatives, has enabled us to retain and write more of the best accounts, leading to Third Quarter 2007 and Nine Months 2007 increases in total policy counts of 14% and 9%, respectively, compared to Third Quarter 2006 and Nine Months 2006. Direct new voluntary policy premiums increased 38% for Third Quarter 2007 and 29% for Nine Months 2007 compared to Third Quarter 2006 and Nine Months 2006. At the same time, these initiatives have allowed us to target price increases for our worst performing business, which contributed to the decrease in our retention in Nine Months 2007 to 79% from 81% in Nine Months 2006, thereby improving the profitability of our retained business.

The improvement in the statutory combined ratio of this line of 5.6 points in Third Quarter 2007 compared to Third Quarter 2006, and 8.7 points in Nine Months 2007 compared to Nine Months 2006 reflects not only the ongoing progress resulting from the execution of our workers compensation strategies, but also reflects favorable prior year statutory development attributable to these strategies of approximately $3 million, or 4.3 points, in Third Quarter 2007, which was relatively flat compared to Third Quarter 2006. For Nine Months 2007, favorable prior year statutory development was approximately $5 million, or 2.2 points, compared to an insignificant level of prior year development in Nine Months 2006.

Commercial Automobile

($ in thousands)	Unaudited Quarter ended September 30, 2007	2006	Change % or Points	Unaudited Nine Months ended September 30, 2007	2006	Change % or Points
Statutory NPW	$ **85,161**	82,593	3%	**255,688**	256,363	%
Statutory NPE	**79,709**	80,646	(1)	**237,311**	241,212	(2)
Statutory combined ratio	**86.3**%	89.0	(2.7)pts	**86.1**%	86.4	(0.3)pts
% of total statutory commercial NPW	**24**%	24		**24**%	24	

Continued strong performance in this line of business is the result of underwriting improvements over the last several years. We have implemented targeted rate decreases on the best accounts to grow this profitable line of business. The total policy count on this line increased 10% in Third Quarter 2007 compared to Third Quarter 2006, driven by new policy count increases of 29% in Third Quarter 2007 compared to Third Quarter 2006. The total policy count on this line increased 8% in Nine Months 2007 compared to Nine Months 2006, driven by new policy count increases of 16% in Nine Months 2007 compared to Nine Months 2006. However, renewal prices, including exposure, decreased 3.0% in Third Quarter 2007 and 2.7% in Nine Months 2007 as compared to decreases of 1.8% in Third Quarter 2006 and 1.0% in Nine Months 2006, which has put pressure on NPW and NPE. Lower severity trends have resulted in favorable prior year loss development of approximately $6 million in Third Quarter 2007 and $16 million in Nine Months 2007 compared to favorable prior year loss development of approximately $3 million in Third Quarter 2006

and $11 million in Nine Months 2006.

Table of Contents

Commercial Property

($ in thousands)	Unaudited Quarter ended September 30, 2007	2006	Change % or Points	Unaudited Nine Months ended September 30, 2007	2006	Change % or Points
Statutory NPW	$ **55,845**	53,403	5%	**156,344**	149,730	4%
Statutory NPE	**48,293**	46,079	5	**141,657**	135,513	5
Statutory combined ratio	**91.0**%	87.0	4.0pts	**92.3**%	84.1	8.2pts
% of total statutory commercial NPW	**16**%	15		**14**%	14	

Net premiums written for this line of business increased in Third Quarter 2007 and Nine Months 2007 compared to the same periods in 2006 due to increases in total policy counts of 12% in Third Quarter 2007 and 10% in Nine Months 2007, and stable retention of approximately 79% over the past two years. This is partially offset by renewal prices, including exposure, that decreased 1.3% in Third Quarter 2007 and remained flat in Nine Months 2007 compared to increases of 1.6% in Third Quarter 2006 and 2.1% in Nine Months 2006.

The statutory combined ratio for commercial property deteriorated in Third Quarter 2007 and Nine Months 2007 compared to the same periods last year, primarily as a result of lower pricing, as well as increases in property losses. These increases were primarily the result of an increase in severity of losses, mainly attributable to flood events and electrical fires. For Third Quarter 2007, catastrophe losses decreased $2.3 million to $1.5 million compared to Third Quarter 2006, however, for Nine Months 2007, catastrophe losses increased $0.3 million to $9.4 million compared to Nine Months 2006.

Personal Lines Results

Personal Lines ($ in thousands)	Unaudited Quarter ended September 30, 2007	2006	Change % or Points	Unaudited Nine Months ended September 30, 2007	2006	Change % or Points
GAAP Insurance Operations Results:						
NPW	$ **53,854**	53,695	%	**154,237**	169,941	(9)%
NPE	**50,279**	53,179	(5)	**151,666**	161,502	(6)
Less:						
Losses and loss expenses incurred	**37,329**	35,732	4	**114,535**	110,951	3
Net underwriting expenses incurred	**16,778**	17,600	(5)	**50,975**	52,759	(3)
Underwriting income (loss)	$ **(3,828)**	(153)	(2,402)%	**(13,844)**	(2,208)	(527)%
GAAP Ratios:						
Loss and loss expense ratio	**74.2**%	67.2	7.0pts	**75.5**%	68.7	6.8pts
Underwriting expense ratio	**33.4**%	33.1	0.3	**33.6**%	32.7	0.9
Combined ratio	**107.6**%	100.3	7.3	**109.1**%	101.4	7.7
Statutory Ratios:[1]						

Loss and loss expense ratio	**74.1**%	65.1	9.0	**74.5**%	67.8	6.7
Underwriting expense ratio	**27.1**%	28.9	(1.8)	**29.6**%	29.1	0.5
Combined ratio	**101.2**%	94.0	7.2pts	**104.1**%	96.9	7.2pts

[1] The statutory ratios include the flood line of business, which is included in the Diversified Insurance Services segment on a GAAP basis and therefore excluded from the GAAP ratios. The total Personal Lines statutory combined ratio excluding flood is 106.2% for Third Quarter 2007 and 109.7% for Nine Months 2007 compared to 100.8% for Third Quarter 2006 and 101.8% for Nine Months 2006.

