SELECTIVE INSURANCE GROUP INC
Form 10-K
February 21, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K
(Mark One)

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

For the fiscal year ended: December 31, 2012
or

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

For the transition period from_______________________to_______________________

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

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

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $2 per share	NASDAQ Global Select Market
5.875% Senior Notes due February 9, 2043	New York Stock Exchange
7.5% Junior Subordinated Notes due September 27, 2066	New York Stock Exchange

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
ý Yes ¨ No

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

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

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

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

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

The aggregate market value of the voting company common stock held by non-affiliates of the registrant, based on the closing price on the NASDAQ Global Select Market, was $933,516,947 on June 30, 2012. As of February 15, 2013, the registrant had outstanding 55,454,587 shares of common stock.

DOCUMENTS INCORPORATED BY REFERENCE
Portions of the registrant's definitive Proxy Statement for the 2013 Annual Meeting of Stockholders to be held on April 24, 2013 are incorporated by reference into Part III of this report.

SELECTIVE INSURANCE GROUP, INC.
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PART I

Item 1. Business.

Overview

Selective Insurance Group, Inc. (referred to as the “Parent”) is a New Jersey holding company that was incorporated in 1977. The Parent has nine insurance subsidiaries that are licensed by various state departments of insurance to write specific lines of property and casualty insurance in the standard market. Two of these subsidiaries, Selective Casualty Insurance Company and Selective Fire and Casualty Insurance Company, were created in 2012 and began writing direct premium in 2013. In addition, in December 2011 we acquired one subsidiary, Mesa Underwriters Specialty Insurance Company ("MUSIC"), that is authorized by various state insurance departments to write property and casualty insurance in the excess and surplus lines ("E&S") market. Our ten insurance subsidiaries are collectively referred to as the “Insurance Subsidiaries.” The Parent and its subsidiaries are collectively referred to as "we," “us,” or “our” in this document.

Our main office is located in Branchville, New Jersey and the Parent’s common stock is publicly traded on the NASDAQ Global Select Market under the symbol “SIGI.” In 2012, we were ranked as the 49th largest property and casualty group in the United States based on 2011 net premium written (“NPW”) in A.M. Best and Company’s (“A.M. Best”) annual list of “Top 200 U.S. Property/Casualty Writers.” We have provided a glossary of terms as Exhibit 99.1 to this Form 10-K, which defines certain industry-specific and other terms that are used in this Form 10-K.

We classify our business into three operating segments:

- Standard Insurance Operations - in which we sell commercial lines ("Commercial Lines") and personal lines ("Personal Lines") insurance products and services that are sold in the standard marketplace including flood business through the National Flood Insurance Program ("NFIP");
- E&S Insurance Operations - in which we sell Commercial Lines insurance products and services that are unavailable in the standard market due to the market conditions or characteristics of the insured that are caused by the insured's claim history or the characteristics of their business; and
- Investments - in which we invest the premiums our Standard Insurance Operations and E&S Insurance Operations collect.

Prior to this year, we classified our business into two segments: Insurance Operations and Investments. The addition of the E&S segment resulted from the acquisitions that we made in 2011 related to this business. For information regarding these acquisition, see Note 12. "Business Combinations" of Item 8. "Financial Statements and Supplementary Data" of this Form 10-K. As our E&S segment currently meets the quantitative threshold for separate segment reporting, our revised segments are reflected throughout this report for all periods presented.

We derive substantially all of our income in three ways:

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

- Net investment income from investments. We generate income from investing: (i) insurance premiums from the time they are collected until the time we need to make certain expenditures such as paying loss and loss expenses, underwriting expenses; (ii) policyholder dividends; and (iii) equity and debt offering obligations. Net investment income consists primarily of interest earned on fixed maturity investments, dividends earned on equity securities, and other income primarily generated from our alternative investment portfolio.

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

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

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

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

Insurance Segments (Standard and E&S)
Overview

We derive all of our insurance operations revenue from selling insurance products and services to businesses and individuals for premium. Our Commercial Lines sales are to businesses, non-profit organizations, and local government entities, and between Standard Insurance Operations and E&S Insurance Operations, represent about 83% of our NPW. Our Personal Lines sales including our flood business are to individuals and represents about 17% of our NPW. The majority of our sales are annual insurance policies. Commercial Lines sales are seasonally heaviest in January and July and lightest during the fourth quarter of the year.

