

SAFETY INSURANCE GROUP INC  
Form DEF 14A  
April 13, 2005

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

**SCHEDULE 14A**

Proxy Statement Pursuant to Section 14(a) of  
the Securities Exchange Act of 1934 (Amendment No. )

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to §240.14a-12

**SAFETY INSURANCE GROUP, INC.**

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(Name of Registrant as Specified In Its Charter)

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(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
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Act

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**SAFETY INSURANCE GROUP, INC.**

**20 Custom House Street, Boston, Massachusetts 02110**

April 13, 2005

To Our Stockholders:

I am pleased to invite you to attend the 2005 Annual Meeting of Stockholders of Safety Insurance Group, Inc., which will be held at 10:00 a.m. on Friday, May 20, 2005, at the Company's headquarters, 20 Custom House Street, Boston, Massachusetts 02110.

The accompanying Notice of the Annual Meeting of Stockholders and Proxy Statement describe in detail the matters to be acted on at this year's Annual Meeting.

If you plan to attend the meeting, please bring a form of personal identification with you and, if you are acting as proxy for another stockholder, please bring written confirmation from the stockholder for whom you are acting as proxy.

Whether or not you expect to attend the meeting, please sign and return the enclosed Proxy Card in the envelope provided. Your cooperation will assure that your shares are voted and will also greatly assist our officers in preparing for the meeting. If you attend the meeting, you may withdraw any proxy previously given and vote your shares in person if you so desire.

Sincerely,

DAVID F. BRUSSARD  
President, Chief Executive Officer  
and Chairman of the Board

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**SAFETY INSURANCE GROUP, INC.**

**20 Custom House Street, Boston, Massachusetts 02110**

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**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS  
TO BE HELD MAY 20, 2005**

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April 13, 2005

To Our Stockholders:

The 2005 Annual Meeting of Stockholders of Safety Insurance Group, Inc. will be held on Friday, May 20, 2005 at 10:00 a.m. at the Company's headquarters, 20 Custom House Street, Boston, Massachusetts 02110. At this meeting you will be asked to consider and vote upon the following:

1. a proposal to elect two of the Company's directors to Class III with a term ending 2008; and
2. the transaction of such other business as may properly come before the meeting or any adjournment or adjournments thereof.

The Board of Directors has fixed April 4, 2005 as the Record Date for determining the stockholders of the Company entitled to notice of and to vote at the 2005 Annual Meeting and any adjournment thereof.

The Company's 2004 Annual Report to Stockholders is enclosed with the mailing of this Notice of Annual Meeting of Stockholders, Proxy Statement and Proxy Card.

We urge you to attend and to participate at the meeting, no matter how many shares you own. Even if you do not expect to attend the meeting personally, we urge you to please vote, and then sign, date and return the enclosed Proxy Card in the postpaid envelope provided.

By Order of the Board of Directors,

WILLIAM J. BEGLEY, JR.

*Vice President, Chief Financial Officer and Secretary*

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**SAFETY INSURANCE GROUP, INC.**

**20 Custom House Street, Boston, Massachusetts 02110**

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**PROXY STATEMENT  
FOR ANNUAL MEETING OF STOCKHOLDERS  
TO BE HELD MAY 20, 2005**

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**GENERAL INFORMATION**

This Proxy Statement is being furnished in connection with the solicitation of proxies on behalf of the Board of Directors (the "Board") of Safety Insurance Group, Inc. (the "Company") for the 2005 Annual Meeting of Stockholders to be held on May 20, 2005 at 10:00 a.m. at the Company's headquarters located at 20 Custom House Street, Boston, Massachusetts 02110 (the "2005 Annual Meeting").

The record date for determining stockholders entitled to vote at the 2005 Annual Meeting has been fixed at the close of business on April 4, 2005 (the "Record Date"). As of the Record Date, 15,643,101 shares of the Company's common stock, par value \$0.01 per share (the "Common Stock"), were outstanding and entitled to be voted. Every stockholder will be entitled to one vote for each share of Common Stock recorded in his or her name on the Company's books as of the Record Date. The Company mailed this Proxy Statement and the related form of proxy (the "Proxy") on or about April 13, 2005.

The shares of Common Stock represented by the enclosed Proxy will be voted as directed by the stockholder or, in the absence of such direction, in favor of the election of the nominees for director designated herein. The enclosed Proxy confers discretionary authority with respect to any other proposals that may properly be brought before the 2005 Annual Meeting. As of the date hereof, management is not aware of any other matters to be presented for action at the 2005 Annual Meeting. If any other matters properly come before the 2005 Annual Meeting, however, the Proxies solicited hereby will be voted in accordance with the recommendation of the Board.

So long as a quorum (a majority of issued and outstanding shares of Common Stock entitled to vote at the 2005 Annual Meeting) is present at the 2005 Annual Meeting either in person or by proxy, a plurality of the votes properly cast is required to elect the directors. Votes withheld from a director nominee, abstentions and broker non-votes (when a registered broker holding a customer's shares in the name of the broker has not received voting instructions on a matter from the customer and is barred from exercising discretionary authority to vote on the matter, which the broker indicates on the Proxy Card) will be treated as present at the 2005 Annual Meeting for the purpose of determining a quorum but will not be counted as votes cast.

Any stockholder giving a Proxy may revoke it at any time before it is exercised by delivering written notice thereof to the Secretary. Any stockholder attending the 2005 Annual Meeting may vote in person whether or not the stockholder has previously filed a Proxy. Presence at the 2005 Annual Meeting by a stockholder who has signed a Proxy, however, does not in itself revoke the Proxy.

The enclosed Proxy is being solicited by the Board. The cost of soliciting Proxies will be borne by the Company, and will consist primarily of preparing and mailing the Proxies and Proxy Statements. The Company will also request persons, firms and corporations holding shares of Common Stock in their names, or in the names of their nominees, which shares are beneficially owned by others, to send this Proxy material to and obtain Proxies from such beneficial owners and will reimburse such holders for their reasonable expenses in so doing.

The Company's Annual Report to Stockholders for the fiscal year ended December 31, 2004, including financial statements and the report of the Company's independent registered public accounting firm, PricewaterhouseCoopers LLP ("PwC"), thereon, accompanies this Proxy Statement. The Annual Report to Stockholders is neither a part of this Proxy Statement nor incorporated herein by reference.

**PROPOSAL 1****ELECTION OF THE COMPANY'S DIRECTORS**

The Board has five members and consists of three classes. Each class serves three years, with terms of office of the respective classes expiring in successive years.

Each of the two Directors whose term expires at this year's 2005 Annual Meeting, David F. Brussard and A. Richard Caputo, Jr., has been nominated for re-election to a three-year term ending at the 2008 Annual Meeting of Stockholders and until their successors, if any, are elected and duly qualified. The remaining three directors will continue to serve in accordance with their terms. **THE BOARD RECOMMENDS A VOTE FOR PROPOSAL 1 WHICH CALLS FOR THE ELECTION OF THE 2005 NOMINEES.**

<b>Director</b>	<b>Age</b>	<b>Director since</b>
<b>Initial Class III Term ending in 2008*</b>		
David F. Brussard, Chairman of the Board (4C)	53	2001
A. Richard Caputo, Jr. (4)	39	2001
<b>Class I Term ending in 2006</b>		
Peter J. Manning (1C)(2)(3)	66	2003
David K. McKown (1)(2C)(3)	67	2002
<b>Class II Term ending in 2007</b>		
Frederic H. Lindeberg (1)(2)(3C)	64	2004

\* Nominated at the 2005 Annual Meeting to a term ending in 2008.

(1) Member of the Audit Committee.

(2) Member of the Compensation Committee.

(3) Member of the Nominating and Governance Committee.

(4) Member of the Investment Committee.

(C) Chairman of the Committee referenced.

The following information with respect to the principal occupation, business experience, recent business activities involving the Company and other affiliations of the nominee and directors has been furnished to the Company by the nominees and directors.

**Nominees for Director**

*David F. Brussard* was appointed Chairman of the Board in March 2004 and President and Chief Executive Officer ("CEO") in June 2001. Mr. Brussard has served as a Director of the Company since October 2001. Since January 1999, Mr. Brussard has been the CEO and President of the Company's two insurance subsidiaries, Safety Insurance Company and Safety Indemnity Insurance Company (together referred to as the "Insurance Subsidiaries"). Previously, Mr. Brussard served as Executive Vice President of the Insurance Subsidiaries from 1985 to 1999 and as Chief Financial Officer and Treasurer of the Insurance Subsidiaries from 1979 to 1999. Mr. Brussard has been employed by one or more of our subsidiaries for over 29 years. Mr. Brussard is also Chairman of the governing committee, and a member of the budget committee, executive committee and nominating committee of the Automobile Insurers Bureau and is Vice Chairman of the Governing Committee, Chairman of the Governing Committee Review Panel, and a member of the Actuarial Committee of Commonwealth Automobile Reinsurers. Mr. Brussard is also on the Board of Trustees of the Insurance Library Association of Boston.





*A. Richard Caputo, Jr.* has served as a director of the Company since June 2001. Mr. Caputo is a Senior Principal and was a Managing Director of The Jordan Company L.P. and its predecessors, a private investment firm, since 1990. Mr. Caputo is also a director of TAL International, Inc., Universal Technical Institute, Inc. and various privately held companies.

#### **Directors Continuing in Office**

*Frederic H. Lindeberg* has served as a director of the Company since August 2004. Mr. Lindeberg has had a consulting practice providing taxation, management and investment counsel since 1991, focusing on finance, real estate, manufacturing and retail industries. Mr. Lindeberg retired in 1991 as Partner-In-Charge of various KPMG tax offices, after 24 years of service where he provided both accounting and tax counsel to various clients. Mr. Lindeberg was formerly an adjunct professor at Penn State Graduate School of Business. Mr. Lindeberg is currently a trustee of Provident Senior Living Trust.

*Peter J. Manning* has served as a director of the Company since September 2003. Mr. Manning retired in 2003 as Vice Chairman of FleetBoston Financial, after thirty-one years with FleetBoston Financial Corporation (formerly BankBoston) where he also held the positions of Comptroller and Executive Vice President and Chief Financial Officer. Mr. Manning started his career with Coopers & Lybrand in 1962 prior to his 1972 employment with BankBoston. He currently is a director of Thermo Electron, Papa Gino's, and various non-profit companies and is Chairman of the Board of the Tournament Players Club of Boston.

*David K. McKown* has served as director of the Company since November 2002. Mr. McKown has been a Senior Advisor to Eaton Vance Management since 2000, focusing on business origination in real estate and asset-based loans. Mr. McKown retired in March 2000 having served as a Group Executive with BankBoston since 1993, where he focused on acquisitions and high-yield bank debt financings. Mr. McKown has been in the banking industry for 41 years, worked for BankBoston for over 32 years and had previously been the head of BankBoston's real estate department, corporate finance department, and a managing director of BankBoston's private equity unit. Mr. McKown is currently a trustee of Equity Office Properties Trust, and a director of Newcastle Investment Corp. and various privately held companies.

#### **Certain Information Regarding the Board of Directors**

##### *Meetings of the Board of Directors*

During 2004, the following meetings of the Board were held: four meetings of the Board, six meetings of the Audit Committee, two meetings of the Compensation Committee, two meetings of the Nominating and Governance Committee and four meetings of the Investment Committee. All of the incumbent Directors attended at least 75% of the Board and committee meetings held while they were members during 2004.

##### *Board Committees*

The Board has determined that Frederic H. Lindeberg, Peter J. Manning and David K. McKown are "independent directors" as determined pursuant to the Marketplace Rules promulgated by the National Association of Securities Dealers, Inc. and the rules and regulations of the U.S. Securities and Exchange Commission (the "SEC").

The Audit Committee is comprised of Peter J. Manning (Chairman), Frederic H. Lindeberg and David K. McKown (the "Audit Committee"). The Board has determined that Peter J. Manning is an Audit Committee financial expert, as established by the rules and regulations of the SEC. For information regarding the functions performed by the Audit Committee, please refer to the "Report of

the Audit Committee" included on page 6 of this Proxy Statement, as well as the Charter of the Audit Committee, attached hereto in Appendix A to this Proxy Statement.