NPW increased slightly to $53.9 million in Third Quarter 2007 compared to Third Quarter 2006 and decreased 9% to $154.2 million in Nine Months 2007 compared to Nine Months 2006. In Third Quarter 2007 compared to Third Quarter 2006, increases in our homeowners business of $1.5 million to $19.0 million and increases in our personal automobile business outside of New Jersey of $1.8 million to $13.1 million were offset by decreased NPW for our New Jersey personal automobile business of $3.2 million to $19.5 million.

Table of Contents

In Nine Months 2007 compared to Nine Months 2006, the NPW decrease was primarily driven by a decline in net premiums written for our New Jersey personal automobile business of $12.2 million to $61.2 million and an $11.3 million benefit in the first quarter of 2006 resulting from the termination of the Quota Share Treaty. Partially offsetting these decreases were increases in our personal automobile business outside of New Jersey of $3.8 million to $37.8 million and increases in our total homeowners business, excluding the impact of the Quota Share Treaty termination, of $3.2 million to $49.1 million.

The decrease in New Jersey personal automobile business in both Third Quarter and Nine Months 2007 was driven by a reduction in the number of New Jersey personal automobiles that we insure, primarily as a result of repricing that portion of our book at revised rates through our MATRIX pricing system. The New Jersey personal automobile market has been influenced by the introduction of new companies writing business in the state with rating plans that allow them to price accounts competitively. Our new Personal Lines rating plan was approved by the New Jersey Department of Banking and Insurance (NJDOBI) and implemented in August 2006. Our new plan allows us to better evaluate and price risks, which will help us to profitably compete for new business in an agent s office. We have moved our entire existing renewal inventory into our new pricing and tiering structure in New Jersey, which has caused a dislocation in this book of business due to the repricing of certain business at higher levels, some of which did not renew. As annual increases or decreases are capped at 20% by the NJDOBI, we expect improvements to materialize over a three year period. We continue to focus on increasing new business production within and outside of New Jersey through this advanced pricing methodology. Total Personal Lines NPW outside of New Jersey increased 13% to $22.2 million for Third Quarter 2007 compared to Third Quarter 2006 and 10% to $62.4 million for Nine Months 2007 compared to Nine Months 2006. In our continuing efforts to improve our existing book of automobile business, we have implemented average renewal rate increases of 13.1% in Pennsylvania effective August 1, 2007, and 8.5% in Maryland effective September 1, 2007. Such rate increases were necessary, as these states have regulatory restrictions on moving the renewal book into our new pricing methodology and the previous rates did not yield sufficient profitability.

NPE decreased reflecting decreases in NPW over the last 12 months.

The deterioration in the GAAP loss and loss expense ratio in Third Quarter 2007 and Nine Months 2007 compared to Third Quarter 2006 and Nine Months 2007 was primarily driven by decreased rates, increased losses in the personal auto line of business for the quarter and increased losses in the personal auto and homeowners lines of business for the year-to-date period. We have also reduced our exposure related to urban enterprise zone business compared to the prior year.

The deterioration in the GAAP underwriting expense ratio in Third Quarter 2007 and Nine Months 2007 compared to Third Quarter 2006 and Nine Months 2006 was primarily attributable to overhead costs that have outpaced premiums earned in Third Quarter 2007 and Nine Months 2007. In addition, costs associated with the reorganization of the Personal Lines department in May of 2007, which reduced the staffing level by 31 employees, added 0.9 points to the underwriting expense ratio in Nine Months 2007.

Reinsurance

Our excess of loss treaties, which renewed on July 1, 2007, have the following characteristics:

Property Excess of Loss

The treaty was renewed with the same limit of $23.0 million in excess of a $2.0 million retention.

The terms and conditions are consistent with the expiring treaty.

Casualty Excess of Loss

The treaty structure remained unchanged. Continuing provisions include:

The Workers Compensation Only treaty renewed with a $3.0 million excess $2.0 million retention.

The Casualty Excess of Loss treaty (Casualty Treaty), which covers all of our casualty business, including workers compensation, renewed with a $45.0 million excess of $5.0 million retention.

The additional layer to the Casualty Treaty, which was placed in January 2007 and provides coverage up to 75% of $40.0 million in excess of $50.0 million, continues in effect until July 2008.

Table of Contents

Consistent with the prior year, the treaty excludes nuclear, biological, chemical, and radiological terrorism losses. Annual aggregate terrorism limits, net of co-participation in the $40.0 million excess of $50.0 million layer, remain at $166.0 million for the casualty excess of loss treaty, and $9.0 million for the workers compensation only treaty.

Property Catastrophe Excess of Loss

We continuously reevaluate our overall reinsurance program and the most effective ways to manage our risk. Our analysis is based on a comprehensive process that includes periodic analysis of modeling results, aggregation of exposures, exposure growth, diversification of risks, limits written, projected reinsurance costs, and projected impact on earnings and statutory surplus. We strive to balance the often opposing considerations of reinsurer credit quality, price, terms, and our appetite for retaining a certain level of risk. Effective June 15, 2007, we placed an additional $50.0 million of coverage on top of our existing $285.0 million in excess of $40.0 million program (with 5% co-participation in all layers) to address growth in insured values. The combined program provides $318.3 million of coverage, net of co-participation, in excess of $40.0 million retention per occurrence and aggregate annual limits of $636.5 million. The following table presents Risk Management Solutions, Inc. s (RMS) v7.0 modeled hurricane losses based on the Insurance Subsidiaries property book of business as of June 30, 2007:

($ in thousands)	Stochastic Basis			Historic Basis		
Occurrence Exceedence Probability	Gross Losses RMS v7.0	Net Losses[1]	Net Losses as a Percent of Equity[2]	Gross Losses RMS v7.0	Net Losses[1]	Net Losses as a Percent of Equity[2]
4.00% (1 in 25 year event)	$ 69,947	$ 29,061	3%	$ 49,277	$ 26,948	3%
2.00% (1 in 50 year event)	$ 134,532	$ 34,689	3%	$ 100,670	$ 32,181	3%
1.00% (1 in 100 year event)	$ 244,445	$ 41,848	4%	$ 190,897	$ 38,639	4%
0.40% (1 in 250 year event)	$ 485,837	$ 121,427	12%	$ 400,631	$ 66,042	6%

[1] Net losses are after-tax and include applicable reinstatement premium.