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

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

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

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

- E&S insurance, which generally provides property and casualty coverage through established underwriting guidelines to small commercial accounts with moderate degrees of hazard that do not have access to coverage in the standard markets because of their small premium size, unique/niche risk characteristics, and/or regulatory restrictions that prevent standard markets from offering appropriate underwriting terms and conditions. E&S property claims are generally reported and settled in a relatively short period of time, whereas E&S casualty claims may take several years to be reported and settled.

We underwrite and insure Commercial Lines of business primarily through traditional insurance and, to a lesser extent, through alternative risk management products, such as retrospective rating plans, self-insured group retention programs, or individual self-insured accounts. The following table shows the principal types of policies we write in our Standard Insurance Operations and our E&S Insurance Operations:

Type of Policy	Category of Insurance	Standard Insurance Operations	E&S Insurance Operations
Commercial Property	Property	X	X
Commercial Automobile	Property/Casualty	X	
General Liability (including Excess Liability/Umbrella)	Casualty	X	X
Workers Compensation	Casualty	X	
Business Owners Policy	Property/Casualty	X	
Bonds (Fidelity and Surety)	Casualty	X	
Flood[1]	Property	X	

[1]Flood insurance premiums and losses are 100% ceded to the federal government's WYO Program. Certain other policies contain minimal Flood or Flood related coverages.

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

Type of Policy	Category of Insurance	Standard Insurance Operations
Homeowners	Property/Casualty	X
Personal Automobile	Property/Casualty	X
Flood[1]	Property	X

[1]Flood insurance premiums and losses are 100% ceded to the federal government's WYO Program. Certain other policies contain minimal Flood or Flood related coverages.

Product Development and Pricing

Our insurance policies are contracts that specify our coverages – what we will pay to or for an insured upon specified losses. We develop our coverages internally and by adopting and modifying forms and statistical data licensed from third party aggregators, notably Insurance Services Office, Inc. ("ISO") and the National Council on Compensation Insurance, Inc. ("NCCI"). Determining the price to charge for our coverages is complicated. At the time we underwrite and issue a policy, we do not know what our actual costs for the policy will be in the future. To calculate and project future costs, we examine and analyze historical statistical data and factor in expected changes in loss trends. In the last five years, we have also developed predictive models for certain of our standard insurance lines. Predictive models analyze historical statistical data regarding our insureds and their loss experience, rank our policies based on this analysis, and apply this risk data to current and future insureds to predict the likely profitability of an account. A model's predictive capabilities are limited by the amount and quality of the statistical data available. As a regional insurance group, our loss experience is not always statistically large enough to analyze and project future costs. Consequently, we use ISO data to supplement our own.

Customers and Customer Markets

Commercial Lines customers represent 83% of our total DPW. We categorize this business as follows:

	Percent of Total Commercial Lines		Average Premium per Policy	Description
Small Business	21	%	$2,488	

			Standard insurance policies generally under $25,000, with certain restrictions for hazard grade and exposure that can be written through our internet-based One & Done® and Two & Done automated underwriting templates.
Middle Market Business	62	%	$9,323	Standard insurance policies that cannot be written through our automated systems and are the focus of our field-based underwriters, known as agency management specialists ("AMSs").
Large Account Business	10	%	$142,140	Standard insurance policies that are larger in size or include alternative risk transfer. This business is written by large account specialists. Approximately 25% of these accounts include alternative risk transfer mechanisms.
E&S Business	7	%	$2,564	E&S insurance policies that are generally written through contract binding authority under established underwriting guidelines with our wholesale general agency partners.

We do not subdivide our Personal Lines customers by size or class. No one customer accounts for 10% or more of our Standard or E&S Insurance Operations segments.

Geographic Markets

We principally sell our standard insurance products and services in 22 states and the District of Columbia in the Eastern and Midwestern regions of the United States. However, we also provide Flood and E&S insurance in all 50 states and the District of Columbia. We believe this geographic diversification lessens our exposure to regulatory, competitive, and catastrophic risk. The following table lists the principal states in which we write business and the percentage of total NPW each represents for the last three fiscal years:

	Year Ended December 31,			
% of NPW	2012		2011	2010
New Jersey	23.3	%	25.3	26.2
Pennsylvania	12.0		13.0	13.8
New York	7.6		8.3	9.0
Maryland	5.7		6.4	6.9
Illinois	4.9		5.5	5.5
Virginia	4.9		5.3	5.3
Indiana	5.0		4.9	4.8
Michigan	3.5		3.6	3.0
Georgia	3.1		3.1	3.1
North Carolina	3.1		3.0	3.3
South Carolina	3.0		2.7	2.6
Ohio	2.6		2.7	2.5
Other states	21.3		16.2	14.0
Total	100.0	%	100.0	100.0

Distribution and Marketing

We sell and distribute our Standard Insurance Operations products and services through independent retail insurance agents. Our Standard Insurance Operations, excluding our flood business, had retail agency agreements with approximately 1,100 independent agencies, as of December 31, 2012, many of which have multiple offices. In total, approximately 1,800 independent agency offices are selling this business for us. In addition, we have approximately 5,000 agents selling our flood products. We sell and distribute our E&S Insurance Operations products through 95 wholesale general agencies, to which we have given contract binding authority for the business they receive from independent retail insurance agents. We pay our agencies commissions and other consideration for business placed with us. We seek to compensate our agencies fairly and consistent with market practices. No one agency is responsible for 10% or more of our combined insurance operations premium.

Independent retail insurance agents and brokers write approximately 80% of standard market commercial property and casualty insurance and approximately a third of the standard market personal lines insurance in the United States according to a study released in 2011 by the Independent Insurance Agents & Brokers of America and E&S business is written almost exclusively through wholesale general agents. We believe that independent retail insurance agents will remain a significant force in overall insurance industry premium production because they represent more than one insurance carrier and can provide a wider choice of commercial lines and personal lines insurance products to insureds. Because our agencies generally represent several of our competitors, we face competition within our distribution channel. As our customers rely heavily on their independent retail insurance agent, it is sometimes difficult to develop brand recognition with our customers, who cannot always differentiate between insurance coverage and insurance carriers.

Our primary marketing strategy with agents is to:

- Use a business model that provides them resources within close geographic proximity, including: (i) field underwriters; (ii) regional office underwriters; (iii) safety management specialists; (iv) field claims personnel; and (v) field marketing specialists. These resources make timely underwriting and claim decisions based on established authority parameters.
- Develop close relationships with each agency and its principals: (i) by soliciting their feedback on products and services; (ii) by advising them concerning company developments; and (iii) through significant interaction with them focusing on producer recruitment, sales training, enhancing customer experience, online marketing, and agency operations.

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

In our most recent survey of our Standard Insurance Operations, which was conducted in 2012, we received an overall satisfaction score of 8.3 out of 10 from our agents, which highlighted our agents' satisfaction with our standard Commercial Lines products, the ease of reporting claims, and the professionalism and effectiveness of our employees.

Field and Technology Strategies Supporting Independent Retail Agent Distribution
We use the service mark "High-tech x High-touch = HT^{2} SM" to describe our Standard Insurance Operations business strategy. "High-tech" refers to our technology that we use to make it easy for our independent retail insurance agents and customers to do standard business with us. "High-touch" refers to the close relationships that we have with our independent retail insurance agents and customers due to our field business model that places underwriters, claims representatives, technical staff, and safety management representatives near our agents and customers.

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

At December 31, 2012, we had approximately 2,100 employees, 300 of which work in the field.

We provide support to our field model from our corporate headquarters in Branchville, New Jersey, and our six regional branches ("Regions"). The table below lists our Regions and where they have office locations:

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

Underwriting Process Involving Agents and Field Model
Our underwriting process requires communication and interaction among:

- Our independent retail agents, who act as front-line underwriters, our AMSs, our SMSs, our field marketing specialists ("FMSs"), as well as our corporate and regional underwriters;
- Our wholesale general agents, who use guidelines developed by our corporate E&S underwriters to write business that they receive from retail insurance agents under contract binding authority.
- Our flood agents who act as front-line underwriters for our business under the NFIP's WYO Program.
- Our corporate underwriting department, which includes our strategic business units ("SBUs"), organized by product and customer type, and our line-of-business units. These units develop our pricing and underwriting guidelines in conjunction with the Regions;
- Our Regions, which establish: (i) annual premium and pricing goals in consultation with the SBUs; (ii) agency new business targets; and (iii) agency profit improvement plans; and
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Our Actuarial Department, located in our corporate headquarters, which assists in the determination of rate and pricing levels, while also monitoring pricing and profitability.