The Compensation Committee is comprised of David K. McKown (Chairman), Frederic H. Lindeberg and Peter J. Manning (the "Compensation Committee"). For information regarding the functions performed by the Compensation Committee, please refer to the "Report of the Compensation Committee" included on page 7 of this Proxy Statement, as well as the Charter of the Compensation Committee, attached hereto in Appendix B to this Proxy Statement.

The Nominating and Governance Committee is comprised of Frederic H. Lindeberg (Chairman), Peter J. Manning and David K. McKown (the "Nominating and Governance Committee"). For information regarding the functions performed by the Nominating and Governance Committee, please refer to the Charter of the Nominating and Governance Committee, attached hereto in Appendix C to this Proxy Statement.

The Investment Committee is comprised of David F. Brussard (Chairman), William J. Begley, Jr., the Company's Chief Financial Officer ("CFO") and A. Richard Caputo, Jr. (the "Investment Committee"). The Investment Committee reviews and evaluates, as may be appropriate, information relating to the Company's invested assets, its investment policies, strategies, objectives and activities.

#### *Board Compensation*

The Company's Bylaws provide that at the discretion of the Board, the directors may be paid their expenses, if any, at each meeting of the Board and may be paid a fixed sum for attendance at each meeting of the Board or a stated salary as a director. Since the Company completed its initial public offering of Common Stock on November 27, 2002 ("IPO") and until January 1, 2004, directors who are employees of the Company did not receive any compensation for serving as directors and those directors who are not employees of the Company received an annual retainer of \$20,000 per year and the Chairman of the Audit Committee received an additional \$10,000 per year, paid in quarterly installments. In addition, in consideration for serving as a director, Mr. Lindeberg, Mr. Manning and Mr. McKown each received a grant of options to purchase 10,000 shares of Common Stock. On April 14, 2004, our Board approved, upon the recommendation of the Compensation Committee, an increase to annual directors fees from \$20,000 to \$35,000 annually per non-management director, plus an additional \$10,000 annually to the Chairman of the Audit Committee to be paid quarterly retroactively effective on January 1, 2004. On March 14, 2005, the Compensation Committee approved a grant of 1,000 shares of restricted stock to each of our non-employee directors effective on March 16, 2005.

#### **Nominating and Governance Committee Policies**

Pursuant to the Charter of the Nominating and Governance Committee, attached hereto in Appendix C to this Proxy Statement, the Nominating and Governance Committee has developed the following policies and procedures relating to the nomination process for directors of the Company and the means by which stockholders may communicate with the Board:

#### *Stockholder Recommendations for Director-Nominees*

The Nominating and Governance Committee will consider recommendations from stockholders as to candidates to be nominated for election to the Board. A stockholder wishing to submit such a recommendation should send a letter to the Secretary of the Company at Safety Insurance Group, Inc., 20 Custom House Street, Boston, Massachusetts 02110, who will forward such recommendations to the Chairman of the Nominating and Governance Committee. Recommendations must be in writing and should include the candidate's name and qualifications for Board membership. This policy is not intended to replace the provisions in the Company's Bylaws related to stockholder nominations for

director, but rather addresses the Nominating and Governance Committee's position on recommendations from stockholders for potential director-nominees. Stockholders wishing to nominate persons for director must comply with Company's Bylaws and any applicable rules of the SEC.

*Director Nominee Evaluation Process*

The Nominating and Governance Committee intends to utilize a variety of methods for identifying and evaluating nominees for director. The Nominating and Governance Committee will regularly assess the appropriate size of the Board, and whether any vacancies are expected due to retirement or otherwise. In the event that vacancies arise, the Nominating and Governance Committee will consider various potential candidates for director. Candidates may come to the attention of the Nominating and Governance Committee through current Board members, professional search firms, stockholders or other persons. In evaluating candidates, the Nominating and Governance Committee seeks to achieve a balance of knowledge, experience and capability on the Board.

*Stockholder Communications to the Board*

Stockholders may communicate directly with any member of the Board or the entire Board by sending correspondence to the Office of Investor Relations, Safety Insurance Group, Inc., 20 Custom House Street, Boston Massachusetts 02110, or emailing [InvestorRelations@SafetyInsurance.com](mailto:InvestorRelations@SafetyInsurance.com). Any such correspondence must contain a clear notation indicating that it is a "Stockholder-Director Communication," and must indicate whether the intended recipients are all members of the Board or certain specified individual directors. The Office of Investor Relations will make copies of all such correspondence and circulate them to the appropriate director or directors.

*Director Attendance at Annual Meetings*

Directors are encouraged but not required to attend the Company's Annual Meetings. One director attended last year's Annual Meeting.

*Minimum Qualifications for Directors*

In addition to the preceding policies and procedures adopted by the Nominating and Governance Committee at the direction of the Board, the Board and Nominating and Governance Committee continue to evaluate their position on establishing minimum qualifications for directors. The Board seeks members with diverse business and professional backgrounds and outstanding integrity, judgment and such other skills and experiences as will enhance the Board's ability to best serve the interest of the Company. The Board has not approved any criteria for nominees for director and believes that establishing such criteria is best left to an evaluation of the needs of the Company at the time the nomination is to be considered. Similarly, the Nominating and Governance Committee has not identified specific, minimum qualifications for director nominees or any specific qualities or skills that it believes are necessary for one or more of the Company's directors to possess.

**REPORT OF THE AUDIT COMMITTEE**

The primary purpose of the Audit Committee is to assist the Board in its general oversight of the Company's accounting and financial reporting process, and is more fully described in its charter which the Board and the Audit Committee have adopted and is included as Appendix A to this Proxy Statement.

Each member of the Audit Committee satisfies the definition of an "independent director" as established by Rule 4200 of the Marketplace Rules promulgated by the National Association of Securities Dealers, Inc.

Management is responsible for the Company's internal controls and the accounting and financial reporting process. PwC is responsible for performing an independent audit of the Company's consolidated financial statements in accordance with auditing standards generally accepted in the United States of America and to issue an opinion thereon. In addition, PwC is responsible for expressing opinions on the effectiveness of the Company's internal control over financial reporting and on management's assessment thereon. The Audit Committee's responsibility is to monitor and oversee these processes.

In connection with the audit of the Company's consolidated financial statements for the year ended December 31, 2004, the Audit Committee has:

reviewed and discussed the audited consolidated financial statements with management;

discussed with the independent auditors the matters required to be discussed by Statement on Auditing Standards No. 61, *Communications with Audit Committees*, as amended; and

received the written disclosures and the letter from the independent auditors required by Independence Standards Board Standard No. 1, *Independence Discussions with Audit Committees*, as amended, and has discussed with the independent auditors their independence.

Based on the review and discussions referred to above, the Audit Committee recommended to the Board that the audited consolidated financial statements be included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004 and be filed with the SEC.

March 10, 2005

Respectfully submitted,

PETER J. MANNING, CHAIRMAN  
FREDERIC H. LINDBERG  
DAVID K. MCKOWN

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**REPORT OF THE COMPENSATION COMMITTEE**

The primary purpose of the Compensation Committee is to establish and review the Company's compensation practices and policies, make recommendations concerning salaries and incentive compensation for the Company's employees and administer the Company's stock plans, and is more fully described in its charter which the Board and the Compensation Committee have adopted and is included as Appendix B to this Proxy Statement.

Each member of the Compensation Committee satisfies the definition of an "independent director" as established by Rule 4200 of the Marketplace Rules promulgated by the National Association of Securities Dealers, Inc.

The Company's compensation program objective is to attract and retain individuals key to the future success of the Company, to motivate and reward employees in achieving the Company's business goals and to align the long-term interests of employees with those of stockholders.

The principal components of the Company's compensation program are base salary, performance-based annual incentive compensation and long-term incentive compensation. Annual base salaries of the Company's CEO and four most highly compensated executive officers (the "Named Executive Officers") and other key executives are set at levels considered to be competitive with amounts paid to executive officers with comparable qualifications, experience and responsibilities at competing companies, based on published surveys, proxy and other information. The 2004 base salaries for the Named Executive Officers, including the Company's CEO, increased from their 2003 base salaries based upon the recommendations of an independent compensation consultant hired by the Compensation Committee. The Company's executive incentive compensation plan is a non-qualified deferred compensation plan (the "Executive Plan"), which provides annual bonuses to key employees who contribute materially to the success of the Company. During 2004, annual incentive compensation under this plan was tied to the achievement of significant individual performance goals. Long-term incentive compensation is provided under the Company's 2002 Management Omnibus Incentive Plan (the "Incentive Plan"), which provides for a variety of stock-based compensation awards including nonqualified stock options, incentive stock options, stock appreciation rights ("SARs") and restricted stock awards intended to attract, retain and motivate selected officers, key employees, directors and consultants to provide superior performance over a longer period of time as well as encourage stock ownership of the Company. A factor considered in determining the grant of awards under the Incentive Plan is the contribution of each employee to the long-term performance of the Company.

In approving the 2004 compensation package for the Company's CEO, Mr. Brussard, the Compensation Committee and the independent compensation consultant compared Mr. Brussard's compensation against the comparative base salaries, annual and long-term incentives and other compensation of chief executives of a peer group of public property and casualty insurance companies of similar size. This review also included, but was not limited to, an assessment of the performance of the Company and its subsidiaries in terms of profitability and growth, an evaluation of its capital position and the implementation of significant cost controls and other initiatives. Mr. Brussard's base salary and potential for incentive compensation as a percentage of base salary were within the median market range. To further align Mr. Brussard's interests with those of the Company's stockholders, and as an incentive for future performance goals, the Compensation Committee approved the grant of 31,081 shares of restricted stock to Mr. Brussard on March 25, 2004 pursuant to the Incentive Plan.

The Compensation Committee will continue during 2005 to carefully consider employee compensation, and the components thereof, in relation to the Company's performance compared to that of industry performance levels for comparable companies and the performance history of the Company itself.

March 11, 2005

Respectfully submitted,

DAVID K. MCKOWN, CHAIRMAN  
FREDERIC H. LINDBERG  
PETER J. MANNING

## SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information as of April 4, 2005 with respect to the beneficial ownership of shares of Common Stock by the following individuals: (a) each person who is known to the Company to be the beneficial owner of more than 5% of the outstanding shares of such stock; (b) each of the Company's directors and director nominees; (c) each of the Company's Named Executive Officers; and (d) all of the Company's directors, director nominees and executive officers as a group. Except as stated below, each holder listed below has sole or shared investment and/or voting power with respect to the shares of Common Stock beneficially owned by the holder, subject to community property laws where applicable. The information in the table and the related notes has been furnished by or on behalf of the indicated owners.

Name and address of beneficial owner	Amount of shares beneficially owned	Percentage of class (%) <sup>(6)</sup>
<b>(a) Security ownership of certain beneficial owners:</b>		
Fairholme Partners, L.P. (1) 51 JFK Parkway Short Hills, NJ 07078	1,238,649	7.9%
JZ Equity Partners plc (2) 17a Curzon Street London, England W1J 5HS	1,984,004	12.6%
Gilder, Gagnon, Howe & Co. LLC (3) 1775 Broadway, 26 <sup>th</sup> Floor New York, NY 10019-1995	2,087,403	13.3%
<b>(b) Security ownership of directors and director nominees:</b>		
David F. Brussard (4)*	660,236	4.2%
A. Richard Caputo, Jr.(5)*	303,027	1.9%
Frederic H. Lindeberg	4,287	0.0%
Peter J. Manning (4)	3,000	0.0%
David K. McKown (4)	5,000	0.0%
<b>(c) Security ownership of Named Executive Officers:</b>		
David F. Brussard (4)	660,236	4.2%
William J. Begley, Jr. (4)	127,818	0.8%
Daniel F. Crimmins (4)	136,821	0.9%
Daniel D. Loranger	305,076	1.9%
Edward N. Patrick, Jr. (4)	247,998	1.6%
<b>(d) All directors, director nominees and executive officers as a group (11 persons)(4)</b>	<b>2,069,917</b>	<b>13.2%</b>

\*  
Nominee for director.