[2] Equity as of September 30, 2007.

Our current catastrophe program provides protection for a 1 in 229 year event, or an event with a 0.4% probability according to the RMS v7.0 historic model, and for a 1 in 175 year event, or an event with 0.6% probability according to the RMS v7.0 stochastic model. The new layer increased the cost of our catastrophe excess of loss program by $1.7 million.

Investments

Our investment portfolio consists primarily of fixed maturity investments (81% at September 30, 2007), but also contains equity securities, short-term investments, and other investments. Our investment philosophy includes certain return and risk objectives for our fixed maturity and equity portfolios. The primary return objective of our fixed maturity portfolio is to maximize after-tax investment yield and income while balancing certain risk objectives, with a secondary objective of meeting or exceeding a weighted-average benchmark of public fixed income indices. The return objective of the equity portfolio is to meet or exceed a weighted-average benchmark of public equity indices. The risk objective for our entire portfolio is to ensure that our investments are structured conservatively, focusing on: (i) asset diversification; (ii) investment quality; (iii) liquidity, particularly to meet the cash obligations of the Insurance Operations segment; (iv) consideration of taxes; and (v) preservation of capital.

($ in thousands)	Unaudited Quarter ended September 30, 2007	2006	Change % or Points	Unaudited Nine Months ended September 30, 2007	2006	Change % or Points

Net investment income before tax	$ 43,674	38,891	12%	$ 124,179	112,283	11%
Net investment income after tax	33,409	30,079	11	96,354	87,355	10
Total invested assets				3,629,792	3,514,601	3
Effective tax rate	23.5%	22.7	0.8Pts	22.4%	22.2	0.2pts
Annual after-tax yield on investment portfolio				3.6%	3.4	0.2

Table of Contents

The increases in net investment income before tax were primarily the result of higher investment yields on our fixed maturity securities as well as increased invested assets within our portfolio. The value of the investment portfolio reached $3.6 billion at September 30, 2007, an increase of 3% compared to $3.5 billion at September 30, 2006. The increase in invested assets was due, in part, to cash flows from operations of $393.1 million in 2006. The junior subordinated notes offering in September 2006 also added approximately $96.8 million in assets in 2006. This increase in invested assets was primarily in fixed maturity securities and other investments. Interest income from fixed maturity securities increased $2.8 million for Third Quarter 2007 compared to Third Quarter 2006 and $8.8 million for Nine Months 2007 compared to Nine Months 2006. Other investment income increased $2.1 million for Third Quarter 2007 compared to Third Quarter 2006 and $3.3 million for Nine Months 2007 compared to Nine Months 2006.

We continue to maintain a conservative, diversified investment portfolio, with fixed maturity investments representing 81% of invested assets at September 30, 2007. Seventy percent (70%) of our fixed maturities portfolio is rated AAA while the portfolio has an average rating of AA, Standard & Poor s (S&P) third highest credit quality rating. High credit quality continues to be a cornerstone of our investment strategy, as evidenced by the fact that almost 100% of the fixed maturities are investment grade. Non-investment grade securities (below BBB-) represented less than 1%, or approximately $10 million, of our fixed maturity portfolio at September 30, 2007 and December 31, 2006. Our mortgage backed securities portfolio totaled $682.6 million at September 30, 2007, with an average credit rating of AA+. Selective has no direct and no indirect sub-prime mortgage exposure. Prior to investing in mortgage-backed securities, we analyze, among other things, each transaction s FICO® credit score and loan to value ratio.

The following table presents the Moody s Investor Service (Moody s) and S&P s ratings of our fixed maturities portfolio:

Rating	Unaudited September 30, 2007	December 31, 2006
Aaa/AAA	70%	73%
Aa/AA	17%	17%
A/A	7%	7%
Baa/BBB	6%	3%
Ba/BB or below	<1%	<1%
Total	100%	100%

Our fixed maturity investment strategy is to make security purchases that are attractively priced in relation to perceived credit risks. We manage the interest rate risk associated with holding fixed maturity investments by monitoring and maintaining the average duration of the portfolio with a view toward achieving an adequate after-tax return without subjecting the portfolio to an unreasonable level of interest rate risk. We invest our fixed maturities portfolio primarily in intermediate-term securities to limit overall interest rate risk of fixed maturity investments. Generally, the Insurance Subsidiaries have a duration mismatch between assets and liabilities. The duration of the fixed maturity portfolio, including short-term investments, is approximately 4 years while the Insurance Subsidiaries liabilities have a duration of approximately 3 years. The current duration of our fixed maturities is within our historical range and is monitored and managed to maximize yield and limit interest rate risk. The duration mismatch is managed with a laddered maturity structure and an appropriate level of short-term investments that avoids liquidation of available-for-sale fixed maturities in the ordinary course of business. Liquidity is always a consideration when buying or selling securities, but because of the high quality and active market for the securities in our investment portfolio, the securities sold have not diminished the overall liquidity of our portfolio. Our liquidity requirements in the past have been met by operating cash flow from our Insurance Operations and Diversified Insurance Services segments and the issuance of debt and equity securities. We expect our liquidity requirements in the future to be met by these sources of funds or, if necessary, borrowings from our credit facility. Managing investment risk by adhering to these strategies is intended to protect the interests of our stockholders and the policyholders of our Insurance

Subsidiaries, while enhancing our financial strength and underwriting capacity.