(1) The general partner of Fairholme Partners, L.P. is Fairholme Capital Management L.L.C., which may be deemed a beneficial owner of Common Stock owned by Fairholme Partners, L.P.

(2) JZ Equity Partners PLC is an investment trust listed on the London Stock Exchange. Its business is to invest, primarily in the United States, in debt and equity securities recommended by Jordan/Zalanick Advisors, Inc., a Delaware corporation, based in New York, that is its sole investment advisor. The Jordan Company L.P. is an affiliate of Jordan/Zalanick Advisors, Inc. JZ Equity Partners PLC is governed by a board of independent directors.

(3) Based on Schedule 13G, dated February 14, 2005, filed by Gilder, Gagnon, Howe & Co. LLC, which states sole voting power over 17,700 shares and shared dispositive power over all 2,087,403 shares.

(4) The table includes the following shares that each individual or group of beneficial owners has the right to acquire through the exercise of vested options: Mr. Brussard 37,358 shares; Mr. Manning 2,000 shares; Mr. McKown 4,000 shares;



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Mr. Begley 9,135 shares; Mr. Crimmins 18,462 shares; Mr. Patrick 9,135 shares; and all directors, director nominees and executive officers as a group 83,033 shares.

- (5) Mr. Caputo is a Senior Principal of The Jordan Company L.P., the private investment firm that sponsored management's buyout of the Company in October 2001. For further discussion of this buyout (the "Acquisition"), see "Certain Relationships and Related Transactions."
- (6) Percentages based upon 15,726,134 shares beneficially owned comprised of 15,643,101 shares of Common Stock outstanding and eligible to vote on the Record Date and 83,033 shares of Common Stock all directors, director nominees and executive officers have the right to acquire through the exercise of vested options.

### **SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's directors, executive officers and persons who own more than ten percent of the Common Stock to file with the SEC initial reports of ownership and reports of changes in ownership of the Common Stock and other equity securities of the Company, if any. Executive officers, directors and greater than ten percent beneficial owners are required to furnish the Company with copies of all Section 16(a) forms they file.

To the Company's knowledge, based solely on the Company's review of the copies of such reports furnished to the Company during the fiscal year ended December 31, 2004, all Section 16(a) filing requirements applicable to its executive officers, directors and greater than ten percent beneficial owners were complied with.



## EXECUTIVE COMPENSATION AND OTHER TRANSACTIONS

## Summary Compensation Table

The following table sets forth all plan and non-plan compensation awarded to, earned by or paid to the Company's CEO and the other Named Executive Officers at the end of fiscal year December 31, 2004.

Name and Principal Position	Year	Annual Compensation			Long-Term Compensation Awards		
		Salary (\$)	Bonus (\$)	Other Annual Compensation (\$)(1)	Restricted Stock Award (\$)(2)	Securities Underlying Options (#)	All Other Compensation (\$)(3)
David F. Brussard	2004	\$ 675,000	\$ 770,000	\$	\$ 575,000		\$ 315,552
President, CEO and	2003	\$ 535,052	\$ 476,395	\$	\$	124,525	\$ 243,472
Chairman of the Board	2002	\$ 513,338	\$ 391,933	\$ 186,518	\$	166,050	\$ 162,394
William J. Begley, Jr.	2004	\$ 250,000	\$ 227,000	\$	\$ 140,000		\$ 106,277
Vice President, CFO	2003	\$ 156,000	\$ 139,403	\$	\$	30,450	\$ 58,964
and Secretary	2002	\$ 148,088	\$ 101,188	\$ 34,371	\$	36,900	\$ 53,573
Daniel F. Crimmins	2004	\$ 245,000	\$ 223,000	\$	\$ 140,000		\$ 123,629
Vice President	2003	\$ 174,000	\$ 165,466	\$	\$	41,860	\$ 73,775
	2002	\$ 166,927	\$ 112,630	\$ 50,652	\$	29,520	\$ 55,289
Daniel D. Loranger	2004	\$ 330,000	\$ 300,000	\$	\$ 225,000		\$ 162,344
Vice President	2003	\$ 252,580	\$ 222,665	\$	\$	58,175	\$ 97,934
	2002	\$ 242,314	\$ 157,220	\$ 93,211	\$	55,350	\$ 64,181
Edward N. Patrick, Jr.	2004	\$ 290,000	\$ 264,000	\$	\$ 140,000		\$ 125,277
Vice President	2003	\$ 241,354	\$ 151,829	\$	\$	30,450	\$ 88,178
	2002	\$ 231,545	\$ 136,051	\$ 72,360	\$	36,900	\$ 57,587

- (1) The amounts shown in 2002 reflect the value of SARs earned and paid during 2002, which became fully vested and were automatically exercised at the close of the Company's initial public offering on November 27, 2002 ("IPO"). The number of securities underlying these SARs granted in 2001 to Mr. Brussard, Mr. Begley, Mr. Crimmins, Mr. Loranger and Mr. Patrick was 36,463 shares, 6,719 shares, 9,902 shares, 18,222 shares and 14,146 shares, respectively.
- (2) The amounts shown in 2004 represent the value of Restricted Stock awards under the Incentive Plan, at the closing stock price on the effective date of the grants. These Restricted Stock awards vest over three years in installments of 30%, 30% and 40% annually from the effective date of grant based on continuous service by the employee throughout such period. The shares underlying the Restricted Stock awards are considered outstanding common stock when awarded and as such are entitled to voting and dividend rights. In March 2004 the Company awarded Mr. Brussard 31,081 shares of restricted stock; Mr. Begley 7,568 shares of restricted stock; Mr. Crimmins 7,568 shares of restricted stock; Mr. Loranger 12,162 shares of restricted stock; and Mr. Patrick 7,568 shares of Restricted Stock. The market value at December 31, 2004 of Mr. Brussard's, Mr. Begley's, Mr. Crimmins's, Mr. Loranger's and Mr. Patrick's unvested restricted stock was \$973,768, \$237,105, \$237,105, \$381,035 and \$237,105, respectively.
- (3) The 2004 amounts under "All Other Compensation" consist of (A) an annual bonus earned in 2004 and allocated to the executive's account under the Executive Plan (Mr. Brussard \$267,402; Mr. Begley \$90,244; Mr. Crimmins \$97,800; Mr. Loranger \$130,233; and Mr. Patrick \$103,005); (B) employer matching contributions paid in 2004 to the Safety Insurance Company 401(k) qualified defined contribution retirement plan (the "Retirement Plan") on behalf of each Named Executive Officer (\$12,000 to each Named Executive Officer); (C) employer matching contributions paid in 2004 to the Executive Plan on behalf of three of the Named Executive Officers (Mr. Brussard \$28,500, Mr. Loranger \$3,609, and Mr. Patrick \$5,400); (D) term life insurance premiums (Mr. Brussard \$2,650, Mr. Begley \$2,033, Mr. Crimmins \$11,829, Mr. Loranger \$14,502, and Mr. Patrick \$2,872); and (E) a holiday gift paid in 2004 (\$2,000 to each Named Executive Officer except \$5,000 to Mr. Brussard).

**Aggregated Option Exercises in 2004 and December 31, 2004 Option Values**

The following table sets forth information with respect to each Named Executive Officer concerning the shares acquired and value realized upon exercise of options during 2004 and the number and value of options held as of December 31, 2004.

Name	Shares Acquired on Exercise (#)	Value Realized (\$)	Number of Securities Underlying Unexercised Options at December 31, 2004 (#)(1)		Value of Unexercised In-the-Money Options at December 31, 2004 \$(2)	
			Exercisable	Unexercisable	Exercisable	Unexercisable
David F. Brussard	64,468	\$ 614,136	39,310	186,797	\$ 753,579	\$ 3,521,004
William J. Begley, Jr.	16,515	\$ 124,381	7,380	43,455	\$ 142,655	\$ 818,031
Daniel F. Crimmins	18,462	\$ 163,938	0	52,918	\$ 0	\$ 992,724
Daniel D. Loranger	39,593	\$ 449,160	0	73,932	\$ 0	\$ 1,387,162
Edward N. Patrick, Jr.	16,515	\$ 145,038	7,380	43,455	\$ 142,655	\$ 818,031

- (1) The options were granted in 2003 and 2002 under the Incentive Plan. No options were granted during 2004. The 2003 options have ten-year terms and vest in three annual installments of 30%, 30% and 40%. The 2002 options have ten-year terms and vest in five equal installments beginning on the first anniversary of their November 27, 2002 grant date. The exercisable options are from both the 2003 and 2002 grants.
- (2) The dollar amounts set forth under these columns are the result of calculations based on the difference between the option exercise prices (\$13.03 for the 2003 grant and \$12.00 for the 2002 grant) and the \$31.33 closing price per share of the Common Stock on December 31, 2004.

**Employment-Related Agreements**

The Company has entered into certain agreements with the Named Executive Officers and with a number of other key executives.

*David F. Brussard.* Under his employment agreement with the Company, Mr. Brussard has agreed to serve as CEO and President of the Company for a five-year term ending December 31, 2009, which automatically renews for successive one-year terms thereafter, subject to at least 180 days' advance notice by either party of a decision not to renew the employment agreement. Under the terms of the employment agreement effective November 8, 2004, Mr. Brussard is entitled to receive an initial annual base salary of \$675,000, to be increased on an annual basis to reflect increases in the cost of living index specified therein or as otherwise determined by the Board or the Compensation Committee. As determined in the sole discretion of the Board, Mr. Brussard will also be paid an annual bonus of not less than 35% of the total amount of bonuses paid in such year to officers of the Company who, on November 8, 2004, held positions entitled Vice President or higher. In addition, Mr. Brussard was paid a transaction bonus of \$217,863 on March 31, 2002 and was paid a transaction bonus of \$200,000 on March 31, 2003 as a result of the consummation of the Acquisition (for further discussion relating to the Acquisition, see "Certain Relationships and Related Transactions"). Mr. Brussard is also entitled to certain perquisites, including reimbursement of expenses, paid vacations, health, life and other similar insurance benefits and a car, all as determined by the Board.

*Other Named Executive Officers.* On November 8, 2004, the Company entered into employment contracts with each of Mr. Begley, Mr. Crimmins, Mr. Loranger and Mr. Patrick. Each of these employment agreements has a term ending December 31, 2007 and automatically renews for successive one-year terms unless either party provides written notice not to renew at least 180 days prior to the scheduled expiration date.

Under their respective employment agreements effective on November 8, 2004, Messrs. Begley, Crimmins, Loranger and Patrick are entitled to receive initial annual base salaries of \$250,000, \$245,000, \$330,000, and \$290,000, respectively, to be increased on an annual basis to reflect increases in the cost of living index specified therein or as otherwise determined by the Board or the Compensation Committee. As determined in the sole discretion of the Board or the Compensation Committee, Messrs. Begley, Crimmins, Loranger and Patrick are paid an annual bonus based on both the Company's and their performance. In addition, Messrs. Begley, Crimmins, Loranger and Patrick were paid transaction bonuses of \$39,644, \$53,699, \$80,634 and \$80,634, respectively, on March 31, 2002 as a result of the consummation of the Acquisition, and are also entitled to certain perquisites, including reimbursement of expenses, paid vacations, health, life and other similar insurance benefits. Mr. Crimmins will also be provided the use of a car of such make and model and upon such terms and conditions as the Board shall determine.

*Provisions Common to Each Named Executive Officer's Employment Agreement.* Certain provisions are common to each of the Named Executive Officers' employment agreements. These common provisions include, among other things, the following:

if the executive's employment is terminated by the Company for a reason other than cause, death, disability or continuous poor performance, or is terminated by the executive for good reason or as a result of the Company's willful and material violation of the executive's employment agreement or certain other agreements between the executive and the Company, then the Company must provide (i) any earned but unpaid base salary and bonus, (ii) a lump sum payment equal to the annual salary he would have received during the remaining term of his employment agreement; and (iii) other customary benefits through the remaining portion of the term of his employment agreement (collectively, the "Severance Payment");

if the executive's employment is terminated by the Company for a reason other than cause, death, disability or continuous poor performance, or is terminated by the executive for good reason or as a result of the Company's willful and material violation of the executive's employment agreement or certain other agreements between the executive and the Company, in each case, within three years after a change of control, then the Company must provide the greater of the Severance Payment or the following: (i) any earned but unpaid base salary and bonus, (ii) a lump sum payment equal to, for the CEO and CFO, three times, and for the remaining Named Executive Officers, two times, the sum of (1) the executive's base salary in effect immediately prior to the date of termination and (2) the most recent annual bonus paid to the executive, and (iii) other customary benefits for a three-year period after the date of termination (for the CEO and CFO) and for the two-year period after the date of termination (for the remaining Named Executive Officers);

the agreements provide for excise tax gross-up payments that reimburse the executives for any excise taxes they may incur under Section 4999 of the Internal Revenue Code;

the agreements contain non-competition and non-solicitation provisions; and

each executive has agreed not to disclose confidential information of the Company.