Table of Contents

Realized Gains and Losses

Realized gains and losses are determined on the basis of the cost of specific investments sold or written-down, and are credited or charged to income. Our Investments segment s results included net realized gains before tax of $2.8 million in Third Quarter 2007 compared to $3.9 million in Third Quarter 2006, and $27.2 million in Nine Months 2007 compared to $25.8 million in Nine Months 2006. The majority of the net realized gains for both the Third Quarter 2007 and Nine Months 2007 reflect the sale of certain long-term equity investments as part of a sector and portfolio reallocation effort. Realized gains were partially offset by realized losses, of which the most significant was the sale of an exchange traded fund (ETF) that we purchased during Third Quarter 2007 to hedge a portion of our equity portfolio during a time of market distress. As a result of the federal funds reduction, improvements were seen in the equity markets leading us to sell our interest in the ETF. This sale resulted in a $4.3 million realized loss for Third Quarter 2007 and Nine Months 2007. There were no write-downs in Third Quarter 2007 and 2006 or Nine Months 2007 and 2006. We maintain a high quality and liquid investment portfolio and the sale of the securities that resulted in net realized gains did not change the overall liquidity of the investment portfolio. We generally sell securities to reduce our exposure to securities and sectors based upon economic evaluations, or if the fundamentals for that security or sector have deteriorated. We typically have a long investment time horizon and our turnover is low, which has resulted in many securities accumulating large unrealized gains. Every purchase or sale is made with the intent of improving future investment returns.

The following table summarizes our realized gains and losses by investment type:

($ in thousands)	Unaudited Quarter ended September 30, 2007	Unaudited Quarter ended September 30, 2006	Unaudited Nine Months ended September 30, 2007	Unaudited Nine Months ended September 30, 2006
Held-to-maturity fixed maturity securities				
Gains	**$**	15		15
Losses				
Available-for-sale fixed maturity securities				
Gains	**90**	39	**445**	1,947
Losses	**(1,079)**	(713)	**(2,087)**	(6,581)
Available-for-sale equity securities				
Gains	**12,910**	5,973	**38,374**	33,879
Losses	**(8,271)**	(1,366)	**(8,691)**	(3,458)
Other investments				
Gains	**847**		**847**	
Losses	**(1,683)**		**(1,683)**	
Total net realized gains	**$ 2,814**	3,948	**27,205**	25,802

Table of Contents

We realized gains and losses from the sale of available-for-sale debt and equity securities during Third Quarter 2007 and Nine Months 2007 and Third Quarter 2006 and Nine Months 2006. The following tables present the period of time that securities sold at a loss were continuously in an unrealized loss position prior to sale:

Period of time in an unrealized loss position ($ in millions)	**Unaudited Quarter ended September 30, 2007**		**Unaudited Quarter ended September 30, 2006**	
	Fair Value on Sale Date	**Realized Loss**	**Fair Value on Sale Date**	**Realized Loss**
Fixed maturity securities:				
0 6 months	$ **15.2**	**0.5**	1.1	0.1
7 12 months	**26.3**	**0.3**	10.6	0.1
Greater than 12 months			9.6	0.3
Total fixed maturity securities	**41.5**	**0.8**	21.3	0.5
Equity securities:				
0 6 months	**55.9**	**8.1**	4.2	1.4
7 12 months				
Greater than 12 months	**0.1**	**0.1**		
Total equity securities	**56.0**	**8.2**	4.2	1.4
Other investments:				
0 6 months	**5.3**	**1.7**		
7 12 months				
Greater than 12 months				
Total other investments	**5.3**	**1.7**		
Total	$ **102.8**	**10.7**	25.5	1.9

Period of time in an unrealized loss position ($ in millions)	**Unaudited Nine Months ended September 30, 2007**		**Unaudited Nine Months ended September 30, 2006**	
	Fair Value on Sale Date	**Realized Loss**	**Fair Value on Sale Date**	**Realized Loss**
Fixed maturity securities:				
0 6 months	$ **29.0**	**0.7**	94.9	1.5
7 12 months	**31.6**	**0.4**	76.6	2.5
Greater than 12 months	**10.2**	**0.2**	33.9	1.5
Total fixed maturity securities	**70.8**	**1.3**	205.4	5.5
Equity securities:				
0 6 months	**58.5**	**8.4**	12.2	2.8

7 12 months		**0.3**	**0.2**	2.4	0.6
Greater than 12 months		**0.1**	**0.1**		
Total equity securities		**58.9**	**8.7**	14.6	3.4
Other investments:					
0 6 months		**5.3**	**1.7**		
7 12 months					
Greater than 12 months					
Total other investments		**5.3**	**1.7**		
Total	$	**135.0**	**11.7**	220.0	8.9

These securities were sold despite the fact that they were in a loss position. The decision to sell these securities was due to: (i) heightened credit risk during the period that the individual security was sold; (ii) the decision to reduce our exposure to certain issuers, industries, or sectors in light of changing economic or regulatory conditions; or (iii) changes in asset mix or allocation modifications for the portfolio.