#### **Executive Incentive Compensation Plan**

The Company established its Executive Plan so that it and related companies may provide executive and management employees selected by the Board, including the Named Executive Officers, with an opportunity to build additional financial security, thereby attracting and retaining key employees. All of the Named Executive Officers are eligible for this plan. Under this plan, an annual allocation amount is made to a bonus pool as of the last day of each calendar year, beginning with calendar year 2002 and ending with the calendar year before the calendar year in which a change of

control occurs. The annual allocation amount for each year is based on a percentage of the combined statutory net income of the Insurance Subsidiaries.

At the end of each calendar year, the Board reviews the performance of eligible individuals, and in its sole discretion, allocates the entire amount in the bonus pool among such eligible individuals. The portion of the bonus pool allocated to an eligible individual is credited to an account established for the individual. The balance of an individual's account is distributed in a lump sum as soon as practicable after the first day on which the individual is no longer employed by the Company or any related company, regardless of the reason for termination of employment. The plan may be amended or terminated by the Board at any time, provided that no amendment or termination may materially adversely affect the rights of any participant with respect to the calendar years ended prior to the date on which such amendment or termination is adopted by the Board.

The Named Executive Officers earned the third annual bonus in 2004 under the Executive Plan in an aggregate amount of \$688,684, consisting of Messrs. Brussard, Begley, Crimmins, Loranger and Patrick who earned \$267,402, \$90,244, \$97,800, \$130,233 and \$103,005, respectively.

On August 21, 2003, our Board approved an amendment to the Executive Plan to provide a deferred compensation benefit with a supplemental matching provision that mirrors the Retirement Plan. In accordance with this amendment, the Company made a matching contribution in an amount equal to 75% of the participant's elective deferrals under the plan up to a maximum of 8% of the participant's compensation during the plan year. Amounts deferred under the Executive Plan do not include amounts deferred under the Retirement Plan, thus the Company's matching contributions under the Executive Plan do not include amounts the Company has matched under the Retirement Plan in any given year. As such, the Company paid employer matching contributions for 2004 to the Executive Plan on behalf of three of the Named Executive Officers (Mr. Brussard \$28,500, Mr. Loranger \$3,609 and Mr. Patrick \$5,400).

On March 15, 2005, this provision was amended to provide that the participant's compensation for this purpose means the participant's base salary and annual bonus received (or deferred) in the plan year. This amendment, however, did not and will not affect the Company's matching contributions in either 2004 or 2005.

## **2002 Management Omnibus Incentive Plan**

Our Board has adopted the Incentive Plan to attract, retain and motivate selected officers, key employees, directors and consultants of the Company through the granting of stock-based compensation awards. The Incentive Plan provides for a variety of awards, including nonqualified stock options, incentive stock options (within the meaning of Section 422 of the Internal Revenue Code), SARs and restricted stock awards. The maximum number of shares of Common Stock with respect to which awards may be granted under the Incentive Plan is 1,250,000 after adjustment for the stock dividend declared in connection with the IPO. This share limitation and the per-share price of such shares are subject to adjustment to reflect stock splits, stock dividends and changes in the Company's capital structure. Shares of stock covered by an award under the Incentive Plan that are forfeited will again be available for issuance in connection with future grants of awards under the plan.

The Compensation Committee of the Board has broad authority to administer the Incentive Plan, including the authority to select plan participants, determine when awards will be made, determine the type and amount of awards, determine the exercise price of options and SARs, determine any limitations, restrictions or conditions applicable to each award, determine the terms of any instrument that evidences an award, determine the manner in which awards may be exercised and interpret the Incentive Plan's provisions. Option awards under the Incentive Plan are generally granted for a ten-year term, but may terminate earlier if the participant's employment terminates before the end of such term. The exercise price for each option granted under the Incentive Plan will be the fair market value of a

share of Common Stock on the effective date of the grant. The exercise price of options granted under the Incentive Plan may be paid (i) in cash, (ii) by delivery of previously-acquired shares of Common Stock, (iii) by any combination of (i) and (ii), (iv) pursuant to a cashless exercise program through an independent broker (as permitted by applicable law), or (v) by any other means the committee approves, in its discretion.

If, while any award granted under the Incentive Plan remains outstanding, a change of control of the Company occurs, then all stock options and SARs outstanding at the time of the change of control will become exercisable in full immediately prior to the change of control and all restrictions with respect to restricted stock awards settled by a payment in cash or shares (at the Compensation Committee's discretion) to each holder.

The Incentive Plan may be suspended, amended or terminated at any time by the Board, including amending any form of award agreement or instrument to be executed pursuant to the Incentive Plan. However, no amendment or termination of the Incentive Plan may, without the affected individual's consent, alter or impair any rights or obligations under any award previously granted under the Incentive Plan.

The Compensation Committee administers the Incentive Plan and determines the terms of awards granted, including the exercise price, the number of shares subject to individual awards and the vesting period of awards. In the case of options intended to qualify as "performance-based compensation" within the meaning of Section 162(m) of the Internal Revenue Code granted under the Incentive Plan, the Compensation Committee will consist of two or more "outside directors" within the meaning of Section 162(m). In addition, before such performance-based compensation is paid, the material terms of the Company's Incentive Plan will be presented to and approved by a majority vote of the Company's stockholders.

On March 9, 2004, the Compensation Committee approved the grant of options to purchase 111,000 shares of Common Stock at the \$18.50 per share closing price of the stock on the grant date to a 53-member group of the Company's employees. These grants were effective on March 25, 2004, have a ten-year term and vest in five equal annual installments beginning on the first anniversary date of these grants.

On March 9, 2004, the Compensation Committee approved the grant of 70,271 shares of restricted stock to the Company's seven member executive management team, comprised of the five Named Executive Officers, Robert J. Kerton and David E. Krupa (the "Management Team"). These awards of restricted stock were made to each of the Named Executive Officers to purchase the following number of shares of Common Stock: 31,081 to Mr. Brussard, 7,568 to Mr. Begley, 7,568 to Mr. Crimmins, 12,162 to Mr. Loranger and 7,568 to Mr. Patrick. These awards were effective on March 25, 2004 and the right to sell or transfer the shares underlying the Restricted Stock awards vests in three annual installments of 30%, 30% and 40% beginning on the first anniversary of the effective date of these awards.

On August 30, 2004, the Compensation Committee approved the grant of options to purchase 10,000 shares of Common Stock at the \$21.40 per share closing price of the stock on the grant date to one of the Company's directors. This grant was effective on the August 30, 2004 grant date, has a ten year term and vests in five equal annual installments beginning on the first anniversary date of this grant.

*Equity Compensation Plan Information*

The following table sets forth information regarding all of the Company's equity compensation plans as of December 31, 2004.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders (1)	711,410	\$ 13.60	298,529
Equity compensation plans not approved by security holders	N/A	N/A	N/A
<b>Total</b>	<b>711,410</b>	<b>\$ 13.60</b>	<b>298,529</b>

(1)

This information pertains to grants made under our Incentive Plan. This plan was approved by our security holders and our Board and was effective prior to the November 27, 2002 date of our IPO. For more detailed information on this plan, see the narrative information above the table and refer to Note 6, Employee Benefit Plans Management Omnibus Incentive Plan in our December 31, 2004 audited financial statements in our Form 10-K filed with the SEC on March 16, 2005.

**Safety Insurance 401(k) Retirement Plan**

Effective January 1, 2002, the Company re-established the Retirement Plan. The Retirement Plan is available to all eligible employees of the Company. An employee must be 21 years of age to be eligible to participate in the Retirement Plan, and is allowed to contribute on a pre-tax basis up to the maximum allowed under federal law. The Retirement Plan is administered by the Company and is subject to the provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"). At the close of each Retirement Plan year, the Company makes a matching contribution equal to 75% of the amount each participant contributed during the plan year from their total pay, up to a maximum amount of 8% of the participant's base salary, to those participants who have contributed to the Retirement Plan, worked 1,000 hours and were employed on the last day of the Retirement Plan year.

**Section 162(m)**

Section 162(m) of the Internal Revenue Code limits publicly-held companies to an annual deduction for federal income tax purposes of \$1.0 million for compensation paid to the Company's Named Executive Officers determined at the end of each year. Under a special rule that applies to corporations that become public through an IPO, this limitation in Section 162(m) generally will not apply to compensation that is paid under the Executive Plan and Incentive Plan before the first meeting of the Company's stockholders in 2006 at which directors will be elected.

Performance-based compensation that meets certain requirements, including stockholder approval, is excluded from this limitation under Section 162(m). In general, compensation qualifies as performance-based compensation under Section 162(m) if (1) it is conditioned on the achievement of one or more pre-established, objective performance goals, (2) such goal or goals are established by a committee of the Board consisting solely of two or more outside directors and (3) material terms of the performance goals under which the compensation is payable are disclosed to, and subsequently approved by, the corporation's stockholders prior to payment. Although awards granted under the Incentive Plan are temporarily exempt from the limitations of Section 162(m), the plan is designed to permit the Compensation Committee to grant awards that qualify as performance-based compensation for purposes of satisfying the conditions of Section 162(m) once the exemption expires. The



Compensation Committee consists of two or more "outside directors" within the meaning of Section 162(m) and before such performance-based compensation is paid, the material terms of the Company's stock plans will be presented to and approved by a majority vote of the Company's stockholders.

#### **Compensation Committee Interlocks and Insider Participation**

The Company's Compensation Committee consists of David K. McKown (Chairman), Frederic H. Lindeberg and Peter J. Manning, who are three independent non-employee directors who have no "interlocking" relationships as defined by the SEC, or other relationships with the Company that would call into question their independence as a member of the Compensation Committee.

#### **CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

The Company's Management Team and a group of investors organized by The Jordan Company consummated the Acquisition of Thomas Black Corporation, the holding company for Safety Insurance Company, on October 16, 2001. The following discussion summarizes material agreements the Company entered into in connection with the Acquisition that are still outstanding.

At the closing of the Acquisition, each member of the Management Team entered into an agreement under which he agreed not to receive certain bonuses to which he would have been entitled following the closing. These bonuses, which would have been payable over the three years following the closing, assuming the members of the Management Team remained employed by the Company or left employment for good reason, would have totaled \$16.0 million in the aggregate.

At the closing of the Acquisition, the Company entered into a stockholders agreement with the Management Team and the other Investors. Upon the IPO, all of the provisions of the stockholders agreement terminated, except for the provisions that entitle the parties to rights to register Common Stock in specified circumstances.



**COMMON STOCK PERFORMANCE GRAPH**

Set forth below is a line graph comparing the dollar change in the cumulative total stockholder return on the Company's Common Stock, for the period beginning on November 27, 2002 (the close of the Company's IPO and first trade date for the Company's common stock) and ending on December 31, 2004, with the cumulative total return of the NASDAQ Stock Market Index and a peer group comprised of six selected property & casualty insurance companies over the same period. The peer group consists of Baldwin & Lyons, Inc., the Commerce Group, Inc., Mercury General Corp., State Auto Financial Corp., Selective Insurance Group, Inc., and 21<sup>st</sup> Century Insurance Group, which has been weighted according to each peer's respective aggregate market capitalization on the November 27, 2002 measurement point. The graph shows the change in value of an initial \$100 investment on November 27, 2002, assuming re-investment of all dividends.