Table of Contents

Unrealized Losses

The following table summarizes the aggregate fair value and gross pre-tax unrealized loss recorded in our accumulated other comprehensive income, by asset class and by length of time, for all available-for-sale securities that have continuously been in an unrealized loss position as of September 30, 2007 and December 31, 2006:

Period of time in an unrealized loss position	**Unaudited**			
	September 30, 2007		**December 31, 2006**	
($ in millions)	**Fair Value**	**Gross Unrealized Loss**	**Fair Value**	**Gross Unrealized Loss**
Fixed maturity securities:				
0 6 months	**$ 303.6**	**6.5**	376.6	1.7
7 12 months	**278.1**	**2.8**	107.6	0.7
Greater than 12 months	**668.2**	**7.9**	705.8	10.1
Total fixed maturity securities	**1,249.9**	**17.2**	1,190.0	12.5
Equity securities:				
0 6 months	**9.1**	**0.4**	7.8	0.2
7 12 months				
Greater than 12 months	**0.6**	**0.1**	0.4	0.2
Total equity securities	**9.7**	**0.5**	8.2	0.4
Other:				
0 6 months			6.9	0.1
7 12 months				
Greater than 12 months				
Total other securities			6.9	0.1
Total	**$ 1,259.6**	**17.7**	1,205.1	13.0

Broad changes in the overall market or interest rate environment generally do not lead to impairment charges. As of September 30, 2007, our portfolio contained 818 securities in an unrealized loss position.

The following table presents information regarding our available-for-sale fixed maturities that were in an unrealized loss position at September 30, 2007 by contractual maturity:

Contractual Maturities	**Amortized**	**Fair**
($ in millions)	**Cost**	**Value**
One year or less	$ 119.1	118.2
Due after one year through five years	627.8	620.3
Due after five years through ten years	445.2	438.2
Due after ten years through fifteen years	25.9	25.3
Due after fifteen years	49.2	47.9
Total	$ 1,267.2	1,249.9

Investments Outlook

During the quarter, the Federal Reserve surprised most investors with a 50 basis point reduction in the federal funds rate when only a 25 basis point reduction was expected. This was the first rate reduction in more than four years. Concerns about the longer-term impacts to the overall U. S. economy from the global liquidity crisis and the associated pullback in credit extension, led to the rate reduction and an attempt to restore market liquidity. The equity market s reaction was a 3.6% gain in the S&P 500 Index over the two days following the rate reduction. Still, the credit crunch remains a source of uncertainty. Economic data remains quite mixed, but points to weaker growth. Although recent consumer spending figures surprised the markets on the upside, the full effects of the weakening housing market may not have fully played out. In our view, subprime mortgage defaults and home foreclosures will probably not peak until well into 2008, thereby dampening consumer confidence.

Table of Contents

The objective for our fixed maturity securities portfolio is to improve the overall diversification of risk away from municipals and mortgage-backed securities, further optimizing the portfolio, and booking attractive relative yields. We plan to reduce municipal positions and add mortgage and asset-backed related products on an opportunistic basis that meet our credit quality parameters, including FICO® credit scores and loan to value ratios.

We continue to position our equity portfolio more defensively, increasing our exposure to the consumer staples sector and maintaining our overweight position in the health care sector. We have also added several large cap multinational equities to our portfolio that we believe are poised to benefit from strong global economic growth prospects. Although we continue to selectively reduce our exposure to energy and materials, we still view these sectors favorably, as we believe the current supply and demand fundamentals should continue to support returns above the market average.

In our other investments portfolio, our strategy will be to continue to engage in additional investments with existing managers, while we look to evaluate new alternative investment ideas that fit into our existing portfolio. Our strategy is to find exceptional managers with a key advantage in alternative strategies that are relatively uncorrelated to the public equity and debt markets. As we add additional managers, we will continue to monitor our exposures by sponsor and strategy.

Diversified Insurance Services Segment

The Diversified Insurance Services operations consist of two core functions: HR Outsourcing and flood insurance. We believe these operations are within markets that continue to offer opportunity for growth. During Third Quarter 2007, these operations provided a contribution of $0.05 per diluted share compared to $0.07 per diluted share in Third Quarter 2006 and $0.17 per diluted share in Nine Months 2007 compared to $0.15 per diluted share in Nine Months 2006. Contributions from the Diversified Insurance Services segment, particularly the flood business, continue to provide some mitigation of insurance pricing cycles and the adverse impact that catastrophe losses have on our Insurance Operations segment. We evaluate the performance of these operations based on several measures, including, but not limited to, results of operations in accordance with GAAP, with a focus on our return on revenue (net income divided by revenues).

The results for this segment s operations are as follows:

	Unaudited Quarter ended			**Unaudited Nine Months ended**		
	September 30,		**% Change**	**September 30,**		**% Change**
($ in thousands)	**2007**	**2006**	**or Points**	**2007**	**2006**	**or Points**
HR Outsourcing						
Revenue	$ **14,048**	15,370	(9)%	$ **45,771**	48,270	(5)%
Pre-tax profit	**818**	1,586	(48)	**3,417**	3,454	(1)
Flood insurance						
Revenue	**13,023**	12,410	5	**37,089**	31,874	16
Pre-tax profit	**2,715**	3,610	(25)	**8,482**	8,260	3
Other						
Revenue	**2,260**	1,504	51	**6,326**	3,967	60
Pre-tax profit	**1,128**	792	42	**3,198**	1,956	63
Total						
Revenue	**29,331**	29,284		**89,186**	84,111	6
Pre-tax profit	**4,661**	5,988	(22)	**15,097**	13,670	10
After-tax profit	**3,075**	3,943	(22)	**9,997**	9,056	10
After-tax return on revenue	**10.5**%	13.5	(3.0)pts	**11.2**%	10.8	0.4pts

Table of Contents

HR Outsourcing

HR Outsourcing revenue declined in Third Quarter 2007 and Nine Months 2007 compared to the same periods in the prior year, primarily as a result of a reduction in worksite lives. As of September 30, 2007, our worksite lives were down 2% to 25,884 compared to 26,464 as of September 30, 2006 resulting from recent economic trends as well as the sale, in Third Quarter 2007, of two large HR Outsourcing clients to companies that manage their payroll and human resources activities in house.

Pre-tax profit decreases in our HR Outsourcing business in Third Quarter 2007 and Nine Months 2007 compared to Third Quarter and Nine Months 2006 are mainly due to pricing pressure on our workers compensation product and the reduced level of worksite lives as mentioned above.

Flood Insurance

Flood premium in force was $138.1 million on approximately 299,000 policies at September 30, 2007, compared to premium in force of $112.3 million on approximately 262,000 policies at September 30, 2006.