**Comparative Cumulative Total Returns since 11/27/2002 IPO Among  
Safety Insurance Group, Inc.,  
Property & Casualty Insurance Peer Group and the NASDAQ Stock Market Index**

**INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

PwC is the Company's principal accountants for the most recently completed fiscal year ended December 31, 2004. The Audit Committee of the Board selected PwC to continue as the Company's independent accountants for fiscal year 2005 at their March 10, 2005 meeting. Representatives of PwC are expected to be present at the 2005 Annual Meeting, will have the opportunity to make a statement if they desire to do so and will be available to respond to appropriate questions.

**Audit Fees.** Aggregate fees were \$819,600 and \$413,000 for 2004 and 2003, respectively. The 2004 fees reflect the aggregate audit fees billed or estimated to be billed by PwC for work performed during 2004. These 2004 fees were for professional services rendered in connection with the audits of the Company's annual financial statements, including the Company's internal control over financial reporting, set forth in the Company's Annual Report on Form 10-K and the review of the Company's quarterly financial statements set forth in its Quarterly Reports on Form 10-Q. The 2003 fees reflect the aggregate audit fees billed related to the year-end audit of the Company's consolidated financial statements including the Company's quarterly reviews and the Sarbanes-Oxley Act of 2002 Section 404 internal control services.

**Audit-Related Fees.** Aggregate fees billed were \$37,000 and \$24,000 for 2004 and 2003, respectively. The 2004 fees were for professional services rendered in connection with employee benefit plan audits and assistance with the routine examination of the Company by the Massachusetts Division of Insurance. The 2003 fees solely related to employee benefit plan audits.

**Tax Fees.** Aggregate fees billed were \$104,700 and \$97,100 for 2004 and 2003, respectively, for professional services rendered in connection with tax compliance and tax consulting services.

**All Other Fees.** Aggregate fees billed were \$1,500 and \$1,400 for 2004 and 2003, respectively, for the Company's licensing of PwC's proprietary research tools.

The Audit Committee has considered and determined that the provision of the non-audit services provided in 2004 and 2003 were compatible with maintaining PwC's independence.

**Audit Committee's Pre-Approval Policies and Procedures**

The Company's Audit Committee has established a policy that all audit and permissible non-audit services provided by the independent registered public accounting firm will be pre-approved by the Audit Committee. These services may include audit services, audit-related services, tax services and other services. The Audit Committee considers whether the provision of each non-audit service is compatible with maintaining the independence of the Company's auditors. Pre-approval is detailed as to the particular service or category of services and is generally subject to a specific budget. The independent auditors and management are required to periodically report to the Audit Committee regarding the extent of services provided by the independent auditors in accordance with this pre-approval, and the fees for the services performed to date.

**OTHER MATTERS**

**Inspectors of Election**

EquiServe Trust Company, N.A., P.O. Box 219045, Kansas City, MO 64121-9045, 1-816-843-4299, www.equiserve.com, has been appointed as Inspectors of Election for the Company's 2005 Annual Meeting. Representatives of EquiServe will attend the 2005 Annual Meeting to receive votes and ballots, supervise the counting and tabulating of all votes and ballots, and determine the results of the vote.

**Available Information**

**The Company is subject to the informational reporting requirements of the Exchange Act of 1934. In accordance therewith, the Company files reports, proxy statements and other information with the SEC. The Company will provide to any stockholder, upon request and without charge, copies of all documents (excluding exhibits unless specifically requested) filed with the SEC. Written, telephone, fax or e-mail requests should be directed to the Office of Investor Relations, Safety Insurance Group Inc., 20 Custom House Street, Boston, MA 02110, Tel: 877-951-2522, Fax: 617-603-4837, or e-Mail to InvestorRelations@SafetyInsurance.com. These documents are also made available on the Company's website, www.SafetyInsurance.com, as soon as reasonably practicable after each press release and SEC Report is filed with, or furnished, to the SEC.**

**Stockholder Proposals for the 2006 Annual Meeting of Stockholders**

Any stockholder proposals intended to be presented at our 2006 Annual Meeting and considered for inclusion in our proxy materials must be received by December 14, 2005. Any stockholder proposals intended to be presented at our 2006 Annual Meeting and not included in our proxy materials must comply with the advance notice provisions in Article I, Section 2 and Article II, Section 1 of our By-laws. Notices must be received by December 14, 2005. In addition, stockholders who wish to nominate directors for election must comply with the procedures described in our By-laws. All stockholder proposals should be directed to our Secretary, William J. Begley, Jr., at our address listed on page 1 of this proxy statement.

By Order of the Board of Directors,

WILLIAM J. BEGLEY, JR.

*Vice President, Chief Financial Officer and Secretary*

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**APPENDIX A**

**Safety Insurance Group, Inc.**

**AUDIT COMMITTEE CHARTER**

As approved by the Audit Committee and the Board on April 7, 2005

This Charter (this "*Charter*") of the Nominating and Governance Committee (the "*Committee*") has been adopted by the Board of Directors (the "*Board*") of Safety Insurance Group, Inc. (the "*Company*").

**I. General Statement of Purpose**

The Audit Committee of the Board of Directors (the "Audit Committee") of Safety Insurance Group, Inc. (the "Company") assists the Board of Directors (the "Board") in general oversight and monitoring of: (i) the integrity and audits of financial statements of the Company; (ii) the independent auditor's qualifications and independence; (iii) the performance of the Company's internal audit function and independent auditors; (iv) the accounting and financial reporting processes of the Company; and (v) the Company's procedures for compliance with legal and regulatory requirements.

**II. Audit Committee Composition**

The Audit Committee shall be comprised of a minimum of three directors as appointed by the Board, who shall meet the independence and audit committee composition requirements of the Marketplace Rules promulgated by the National Association of Securities Dealers, Inc., as may be modified or supplemented, Section 10A(m)(3) of the Securities Exchange Act of 1934, as amended, the rules and regulations of the U.S. Securities and Exchange Commission (the "Commission") and any applicable requirements of state law. Each member of the Audit Committee shall be able to read and understand fundamental financial statements, including a balance sheet and statements of operations, comprehensive income and cash flows, and to the extent required, at least one member shall be an "Audit Committee Financial Expert" as such term is defined by the Commission.

The members of the Audit Committee shall be elected by the Board and shall continue to serve as such until the next annual meeting of the Board or until their respective successors are designated. Any vacancy that might arise in the membership of the Audit Committee shall be filled by appointment of the Board.

**III. Meetings**

The Audit Committee will meet as often as may be deemed necessary or appropriate and at such times and places as it shall determine, but not less frequently than quarterly. The Audit Committee will meet periodically with management, the internal auditors and the independent auditor in separate executive sessions. The Audit Committee will record the actions taken at such meetings and will report to the Board with respect to its meetings.

**IV. Responsibilities and Authority**

The Audit Committee shall have the sole authority to appoint, replace, determine funding for, and oversee the independent auditor. The Audit Committee shall be directly responsible for the compensation and oversight of the work of the independent auditor (including resolution of disagreements between management and the independent auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or related work, or performing other audit, review or attest services for the Company. The independent auditor shall report directly to the Audit Committee.

The Audit Committee shall preapprove all auditing and review services and permitted non-audit services (including the fees and terms thereof) to be performed for the Company by its independent auditor in accordance with applicable rules and regulations.

The Audit Committee shall have the authority, to the extent it deems necessary or appropriate, to retain independent legal, accounting or other advisors. The Company shall provide for appropriate funding, as determined by the Audit Committee, for payment of compensation to the independent auditor for the purpose of rendering or issuing an audit report and to any advisors employed by the Audit Committee.

The Audit Committee shall be responsible for (i) ensuring its receipt of a formal written statement delineating all relationships between the independent auditor and the Company from the independent auditors, consistent with Independence Standards Board Standard No. 1., as may be modified or supplemented; (ii) actively engaging in a dialogue with the independent auditors with respect to any disclosed relationships or services that may impact the objectivity and independence of the independent auditors; and (iii) taking, or recommending that the Board take, appropriate action to oversee the independence of the independent auditor.

The Audit Committee shall establish procedures for the receipt, retention, and treatment of complaints received by the Company regarding accounting, internal accounting controls, or auditing matters, and the confidential, anonymous submission by employees of the Company of concerns regarding questionable accounting or auditing matters.

#### **V. Audit Committee Principal Processes**

The principal processes of the Audit Committee will generally include the following which are set forth as a guide with the understanding that the Audit Committee may supplement them as appropriate:

A.

Financial Statement and Disclosure

1. Review and discuss with management and the independent auditor the annual earnings release and annual audited financial statements, including disclosures made in management's discussion and analysis.
2. Review and discuss with management and the independent auditor the Company's quarterly earnings releases and quarterly financial statements prior to the filing of its Form 10-Q, including disclosures made in management's discussion and analysis and the results of the independent auditor's review of the quarterly financial statements.
3. Discuss with management and the independent auditor significant financial reporting issues and judgments made in connection with the preparation of the Company's financial statements, including any significant changes in the Company's selection or application of accounting principles, any major issues as to the adequacy of the Company's internal controls and any special steps adopted in light of material control deficiencies.
4. Review and discuss quarterly reports from the independent auditors on: (a) all critical accounting policies and practices to be used; (b) all alternative treatments of financial information within generally accepted accounting principles that have been discussed with management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the independent auditor; and (c) other material written communications between the independent auditor and management, such as any management letter or schedule of unadjusted differences.
5. Review management's conclusions about the Company's disclosure controls and procedures.

6. Discuss with the independent auditor the matters required to be discussed by Statement on Auditing Standards No. 61 relating to the conduct of the audit, including any difficulties encountered in the course of the audit work, any restrictions on the scope of activities or access to requested information, and any significant disagreements with management.
7. Review disclosures made to the Audit Committee by the Company's CEO and CFO during their certification process for the Form 10-K and Form 10-Q about any significant deficiencies in the design or operation of internal controls or material weaknesses therein and any fraud involving management or other employees who have a significant role in the Company's internal controls.

**B.**

Oversight of the Company's Relationship with the Independent Auditor

1. Evaluate the qualifications, performance and independence of the independent auditor, including considering whether the auditor's quality controls are adequate and the provision of permitted non-audit services is compatible with maintaining the auditor's independence, and taking into account the opinions of management and internal auditors.
2. Ensure the rotation of the lead (or coordinating) audit partner having primary responsibility for the audit and the audit partner responsible for reviewing the audit as required by law.

**C.**

Oversight of the Company's Internal Audit Function

1. Review the appointment and replacement of the senior internal auditing executive.
2. Review the significant reports to management prepared by the internal auditing department and management's responses.
3. Discuss with the independent auditor and management the internal audit department responsibilities, budget and staffing and any recommended changes in the planned scope of the internal audit.

**VI. Annual Evaluation**

The Audit Committee shall review and reassess this Charter on an annual basis.

**VII. Limitation of Audit Committee's Role**

Notwithstanding the responsibilities and powers of the Audit Committee set forth in this Charter, the Audit Committee does not have the responsibility of planning or conducting audits of the Company's financial statements or determining whether or not the Company's financial statements are complete, accurate and in accordance with generally accepted accounting principles or the rules of the Commission. Such responsibilities are the duty of management and the independent auditor.

**APPENDIX B**

**Safety Insurance Group, Inc.**

**COMPENSATION COMMITTEE CHARTER**

As approved by the Compensation Committee and the Board on March 25, 2004  
and reaffirmed by the Compensation Committee on April 7, 2005

This Charter (this "*Charter*") of the Compensation Committee (the "*Committee*") has been adopted by the Board of Directors (the "*Board*") of Safety Insurance Group, Inc. (the "*Company*").

**I. General Statement of Purpose**

The Committee shall assist in fulfilling the Board's oversight responsibilities relating to compensation including, but not limited to: (i) reviewing and making recommendations to the Board on the Company's compensation practices and policies; (ii) determining or recommending to the Board for determination, the salaries and incentive compensation of the Chief Executive Officer and all other executive officers; and (iii) administering and interpreting the Company's equity-based plans. The Committee shall also prepare the report required to be included in the Company's annual proxy statements pursuant to the rules promulgated by the United States Securities and Exchange Commission.