Revenue increases were mainly attributable to the increase in flood premium in force as noted above. Partially offsetting the impact of premium in force for Third Quarter 2007 was reduced weather-related flood claim revenue of $0.1 million compared to $1.1 million in Third Quarter 2006 that resulted from less significant storm activity in the current quarter compared to the same quarter last year. Additionally, for both Third Quarter 2007 and Nine Months 2007, revenues were negatively impacted by a decrease in the fee paid to us by the National Flood Insurance Program (NFIP) of 0.6 points to 30.2% from 30.8%, which was effective for the NFIP s fiscal year beginning on October 1, 2006.

The fluctuations in pre-tax profit, which decreased $0.9 million in Third Quarter 2007 compared to Third Quarter 2006 and increased $0.2 million in Nine Months 2007 compared to Nine Months 2006, were driven by the revenue items noted above. Although the weather-related flood claim revenue negatively impacted Third Quarter 2007 results by $1.0 million, the impact on a year-to-date basis was less significant at only $0.2 million.

Diversified Insurance Services Outlook

Our HR Outsourcing products, which are packaged as an Employer Protection Program (EPP), offer an additional revenue stream for our independent agents. Since unveiling the EPP during the First Quarter 2006, agents have gained a better understanding of the HR Outsourcing product; however, consistent with trends in the professional employer industry that are pointing to flat to negative growth in worksite lives, our client sales continue to be difficult. Additionally, in Florida, which represents 31% of our co-employer service fees, we expect another workers compensation rate reduction in 2008, which would be in addition to the 15.7% rate decrease that was effective January 1, 2007 for voluntary industrial classes. Future reductions in this rate could adversely affect our HR Outsourcing s results of operations, as workers compensation insurance is an important component of the EPP product.

Table of Contents

The viability of the NFIP s reinsurance program under the Write-Your-Own (WYO) Program is an essential component of our Diversified Insurance Services operations as we write flood insurance under the WYO Program. In 2005, the destruction caused by the active hurricane season stressed the NFIP with excessive levels of flood losses. We continue to monitor developments with the NFIP regarding its ability to pay claims in the event of another large-scale disaster. Congress controls the federal agency s funding authority, which topped out after Hurricane Katrina, and is again nearing maximum capacity. Bills are pending in the House and Senate that could impact the NFIP. These bills contain substantial legislative changes and revisions to the NFIP and WYO Program, some of which may be favorable and some of which may be unfavorable for us. It is uncertain, at present, what the net impact to us may be if the legislation is passed. As described above, the fee paid to us by the NFIP decreased 0.6 points to 30.2% of premiums written effective October 1, 2006. Future reductions in this rate are anticipated and could occur through additional legislative activity.

Financial Condition, Liquidity, and Capital Resources

Capital resources and liquidity represent our overall financial strength and 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

Liquidity is a measure of our ability to generate sufficient cash flows to meet the short and long-term cash requirements of our business operations. Although above our required liquidity levels for operations, adequate returns on short-term assets have led us to increase our cash and short-term investments position to $231.4 million at September 30, 2007 from $203.5 million at December 31, 2006. Sources of cash consist of dividends from our subsidiaries, the issuance of debt and equity securities, as well as the sale of Common Stock under our employee and agent stock purchase plans. However, our ability to receive dividends from our subsidiaries is restricted. Dividends from our Insurance Subsidiaries to Selective Insurance Group, Inc. are subject to the approval and/or review of the insurance regulators in the respective domiciliary states of the Insurance Subsidiaries under insurance holding company acts, and are generally payable only from earned surplus as reported in the statutory annual statements of those subsidiaries as of the preceding December 31. Based on the 2006 statutory financial statements, the Insurance Subsidiaries are permitted to pay to Selective Insurance Group, Inc. ordinary dividends in the aggregate amount of approximately $141.9 million in 2007. For additional information regarding dividend restrictions, refer to Note 9, Indebtedness and Note 10, Stockholders Equity of the Notes to Consolidated Financial Statements, included in Item 8. Financial Statements and Supplementary Data of Selective s 2006 Annual Report.

Our Insurance Subsidiaries generate cash flows primarily from insurance float, which is created by the investment income earned on collected premiums before losses are paid. The period of the float can extend over many years. To provide liquidity while maintaining consistent investment performance, we ladder our fixed maturity investments so that some issues are always approaching maturity and provide a source of predictable cash flow for claim payments in the ordinary course of business. The duration of the fixed maturity portfolio, including short-term investments, was approximately 4 years as of September 30, 2007, while the liabilities of our Insurance Subsidiaries have a duration of approximately 3 years. In addition, the Insurance Subsidiaries purchase reinsurance coverage for protection against any significantly large claims or catastrophes that may occur during the year. Our consolidated investment portfolio was $3.6 billion at September 30, 2007 and December 31, 2006.

Selective has a syndicated line of credit agreement with Wachovia Bank, National Association as administrative agent. Under this agreement, Selective has access to a $50 million credit facility, which can be increased to $75 million with the consent of all lending parties. At September 30, 2007, no balances were outstanding under this credit facility.

Table of Contents

Selective HR Solutions (SHRS), our HR Outsourcing business, generates cash flows from its operations. Dividends from SHRS to Selective Insurance Group, Inc. are restricted by the operating needs of this entity as well as professional employer organization licensing requirements to maintain a current ratio of at least 1:1. The current ratio, which SHRS generally maintains just above 1:1, provides an indication of a company s ability to meet its short-term obligations and is calculated by dividing current assets by current liabilities. SHRS provided dividends to Selective Insurance Group, Inc. of $0.9 million in Third Quarter 2007 compared to $1.3 million in Third Quarter 2006 and $3.4 million in Nine Months 2007 compared to $3.1 million in Nine Months 2006.

Dividends on shares of our Common Stock are declared and paid at the discretion of our Board of Directors based on our operating results, financial condition, capital requirements, contractual restrictions, and other relevant factors. Our ability to declare dividends is restricted by covenants contained in the notes payable that we issued on May 4, 2000 (the 2000 Senior Notes). All such covenants were met during Third Quarter 2007 and Third Quarter 2006. For further information regarding our notes payable, see Note 9, entitled, Indebtedness, included in Item 8. Financial Statements and Supplementary Data of Selective s 2006 Annual Report. At September 30, 2007, the amount available for dividends to holders of our Common Stock, in accordance with the restrictions of the 2000 Senior Notes, was $316.3 million. On January 30, 2007, our Board of Directors declared a two-for-one stock split of our Common Stock, in the form of a share dividend of one additional share of Common Stock for each outstanding share of Common Stock (the Share Dividend). The Share Dividend was paid on February 20, 2007 to stockholders of record as of the close of business on February 13, 2007. The effect of the Share Dividend has been recognized retroactively in all share and per share data, as well as the capital stock account balances, in the accompanying consolidated financial statements, notes to consolidated financial statements and supplemental financial data. Book value per share increased to $19.64 as of September 30, 2007 compared to $18.81 as of December 31, 2006. Our ability to continue to pay dividends to our stockholders is also dependent in large part on the ability of our Insurance Subsidiaries and the subsidiaries in our Diversified Insurance Services segment to pay dividends to Selective Insurance Group, Inc. Restrictions on the ability of our subsidiaries, particularly the Insurance Subsidiaries, to declare and pay dividends to Selective Insurance Group, Inc., could materially affect our ability to pay principal and interest on indebtedness and dividends on Common Stock.

We have historically met our liquidity requirements through dividends from our subsidiaries and by issuing debt and equity securities. We expect to meet our liquidity requirements by these sources in the future. The Insurance Subsidiaries have historically met their liquidity requirements from insurance premiums and investment income. These items have historically provided more than sufficient funds to pay losses, operating expenses, and dividends to Selective Insurance Group, Inc.

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, 2007, we had stockholders equity of $1,042.6 million and total debt of $333.1 million. In addition, we have an irrevocable trust valued at $13.1 million to provide for the repayment of notes having maturities in 2008.

Our cash requirements include, but are not limited to, principal and interest payments on senior convertible notes, various notes payable and convertible subordinated debentures, dividends to stockholders, payment of claims, the purchase of investments 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 titled Contractual Obligations and Contingent Liabilities and Commitments.

Table of Contents

As active capital managers, we continually monitor our cash requirements as well as 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 a 25% debt-to-capital ratio and a premiums to surplus ratio sufficient to maintain an A+ (Superior) financial strength A.M. Best rating for our Insurance Subsidiaries. Based on our analysis and market conditions, we may take a variety of actions including, but not limited to, contributing capital to the subsidiaries in our Insurance Operations and Diversified Insurance Services segments, issuing additional debt and/or equity securities, repurchasing shares of our Common Stock, or increasing stockholders dividends. The following are a few examples of capital management actions we have taken during 2007:

On March 8, 2007, Selective Insurance Group, Inc. entered into a written trading plan under Rule 10b5-1 under the Securities Exchange Act of 1934 (Trading Plan) with a broker to facilitate the purchase of its Common Stock. Rule 10b5-1 allows a company to purchase its shares at times when it ordinarily would not be in the market because of self-imposed trading blackout periods, such as the time preceding its quarterly earnings releases.

On July 24, 2007, the Board of Directors authorized a new stock repurchase program for up to 4 million shares, which expires on July 26, 2009.

In Third Quarter and Nine Months 2007, we repurchased approximately 0.5 million shares for $9.9 million and 5.7 million shares for $143.3 million, respectively, under our previous and current share repurchase programs.

On October 23, 2007, the Board of Directors declared, for stockholders of record as of November 15, 2007, a dividend of $0.13 per share to be paid on December 3, 2007. This is an 8% increase compared to the dividend declared in Third Quarter 2007.

On October 25, 2007, Selective Insurance Group, Inc. announced that it has called for redemption on November 30, 2007 of one-half of its outstanding 1.6155% Senior Convertible Notes due 2032 (the Notes). The record date for the redemption is November 5, 2007. The Notes called for redemption will be redeemed at $380.12 Note issue price plus $4.62 call premium for a redemption price of $384.74 per $1,000 Note, plus accumulated and unpaid cash interest up to, but not including, November 30, 2007. We plan to net share settle any voluntary conversions that are presented before the November 30, 2007 redemption date. This transaction will result in a net reduction of up to 1.2 million shares, depending on the number of bonds converted and the average share price during the conversion period. The expected reduction to our diluted weighted average share calculation resulting from this transaction will have a minimal impact in 2007.

Off-Balance Sheet Arrangements

At September 30, 2007 and December 31, 2006, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or for other contractually narrow or limited purposes. As such, we are not exposed to any financing, liquidity, market, or credit risk that could arise if we had engaged in such relationships.

Contractual Obligations and Contingent Liabilities and Commitments

Our future cash payments associated with loss and loss expense reserves, and contractual obligations pursuant to operating leases for office space and equipment, senior convertible notes, convertible subordinated debentures and notes payable have not materially changed since December 31, 2006. We expect to have the capacity to repay and/or refinance these obligations as they come due.

At September 30, 2007, we had additional limited partnership investment commitments within Other investments of up to $151.9 million; but 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 19

of the Notes to Consolidated Financial Statements, included in Item 8. Financial Statements and Supplementary Data of Selective s 2006 Annual Report.