**II. Responsibilities and Authority**

In furtherance of this purpose, the Committee shall have the following responsibilities and authority:

- a. The Committee shall approve, and review at least annually, the terms of any agreement providing for the compensation of the Chief Executive Officer. If there is no such agreement in place, or if such agreement provides for compensation based upon a determination by the Board, the Committee shall determine, or recommend to the Board for determination, the Chief Executive Officer's annual compensation, including salary, bonus, incentive and equity compensation.
- b. The Committee shall approve, and review at least annually, the terms of any agreement providing for the compensation of any executive officer of the Company. If there is no such agreement in place, or if such agreement provides for compensation based upon a determination by the Board, the Committee shall determine, or recommend to the Board for determination, the annual compensation, including salary, bonus, incentive and equity compensation of such executive officers.
- c. To consider and take actions with respect to adoption, amendment, administration or termination of long-term incentive plans, equity/stock plans (subject to paragraph 4 below), retirement or pension plans, and other plans related to compensation of current and former employees of the Company.
- d. To review the terms and conditions of compensation and incentive plans, evaluate the performance of compensation and incentive plans, and approve, and recommend to the Board for its approval, the initial adoption of any equity-based plans and any material modifications to such plans (such as an increase in the number of shares of the Company's common stock available for grant thereunder) as the Committee deems appropriate.
- e. To recommend to the Board the compensation of outside directors.

- f. To delegate any of its responsibilities to subcommittees as the Committee may deem appropriate in its sole discretion.
- g. To exercise such additional powers as may be reasonably necessary, in the Committee's discretion, to fulfil its responsibilities hereunder.

### **III. Outside Advisors**

The Committee, acting by majority vote, shall have the authority to retain and terminate compensation consultants to assist in the evaluation of Chief Executive Officer or executive officer compensation, including sole authority to approve such consultants' fees and any other retention terms. The Committee, acting by majority vote, shall also have sole authority to obtain advice and assistance from internal or external legal, accounting or other advisors to assist the Committee in fulfilling its responsibilities hereunder.

### **IV. Annual Evaluation**

The Committee shall review this Charter annually and recommend to the Board any improvements to this Charter it deems necessary.

### **V. Membership**

The Committee shall consist of no fewer than two (2) directors, as determined by the Board. Each Committee member shall meet the independence requirements of the Marketplace Rules promulgated by the National Association of Securities Dealers, Inc., as determined by the Board, and any other requirements set forth in applicable laws, rules and regulations.

Committee members shall be appointed annually by a majority vote of the Board on the recommendation of the Nominating and Corporate Governance Committee. The Committee members may be removed, with or without cause, by a majority vote of the Board.

### **VI. Chairman**

The Committee shall include a Committee chairman. The Committee chairman shall be appointed by a majority vote of the Board. The Committee chairman shall be entitled to chair all regular sessions of the Committee, add topics to the agenda, and cast a vote to resolve any ties.

### **VII. Meetings**

The Committee shall meet as often as necessary to carry out its responsibilities, but at least twice yearly. The Committee chairman may call a Committee meeting upon due notice of each other Committee member at least forty-eight (48) hours prior to the meeting, unless such notice is waived by any Committee member not receiving such notice. Any Committee member may request the Committee chairman to call a meeting. A majority of Committee members, acting in person or by proxy, shall constitute a quorum. The Committee shall be responsible for maintaining minutes and other applicable records of each Committee meeting. The Committee shall report its actions and recommendations to the Board after each Committee meeting.

The Committee may invite to, or exclude from, its meetings any individual it deems appropriate in order to carry out its responsibilities.



**APPENDIX C**

**Safety Insurance Group, Inc.**

**NOMINATING AND GOVERNANCE COMMITTEE CHARTER**

As approved by the Nominating and Governance Committee on March 8, 2005 and the Board on March 10, 2005

This Charter (this "*Charter*") of the Nominating and Governance Committee (the "*Committee*") has been adopted by the Board of Directors (the "*Board*") of Safety Insurance Group, Inc. (the "*Company*").

**I. General Statement of Purpose**

The Committee shall assist the Board in identifying individuals qualified to become Board members, recommend director-nominees to the Board for annual shareholders' meetings, take a leadership role in shaping the Company's corporate governance and oversee the evaluation of the Board, management and the Board committees.

**II. Responsibilities and Authority**

In furtherance of this purpose, the Committee shall have the following responsibilities and authority:

1. To lead the search for individuals qualified to become Board members to the extent necessary to fill vacancies on the Board or as otherwise desired by the Board.
2. To develop and recommend to the Board for its approval a policy regarding director nominees recommended by shareholders, including the procedures to be followed by shareholders in submitting such recommendations. The Committee shall assess the adequacy of such policy on an annual basis, or more frequently as circumstances dictate, and recommend changes to the Board.
3. To develop a process for identifying and evaluating director nominees. The Committee shall assess the adequacy of such process on an annual basis, or more frequently as circumstances dictate, and implement any changes to such policy as determined by a majority vote of the Committee.
4. To conduct all necessary and appropriate inquiries into the background and qualifications of each possible director nominee.
5. To make an annual report to the Board on emergency as well as expected CEO succession planning. The full Board will work with the Committee to recommend and evaluate potential successors to the CEO.
6. To develop a process for shareholders of the Company to send communications to the Board. The Committee shall assess the adequacy of such process on an annual basis, or more frequently as circumstances dictate, and implement any changes to such policy as determined by a majority vote of the Committee.
7. To develop and recommend to the Board for its approval a policy regarding Board members' attendance at annual meetings. The Committee shall assess the adequacy of such policy on an annual basis, or more frequently as circumstances dictate, and recommend changes to the Board.
8. To review written communications from shareholders concerning the Company's annual general meeting and governance process and make recommendations to the Board as necessary.



9. To annually review and reassess the adequacy of the Company's Code of Business Conduct and recommend changes to the Board as necessary.
10. To review requests from directors and executive officers of the Company for waivers from the Company's Code of Business Conduct, to make recommendations to the Board concerning such requests, and to review any required disclosures relating to such waivers.
11. To review and approve all related-party transactions, as such term is defined in the NASDAQ Marketplace Rules.
12. To delegate any of its responsibilities to subcommittees as the Committee may deem appropriate in its sole discretion.
13. To exercise such additional powers as may be reasonably necessary, in the Committee's discretion, to fulfill its responsibilities hereunder.

### **III. Outside Advisors**

The Committee, acting by majority vote, shall have sole authority to retain and terminate any search firm employed to identify director nominees, including sole authority to approve the search firm's fees and any other retention terms. The Committee, acting by majority vote, shall also have sole authority to obtain advice and assistance from internal or external legal, accounting, or other advisors to assist the Committee in fulfilling its responsibilities hereunder.

### **IV. Annual Evaluation**

The Committee shall review this Charter annually and recommend to the Board any improvements to this Charter it deems necessary.

### **V. Membership**

The Committee shall consist of no fewer than two (2) directors, as determined by the Board. Each Committee member shall meet the independence requirements of the Marketplace Rules promulgated by the National Association of Securities Dealers, Inc., as determined by the Board, and any other requirements set forth in applicable laws, rules and regulations. The Committee members shall be appointed annually, and may be removed, with or without cause, by a majority vote of the Board.

### **VI. Chairman**

The Committee shall include a Committee chairman. The Committee chairman shall be appointed by a majority vote of the Board. The Committee chairman shall be entitled to chair all regular sessions of the Committee, add topics to the agenda, and cast a vote to resolve any ties.

### **VII. Meetings**

The Committee shall meet as often as necessary to carry out its responsibilities, but at least twice yearly. The Committee chairman may call a Committee meeting upon due notice of each other Committee member at least forty-eight (48) hours prior to the meeting, unless such notice is waived by any Committee member not receiving such notice. Any Committee member may request the Committee chairman to call a meeting. A majority of Committee members, acting in person or by proxy, shall constitute a quorum. The Committee shall be responsible for maintaining minutes and other applicable records of each Committee meeting. The Committee shall report its actions and recommendations to the Board after each Committee meeting.

DETACH HERE

**PROXY**

**SAFETY INSURANCE GROUP, INC.**

**20 CUSTOM HOUSE STREET  
BOSTON, MASSACHUSETTS 02110**

**THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS**

The undersigned stockholder of Safety Insurance Group, Inc. hereby appoints David F. Brussard and William J. Begley, Jr. (each with power to act without the other and with power of substitution) as proxies to represent the undersigned at the 2005 Annual Meeting of the common stockholders of Safety Insurance Group, Inc. to be held at 10:00 a.m. on Friday, May 20, 2005 and at any postponement or adjournment thereof, with all the power the undersigned would possess if personally present, and to vote all shares of common stock which the undersigned may be entitled to vote at said meeting, hereby revoking any proxy heretofore given.

**THIS PROXY, WHEN PROPERLY EXECUTED, WILL BE VOTED AS SPECIFIED ON THE REVERSE SIDE. IF NO SPECIFICATION IS MADE, IT IS THE INTENTION OF THE PROXIES TO VOTE FOR THE NOMINEES FOR DIRECTOR LISTED ON THE REVERSE SIDE AND AT THE DISCRETION OF THE PROXIES ON ANY OTHER MATTERS THAT MAY PROPERLY COME BEFORE THE MEETING OR ANY POSTPONEMENT OR ADJOURNMENT THEREOF.**

**SEE REVERSE  
SIDE**

**CONTINUED AND TO BE SIGNED ON REVERSE  
SIDE**

**SEE REVERSE  
SIDE**

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# SAFETY INSURANCE GROUP, INC.

C/O EQUISERVE TRUST COMPANY, N.A.  
P.O. BOX 8694  
EDISON, NJ 08818-8694

DETACH HERE IF YOU ARE RETURNING YOUR PROXY CARD BY MAIL.

Please mark  
y votes as in  
this example

**THE BOARD OF DIRECTORS  
RECOMMENDS A VOTE "FOR" THE  
FOLLOWING:**

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## SAFETY INSURANCE GROUP, INC.

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1. ELECTION OF TWO CLASS III DIRECTORS  
TO SERVE A THREE-YEAR TERM  
EXPIRING IN 2008.

**Nominees:** (01) David F. Brussard  
(02) A. Richard Caputo, Jr.

FOR ALL NOMINEES             WITHHELD FROM ALL NOMINEES

FOR ALL EXCEPT      \_\_\_\_\_

To withhold authority to vote for a nominee, mark "For All Except" and write the nominee's number on the line above.

Mark box at right for address change and note at left

**THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED**

Please date and sign exactly as your name or names appear herein. Corporate or partnership proxies should be signed in full corporate or partnership name by an authorized person. Persons signing in a fiduciary capacity should indicate their full title in such capacity.

Signature: \_\_\_\_\_

Signature (Joint

Date: \_\_\_\_\_ Owner): \_\_\_\_\_ Date: \_\_\_\_\_

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- partnerships or other entities classified as partnerships for U.S. federal income tax purposes;
- regulated investment companies;
- real estate investment trusts; or
- tax-exempt entities, including “individual retirement accounts” or “Roth IRAs” as defined in Section 408 or 408A of the Code, respectively.

If an entity that is classified as a partnership for U.S. federal income tax purposes holds the securities, the U.S. federal income tax treatment of a partner will generally depend on the status of the partner and the activities of the partnership. If you are a partnership holding the securities or a partner in such a partnership, you should consult your tax adviser as to the particular U.S. federal tax consequences of holding and disposing of the securities to you.

As the law applicable to the U.S. federal income taxation of instruments such as the securities is technical and complex, the discussion below necessarily represents only a general summary. The effect of any applicable state, local or non-U.S. tax laws is not discussed, nor are any alternative minimum tax consequences or consequences resulting from the Medicare tax on investment income. Moreover, the discussion below does not address the consequences to taxpayers subject to special tax accounting rules under Section 451(b) of the Code.

This discussion is based on the Code, administrative pronouncements, judicial decisions and final, temporary and proposed Treasury regulations, all as of the date hereof, changes to any of which subsequent to the date hereof may affect the tax consequences described herein. Persons considering the purchase of the securities should consult their tax advisers with regard to the application of the U.S. federal income tax laws to their particular situations as well as any tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.