Table of Contents

Ratings

We are rated by major rating agencies, which provide opinions of our financial strength, operating performance, strategic position, and ability to meet policyholder obligations. We believe that our ability to write insurance business is most influenced by our rating from A.M. Best, which currently rates us A+ (Superior), their second highest of fifteen ratings, and has been our rating for 46 consecutive years. The financial strength reflected by our A.M. Best rating is a competitive advantage in the marketplace and influences where independent insurance agents place their business. A downgrade from A.M. Best, could: (i) affect our ability to write new business with customers and/or agents, some of whom are required (under various third party agreements) to maintain insurance with a carrier that maintains a specified A.M. Best minimum rating; (ii) be an event of default under our line of credit; or (iii) make it more expensive for us to access capital markets. In Third Quarter 2007, S&P s Insurance Rating Services (S&P) reaffirmed our financial strength rating of A+. S&P s reaffirmation cites our strong competitive position with close ties to our agents, strong operating performance, very strong operating company capitalization, and good financial flexibility. During Third Quarter 2006, Moody s elevated their outlook regarding Selective to positive. The financial strength of our insurance business has been rated, A2 by Moody s since 2001 and A+ by Fitch Ratings since 2004. Our Moody s and S&P financial strength ratings affect our ability to access capital markets, and our interest rate under our line of credit varies based upon Selective Insurance Group Inc. s debt ratings from Moody s and S&P. 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. We review our financial debt agreements for any potential rating triggers that could dictate a material change in terms if our credit ratings were to change.

Federal Income Taxes

Total federal income tax expense decreased by $3.0 million for Third Quarter 2007 to $9.6 million and $8.8 million for Nine Months 2007 to $33.4 million, compared to Third Quarter 2006 and Nine Months 2006. The decrease was primarily attributable to decreased pre-tax income from our Insurance Operations segment. The effective tax rate for Third Quarter 2007 was 20.5%, compared with 24.9% for Third Quarter 2006 and 23.3% for Nine Months 2007 compared to 26.0% for Nine Months 2006. Our effective tax rate differs from the federal corporate rate of 35% primarily as a result of tax-advantaged investment income.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in the information about market risk set forth in Selective s 2006 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 2007 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In the ordinary course of conducting business, Selective and its subsidiaries are named as defendants in various legal proceedings. Most of these proceedings are claims litigation involving Selective s 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. Selective accounts for such activity through the establishment of unpaid loss and loss adjustment expense reserves. Selective s management expects 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 Selective s consolidated financial condition, results of operations, or cash flows.

Selective s 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 state class actions seeking certification of a state or national class. Such putative class actions have alleged, for example, improper reimbursement of medical providers paid under workers compensation and personal and commercial automobile insurance policies. Selective s Insurance Subsidiaries are also from time-to-time involved 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. Selective believes that it has valid defenses to these cases, and settled one such case in Third Quarter 2007 that had been filed in Fulton County, Georgia, Fields, et al. v. Selective Insurance Company of South Carolina, et al. Selective s management expects that the ultimate liability, if any, with respect to such lawsuits, after consideration of provisions made for estimated losses, will not be material to Selective s 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 Selective s consolidated results of operations or cash flows in particular quarterly or annual periods.

Table of Contents

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

The following table provides information regarding Selective s purchases of its Common Stock in Third Quarter 2007:

Period	Total Number of Shares Purchased[1]	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Number of Shares that May Yet Be Purchased Under the Announced Program[2]
July 1 31, 2007	1,019	$ 26.88		4,000,000
August 1 31, 2007	124,631	20.92	116,400	3,883,600
September 1 30, 2007	368,124	20.58	364,300	3,519,300
Total	493,774	$ 20.68	480,700	

1 During Third Quarter 2007, 5,502 shares were purchased from employees in connection with the vesting of restricted stock and 7,572 shares were purchased from employees in connection with stock option exercises. These repurchases were made in connection with satisfying tax withholding obligations with respect to those employees. These shares were not purchased as part of the publicly announced program. The shares were purchased at the current market prices of Selective s Common Stock on the dates of the purchases.

2 On July 24, 2007, the Board of Directors authorized a new share repurchase program for up to 4 million shares, which expires on July 26, 2009. During Third Quarter 2007, 480,700 shares were repurchased, leaving 3,519,300 shares remaining to be purchased under the authorized program.

ITEM 6. EXHIBITS

(a) Exhibits:

Exhibit No.

* 10.1	Amendment No. 2 to the Selective Insurance Group, Inc. Stock Purchase Plan for Independent Insurance Agencies.
* 11	Statement Re: Computation of Per Share Earnings.
* 31.1	Rule 13a-14(a) Certification of the Chief Executive Officer of Selective Insurance Group, Inc. (Section 302 of the Sarbanes-Oxley Act of 2002).
* 31.2	Rule 13a-14(a) Certification of the Chief Financial Officer of Selective Insurance Group, Inc. (Section 302 of the Sarbanes-Oxley Act of 2002).
* 32.1	Certification of Chief Executive Officer of Selective Insurance Group, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
* 32.2	Certification of Chief Financial Officer of Selective Insurance Group, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed herewith

36

Table of Contents

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 — November 2, 2007

Gregory E. Murphy
Chairman of the Board, President and Chief Executive Officer

By: /s/ Dale A. Thatcher — November 2, 2007

Dale A. Thatcher
Executive Vice President, Chief Financial Officer and Treasurer

Table of Contents

EXHIBIT INDEX

Exhibit No.	
* 10.1	Amendment No. 2 to the Selective Insurance Group, Inc. Stock Purchase Plan for Independent Insurance Agencies.
* 11	Statement Re: Computation of Per Share Earnings.
* 31.1	Rule 13a-14(a) Certification of the Chief Executive Officer of Selective Insurance Group, Inc. (Section 302 of the Sarbanes-Oxley Act of 2002).
* 31.2	Rule 13a-14(a) Certification of the Chief Financial Officer of Selective Insurance Group, Inc. (Section 302 of the Sarbanes-Oxley Act of 2002).
* 32.1	Certification of Chief Executive Officer of Selective Insurance Group, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
* 32.2	Certification of Chief Financial Officer of Selective Insurance Group, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed herewith