## **General**

Due to the absence of statutory, judicial or administrative authorities that directly address the treatment of the securities or instruments that are similar to the securities for U.S. federal income tax purposes, no assurance can be given that the IRS or a court will agree with the tax treatment described herein. We intend to treat a security for U.S. federal income tax purposes as a single financial contract that provides for a coupon that will be treated as gross income to you at the time received or accrued in accordance with your regular method of tax accounting. In the opinion of our counsel, Davis Polk & Wardwell LLP, this treatment of the securities is reasonable under current law; however, our counsel has advised us that it is unable to conclude affirmatively that this treatment is more likely than not to be upheld, and that alternative treatments are possible.

**You should consult your tax adviser regarding all aspects of the U.S. federal tax consequences of an investment in the securities (including possible alternative treatments of the securities). Unless otherwise stated, the following discussion is based on the treatment of each security as described in the**

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Morgan Stanley Finance LLC

Contingent Income Auto-Callable Securities due March 11, 2022

Based on the Performance of the Common Stock of lululemon athletica inc.

Principal at Risk Securities

**previous paragraph.**

### **Tax Consequences to U.S. Holders**

This section applies to you only if you are a U.S. Holder. As used herein, the term “U.S. Holder” means a beneficial owner of a security that is, for U.S. federal income tax purposes:

- a citizen or individual resident of the United States;
- a corporation, or other entity taxable as a corporation, created or organized in or under the laws of the United States, any state thereof or the District of Columbia; or
- an estate or trust the income of which is subject to U.S. federal income taxation regardless of its source.

### ***Tax Treatment of the Securities***

Assuming the treatment of the securities as set forth above is respected, the following U.S. federal income tax consequences should result.

*Tax Basis.* A U.S. Holder’s tax basis in the securities should equal the amount paid by the U.S. Holder to acquire the securities.



*Tax Treatment of Coupon Payments.* Any coupon payment on the securities should be taxable as ordinary income to a U.S. Holder at the time received or accrued, in accordance with the U.S. Holder's regular method of accounting for U.S. federal income tax purposes.

*Sale, Exchange or Settlement of the Securities.* Upon a sale, exchange or settlement of the securities, a U.S. Holder should recognize gain or loss equal to the difference between the amount realized on the sale, exchange or settlement and the U.S. Holder's tax basis in the securities sold, exchanged or settled. For this purpose, the amount realized does not include any coupon paid at settlement and may not include sale proceeds attributable to an accrued coupon, which may be treated as a coupon payment. Any such gain or loss recognized should be long-term capital gain or loss if the U.S. Holder has held the securities for more than one year at the time of the sale, exchange or settlement, and should be short-term capital gain or loss otherwise. The ordinary income treatment of the coupon payments, in conjunction with the capital loss treatment of any loss recognized upon the sale, exchange or settlement of the securities, could result in adverse tax consequences to holders of the securities because the deductibility of capital losses is subject to limitations.

### ***Possible Alternative Tax Treatments of an Investment in the Securities***

Due to the absence of authorities that directly address the proper tax treatment of the securities, no assurance can be given that the IRS will accept, or that a court will uphold, the treatment described above. In particular, the IRS could seek to analyze the U.S. federal income tax consequences of owning the securities under Treasury regulations governing contingent payment debt instruments (the "Contingent Debt Regulations"). If the IRS were successful in asserting that the Contingent Debt Regulations applied to the securities, the timing and character of income thereon would be significantly affected. Among other things, a U.S. Holder would be required to accrue into income original issue discount on the securities every year at a "comparable yield" determined at the time of their issuance, adjusted upward or downward to reflect the difference, if any, between the actual and the projected amount of any contingent payments on the securities. Furthermore, any gain realized by a U.S. Holder at maturity or upon a sale, exchange or other disposition of the securities would be treated as ordinary income, and any loss realized would be treated as ordinary loss to the extent of the U.S. Holder's prior accruals of original issue discount and as capital loss thereafter. The risk that financial instruments providing for buffers, triggers or similar downside protection features, such as the securities, would be recharacterized as debt is greater than the risk of recharacterization for comparable financial instruments that do not have such features.

Other alternative federal income tax treatments of the securities are possible, which, if applied, could significantly affect the timing and character of the income or loss with respect to the securities. In 2007, the U.S. Treasury Department and the IRS released a notice requesting comments on the U.S. federal income tax treatment of "prepaid forward contracts" and similar instruments. The notice focuses on whether to require holders of "prepaid forward contracts" and similar instruments to accrue income over the term of their investment. It also asks for comments on a number of related topics, including the character of income or loss with respect to these instruments; whether short-term instruments should be subject to any such accrual regime; the relevance of factors such as the exchange-traded status of the instruments and the nature of the underlying property to which the instruments are linked; whether these instruments are or should be subject to the "constructive ownership" rule, which very generally can operate to recharacterize certain long-term capital gain as ordinary income and impose an interest charge; and

appropriate transition rules and effective dates. While it is not clear whether instruments such as the securities would be viewed as similar to the prepaid forward contracts described in the notice, any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the securities, possibly with retroactive effect. U.S. Holders should consult their tax advisers regarding the U.S. federal income tax consequences of an investment in the securities, including possible alternative treatments and the issues presented by this notice.

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Based on the Performance of the Common Stock of lululemon athletica inc.

Principal at Risk Securities

### ***Backup Withholding and Information Reporting***

Backup withholding may apply in respect of payments on the securities and the payment of proceeds from a sale, exchange or other disposition of the securities, unless a U.S. Holder provides proof of an applicable exemption or a correct taxpayer identification number and otherwise complies with applicable requirements of the backup withholding rules. The amounts withheld under the backup withholding rules are not an additional tax and may be refunded, or credited against the U.S. Holder's U.S. federal income tax liability, provided that the required information is timely furnished to the IRS. In addition, information returns will be filed with the IRS in connection with payments on the securities and the payment of proceeds from a sale, exchange or other disposition of the securities, unless the U.S. Holder provides proof of an applicable exemption from the information reporting rules.

### **Tax Consequences to Non-U.S. Holders**

This section applies to you only if you are a Non-U.S. Holder. As used herein, the term "Non-U.S. Holder" means a beneficial owner of a security that is for U.S. federal income tax purposes:

- an individual who is classified as a nonresident alien;
- a foreign corporation; or
- a foreign estate or trust.

The term "Non-U.S. Holder" does not include any of the following holders:

- a holder who is an individual present in the United States for 183 days or more in the taxable year of disposition and who is not otherwise a resident of the United States for U.S. federal income tax purposes;

- certain former citizens or residents of the United States; or
- a holder for whom income or gain in respect of the securities is effectively connected with the conduct of a trade or business in the United States.

Such holders should consult their tax advisers regarding the U.S. federal income tax consequences of an investment in the securities.

Although significant aspects of the tax treatment of each security are uncertain, we intend to withhold on any coupon paid to a Non-U.S. Holder generally at a rate of 30% or at a reduced rate specified by an applicable income tax treaty under an “other income” or similar provision. We will not be required to pay any additional amounts with respect to amounts withheld. In order to claim an exemption from, or a reduction in, the 30% withholding tax, a Non-U.S. Holder of the securities must comply with certification requirements to establish that it is not a U.S. person and is eligible for such an exemption or reduction under an applicable tax treaty. If you are a Non-U.S. Holder, you should consult your tax adviser regarding the tax treatment of the securities, including the possibility of obtaining a refund of any withholding tax and the certification requirement described above.

#### ***Section 871(m) Withholding Tax on Dividend Equivalents***

Section 871(m) of the Code and Treasury regulations promulgated thereunder (“Section 871(m)”) generally impose a 30% (or a lower applicable treaty rate) withholding tax on dividend equivalents paid or deemed paid to Non-U.S. Holders with respect to certain financial instruments linked to U.S. equities or indices that include U.S. equities (each, an “Underlying Security”). Subject to certain exceptions, Section 871(m) generally applies to securities that substantially replicate the economic performance of one or more Underlying Securities, as determined based on tests set forth in the applicable Treasury regulations (a “Specified Security”). However, pursuant to an IRS notice, Section 871(m) will not apply to securities issued before January 1, 2021 that do not have a delta of one with respect to any Underlying Security. Based on our determination that the securities do not have a delta of one with respect to any Underlying Security, our counsel is of the opinion that the securities should not be Specified Securities and, therefore, should not be subject to Section 871(m).

Our determination is not binding on the IRS, and the IRS may disagree with this determination. Section 871(m) is complex and its application may depend on your particular circumstances, including whether you enter into other transactions with respect to an Underlying Security. If Section 871(m) withholding is required, we will not be required to pay any additional amounts with respect to the amounts so withheld. You should consult your tax adviser regarding the potential application of Section 871(m) to the securities.

*U.S. Federal Estate Tax*

Individual Non-U.S. Holders and entities the property of which is potentially includible in such an individual's gross estate for U.S. federal estate tax purposes (for example, a trust funded by such an individual and with respect to which the individual has retained certain interests or powers) should note that, absent an applicable treaty exemption, the securities may be treated as U.S.-situs property subject to U.S. federal estate tax. Prospective investors that are non-U.S. individuals, or are entities of the type described above, should consult their tax advisers regarding the U.S. federal estate tax consequences of an investment in the securities.

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Morgan Stanley Finance LLC

Contingent Income Auto-Callable Securities due March 11, 2022

Based on the Performance of the Common Stock of lululemon athletica inc.

Principal at Risk Securities

### ***Backup Withholding and Information Reporting***

Information returns will be filed with the IRS in connection with any coupon payment and may be filed with the IRS in connection with the payment at maturity on the securities and the payment of proceeds from a sale, exchange or other disposition. A Non-U.S. Holder may be subject to backup withholding in respect of amounts paid to the Non-U.S. Holder, unless such Non-U.S. Holder complies with certification procedures to establish that it is not a U.S. person for U.S. federal income tax purposes or otherwise establishes an exemption. The amount of any backup withholding from a payment to a Non-U.S. Holder will be allowed as a credit against the Non-U.S. Holder's U.S. federal income tax liability and may entitle the Non-U.S. Holder to a refund, provided that the required information is timely furnished to the IRS.

### **FATCA**

Legislation commonly referred to as "FATCA" generally imposes a withholding tax of 30% on payments to certain non-U.S. entities (including financial intermediaries) with respect to certain financial instruments, unless various U.S. information reporting and due diligence requirements have been satisfied. An intergovernmental agreement between the United States and the non-U.S. entity's jurisdiction may modify these requirements. FATCA generally applies to certain financial instruments that are treated as paying U.S.-source interest or other U.S.-source "fixed or determinable annual or periodical" income ("FDAP income"). Withholding (if applicable) applies to payments of U.S.-source FDAP income and to payments of gross proceeds of the disposition (including upon retirement) of certain financial instruments treated as providing for U.S.-source interest or dividends. Under recently proposed regulations (the preamble to which specifies that taxpayers are permitted to rely on them pending finalization), no withholding will apply on payments of gross proceeds. While the treatment of the securities is unclear, you should assume that any coupon payment with respect to the securities will be subject to the FATCA rules. If withholding applies to the securities, we will not be required to pay any additional amounts with respect to amounts withheld. Both U.S. and Non-U.S. Holders should consult their tax advisers regarding the potential application of FATCA to the securities.

**The discussion in the preceding paragraphs, insofar as it purports to describe provisions of U.S. federal income tax laws or legal conclusions with respect thereto, constitutes the full opinion of Davis Polk & Wardwell LLP regarding the material U.S. federal tax consequences of an investment in the securities.**

The proceeds from the sale of the securities will be used by us for general corporate purposes. We will receive, in aggregate, \$10 per security issued, because, when we enter into hedging transactions in order to meet our obligations under the securities, our hedging counterparty will reimburse the cost of the agent's commissions. The costs of the securities borne by you and described beginning on page 2 above comprise the agent's commissions and the cost of issuing, structuring and hedging the securities.

**Use of proceeds and hedging:**

On or prior to the pricing date, we hedged our anticipated exposure in connection with the securities by entering into hedging transactions with our affiliates and/or third-party dealers. We expect our hedging counterparties to have taken positions in the underlying stock and in futures and/or options contracts on the underlying stock. Such purchase activity could have increased the initial share price, and, as a result, could have increased the downside threshold price, which is the price at or above which the underlying stock must close on each determination date in order for you to earn a contingent quarterly coupon, and, if the securities are not redeemed prior to maturity, in order for you to avoid being exposed to the negative price performance of the underlying stock at maturity. In addition, through our affiliates, we are likely to modify our hedge position throughout the term of the securities, including on the determination dates, by purchasing and selling the underlying stock, options contracts relating to the underlying stock or any other available securities or instruments that we may wish to use in connection with such hedging activities, including by purchasing or selling any such securities or instruments on one or more determination dates. As a result, these entities may be unwinding or adjusting hedge positions during the term of the securities, and the hedging strategy may involve greater and more frequent dynamic adjustments to the hedge as the final determination date approaches. We cannot give any assurance that our hedging activities will not affect the value of the underlying stock, and, therefore, adversely affect the value of the securities or the payment you will receive at maturity, if any. For further information on our use of proceeds and hedging, see "Use of Proceeds and Hedging" in the accompanying product supplement for auto-callable securities.

**Benefit plan investor considerations:**

Each fiduciary of a pension, profit-sharing or other employee benefit plan subject to Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") (a "Plan"), should consider the fiduciary standards of ERISA in the context of the Plan's particular circumstances before authorizing an investment in the securities. Accordingly, among other factors, the fiduciary should consider whether the investment would satisfy the prudence and diversification requirements of ERISA and would be consistent with the documents and instruments governing the Plan.

In addition, we and certain of our affiliates, including MS & Co., may each be considered a "party in interest" within the meaning of ERISA, or a "disqualified person" within the meaning of the Internal Revenue Code of 1986, as amended (the "Code"), with respect to many Plans, as well as

many individual retirement accounts and Keogh plans (such accounts and plans, together with other plans, accounts and arrangements subject to Section 4975 of the Code, also “Plans”). ERISA Section 406 and Code Section 4975 generally prohibit transactions between Plans and parties in interest or disqualified persons. Prohibited transactions within the meaning of ERISA or the Code would likely arise, for example, if the securities are acquired by or with the assets of a Plan with respect to which MS & Co. or any of its affiliates is a service provider or other party in interest, unless the securities are acquired pursuant to an exemption from the “prohibited transaction” rules.

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violation of these “prohibited transaction” rules could result in an excise tax or other liabilities under ERISA and/or Section 4975 of the Code for those persons, unless exemptive relief is available under an applicable statutory or administrative exemption.

The U.S. Department of Labor has issued five prohibited transaction class exemptions (“PTCEs”) that may provide exemptive relief for direct or indirect prohibited transactions resulting from the purchase or holding of the securities. Those class exemptions are PTCE 96-23 (for certain transactions determined by in-house asset managers), PTCE 95-60 (for certain transactions involving insurance company general accounts), PTCE 91-38 (for certain transactions involving bank collective investment funds), PTCE 90-1 (for certain transactions involving insurance company separate accounts) and PTCE 84-14 (for certain transactions determined by independent qualified professional asset managers). In addition, ERISA Section 408(b)(17) and Code Section 4975(d)(20) provide an exemption for the purchase and sale of securities and the related lending transactions, provided that neither the issuer of the securities nor any of its affiliates has or exercises any discretionary authority or control or renders any investment advice with respect to the assets of the Plan involved in the transaction and provided further that the Plan pays no more, and receives no less, than “adequate consideration” in connection with the transaction (the so-called “service provider” exemption). There can be no assurance that any of these class or statutory exemptions will be available with respect to transactions involving the securities.

Because we may be considered a party in interest with respect to many Plans, the securities may not be purchased, held or disposed of by any Plan, any entity whose underlying assets include “plan assets” by reason of any Plan’s investment in the entity (a “Plan Asset Entity”) or any person investing “plan assets” of any Plan, unless such purchase, holding or disposition is eligible for exemptive relief, including relief available under PTCEs 96-23, 95-60, 91-38, 90-1, 84-14 or the service provider exemption or such purchase, holding or disposition is otherwise not prohibited. Any purchaser, including any fiduciary purchasing on behalf of a Plan, transferee or holder of the securities will be deemed to have represented, in its corporate and its fiduciary capacity, by its purchase and holding of the securities that either (a) it is not a Plan or a Plan Asset Entity and is not purchasing such securities on behalf of or with “plan assets” of any Plan or with any assets of a governmental, non-U.S. or church plan that is subject to any federal, state, local or non-U.S. law that is substantially similar to the provisions of Section 406 of ERISA or Section 4975 of the Code (“Similar Law”) or (b) its purchase, holding and disposition of these securities will not constitute or result in a non-exempt prohibited transaction under Section 406 of ERISA or Section 4975 of the Code or violate any Similar Law.

Due to the complexity of these rules and the penalties that may be imposed upon persons involved in non-exempt

prohibited transactions, it is particularly important that fiduciaries or other persons considering purchasing the securities on behalf of or with “plan assets” of any Plan consult with their counsel regarding the availability of exemptive relief.

The securities are contractual financial instruments. The financial exposure provided by the securities is not a substitute or proxy for, and is not intended as a substitute or proxy for, individualized investment management or advice for the benefit of any purchaser or holder of the securities. The securities have not been designed and will not be administered in a manner intended to reflect the individualized needs and objectives of any purchaser or holder of the securities.

Each purchaser or holder of any securities acknowledges and agrees that:

(i) the purchaser or holder or its fiduciary has made and shall make all investment decisions for the purchaser or holder and the purchaser or holder has not relied and shall not rely in any way upon us or our affiliates to act as a fiduciary or adviser of the purchaser or holder with respect to (A) the design and terms of the securities, (B) the purchaser or holder’s investment in the securities, or (C) the exercise of or failure to exercise any rights we have under or with respect to the securities;

(ii) we and our affiliates have acted and will act solely for our own account in connection with (A) all transactions relating to the securities and (B) all hedging transactions in connection with our obligations under the securities;

(iii) any and all assets and positions relating to hedging transactions by us or our affiliates are assets and positions of those entities and are not assets and positions held for the benefit of the purchaser or holder;

(iv) our interests are adverse to the interests of the purchaser or holder; and

(v) neither we nor any of our affiliates is a fiduciary or adviser of the purchaser or holder in connection with any such assets, positions or transactions, and any information that we or any of our affiliates may provide is not intended to be impartial investment advice.

Each purchaser and holder of the securities has exclusive responsibility for ensuring that its purchase, holding and disposition of the securities do not violate the prohibited transaction rules of ERISA or the Code or any Similar Law. The sale of any securities to any Plan or plan subject to Similar Law is in no respect a representation by us or any of our affiliates or representatives that such an investment meets all relevant legal requirements with respect to

investments by plans generally or any particular plan, or that such an investment is appropriate for plans generally or any particular plan. In this regard, neither this discussion nor anything provided in this document is or is intended to be investment advice directed at any potential Plan purchaser or at Plan purchasers generally and such purchasers of these securities should consult and rely on their own counsel and advisers as to whether an investment in these securities is suitable.

However, individual retirement accounts, individual retirement annuities and Keogh plans, as well as employee benefit plans that permit participants to direct the investment of their accounts, will not be permitted to purchase or hold the securities if the account, plan or annuity is for the benefit of an employee of Morgan Stanley or

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Morgan Stanley Wealth Management or a family member and the employee receives any compensation (such as, for example, an addition to bonus) based on the purchase of the securities by the account, plan or annuity.

**Additional considerations:**

Client accounts over which Morgan Stanley, Morgan Stanley Wealth Management or any of their respective subsidiaries have investment discretion are not permitted to purchase the securities, either directly or indirectly.

The agent may distribute the securities through Morgan Stanley Smith Barney LLC (“Morgan Stanley Wealth Management”), as selected dealer, or other dealers, which may include Morgan Stanley & Co. International plc (“MSIP”) and Bank Morgan Stanley AG. Morgan Stanley Wealth Management, MSIP and Bank Morgan Stanley AG are affiliates of ours. Selected dealers, including Morgan Stanley Wealth Management, and their financial advisors will collectively receive from the agent, Morgan Stanley & Co. LLC, a fixed sales commission of \$0.20 for each security they sell. In addition, Morgan Stanley Wealth Management will receive a structuring fee of \$0.05 for each security.

**Supplemental information regarding plan of distribution; conflicts of interest:**

MS & Co. is an affiliate of MSFL and a wholly owned subsidiary of Morgan Stanley, and it and other affiliates of ours expect to make a profit by selling, structuring and, when applicable, hedging the securities.

MS & Co. will conduct this offering in compliance with the requirements of FINRA Rule 5121 of the Financial Industry Regulatory Authority, Inc., which is commonly referred to as FINRA, regarding a FINRA member firm’s distribution of the securities of an affiliate and related conflicts of interest. MS & Co. or any of our other affiliates may not make sales in this offering to any discretionary account. See “Plan of Distribution (Conflicts of Interest)” and “Use of Proceeds and Hedging” in the accompanying product supplement for auto-callable securities.

**Validity of the securities:**

In the opinion of Davis Polk & Wardwell LLP, as special counsel to MSFL and Morgan Stanley, when the securities offered by this pricing supplement have been executed and issued by MSFL, authenticated by the trustee pursuant to the MSFL Senior Debt Indenture (as defined in the accompanying prospectus) and delivered against payment as contemplated herein, such securities will be valid and binding obligations of MSFL and the related guarantee will be a valid and binding obligation of Morgan Stanley, enforceable in accordance with their terms, subject to applicable bankruptcy, insolvency and similar laws affecting creditors’ rights generally, concepts

of reasonableness and equitable principles of general applicability (including, without limitation, concepts of good faith, fair dealing and the lack of bad faith), *provided* that such counsel expresses no opinion as to (i) the effect of fraudulent conveyance, fraudulent transfer or similar provision of applicable law on the conclusions expressed above and (ii) any provision of the MSFL Senior Debt Indenture that purports to avoid the effect of fraudulent conveyance, fraudulent transfer or similar provision of applicable law by limiting the amount of Morgan Stanley's obligation under the related guarantee. This opinion is given as of the date hereof and is limited to the laws of the State of New York, the General Corporation Law of the State of Delaware and the Delaware Limited Liability Company Act. In addition, this opinion is subject to customary assumptions about the trustee's authorization, execution and delivery of the MSFL Senior Debt Indenture and its authentication of the securities and the validity, binding nature and enforceability of the MSFL Senior Debt Indenture with respect to the trustee, all as stated in the letter of such counsel dated November 16, 2017, which is Exhibit 5-a to the Registration Statement on Form S-3 filed by Morgan Stanley on November 16, 2017.

**Contact:**

Morgan Stanley Wealth Management clients may contact their local Morgan Stanley branch office or our principal executive offices at 1585 Broadway, New York, New York 10036 (telephone number (866) 477-4776). All other clients may contact their local brokerage representative. Third-party distributors may contact Morgan Stanley Structured Investment Sales at (800) 233-1087.

Morgan Stanley and MSFL have filed a registration statement (including a prospectus, as supplemented by the product supplement for auto-callable securities) with the Securities and Exchange Commission, or SEC, for the offering to which this communication relates. You should read the prospectus in that registration statement, the product supplement for auto-callable securities and any other documents relating to this offering that Morgan Stanley and MSFL have filed with the SEC for more complete information about Morgan Stanley, MSFL and this offering. You may get these documents without cost by visiting EDGAR on the SEC web site at [www.sec.gov](http://www.sec.gov). Alternatively, Morgan Stanley, MSFL, any underwriter or any dealer participating in the offering will arrange to send you the product supplement for auto-callable securities and prospectus if you so request by calling toll-free 1-(800)-584-6837.

**Where you can find more information:**

You may access these documents on the SEC web site at [www.sec.gov](http://www.sec.gov) as follows:

**[Product Supplement for Auto-Callable Securities dated November 16, 2017](#)**

**[Prospectus dated November 16, 2017](#)**

Terms used but not defined in this document are defined in the product supplement for auto-callable securities or in the prospectus.

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