We also have an underwriting service center ("USC") located in Richmond, Virginia. The USC assists our independent retail agents by servicing our Standard Insurance Operations through Personal Lines, Commercial Lines and Small Business and Middle Market accounts. At the USC, our employees are licensed agents who respond to customer inquiries about insurance coverage, billing transactions, and other matters. For the convenience of using the USC and our handling of certain transactions, our independent retail agents agree to receive a slightly lower than standard commission for the premium associated with the USC. As of December 31, 2012 our USC was servicing standard Commercial Lines NPW of $47 million, and Personal Lines NPW of $27 million. The $74 million total serviced by the USC represents 4% of our total NPW.

We believe that our field model has a distinct advantage in its ability to provide a wide range of front-line safety management services focused on improving an insured’s safety and risk management programs – and we have obtained the service mark “Safety Management: Solutions for a safer workplace®.” Safety management services include: (i) risk evaluation and improvement surveys intended to evaluate potential exposures and provide solutions for mitigation; (ii) Internet-based safety management educational resources, including a large library of coverage-specific safety materials, videos and online courses, such as defensive driving and employee educational safety courses; (iii) thermographic infrared surveys aimed at identifying electrical hazards; and (iv) Occupational Safety and Health Administration construction and general industry certification training. Risk improvement efforts for existing customers are designed to improve loss experience and policyholder retention through valuable ongoing consultative service. Our safety management goal is to work with our insureds to identify and eliminate potential loss exposures.

Claims Management and Field Claims Model

Effective, fair, and timely claims management is one of the most important services that we provide our customers and agents. It also is one of the critical factors in achieving underwriting profitability. We have structured our claims organization to emphasize: (i) cost-effective delivery of claims services and control of loss and loss expenses; and (ii) maintenance of timely and adequate claims reserves. In connection with our Standard Insurance Operations, we believe that we can achieve lower claims expenses through our field model by locating claims representatives in close proximity to our customers and independent retail agents. For our E&S Insurance Operations, we use external adjusters who are situated close to claimants.

Claims management specialists (“CMSs”) are primarily responsible for investigating and settling the majority of our Standard Insurance Operations' non-workers compensation claims directly with insureds and claimants. By promptly and personally investigating claims, we believe CMSs are able to provide better customer and agent service and quickly resolve claims within their authority. All workers compensation claims are handled in the Regional Claim Offices. Workers compensation adjusters specialize in investigation, medical management or lost-time claims. Because of the special nature of property claims, CMSs refer those claims above certain amounts to our general property adjusters for consultation. We also refer complex liability claims to an experienced adjusting team that focuses solely on complex large exposure liability claims. All environmental claims are referred to our specialized corporate environmental unit. This structure allows us to provide experienced adjusting to each claim segment.

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

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

Technology

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

- Our independent retail agents, wholesale agents, and customers with access to accurate business information and the ability to process certain transactions from their locations, seamlessly integrating those transactions into our systems;
- Our SIU investigators access to our business intelligence systems to better identify claims with potential fraudulent activities;
- Our claims recovery and subrogation departments have the ability to expand and enhance their models through the use of our business intelligence systems, an effort that is expected to be completed over the coming year; and
- Our underwriters with targeted pricing tools to enhance profitability while growing the business.

In 2012, we received the Interface Partner Award from Applied Systems, an automated solutions provider to independent retail insurance agents for the fifth consecutive year. The award recognizes our leadership and innovation in our interface advancements in download and real-time rating. We also received the following four awards from the Association of Cooperative Operations Research and Development ("ACORD"):

- The Property & Casualty Straight-Through Processing of Data Accomplishment Award, which recognizes automation of the policy life cycle using ACORD standards and forms, including real-time rating/submission, policy download, and endorsement processing.
- The AUGIE (ACORD-User Group Information Exchange) Commercial Lines Download Accomplishment Award, which recognizes Selective's use of ACORD Standards to streamline workflows and improve quality of data available to users who need to service their customers.
- The Property & Casualty AL3 Download Recognition Award, for using current electronic data interchange (EDI) standards and having a solid history of download success using AL3 standards.
- The Property & Casualty Outstanding Contribution Accomplishment Award, for promoting the implementation and education of ACORD standards and best practices.

We manage our information technology projects through an Enterprise Project Management Office (“EPMO”). The EPMO is staffed by certified individuals who apply methodologies to: (i) communicate project management standards; (ii) provide project management training and tools; (iii) review project status and cost; and (iv) provide non-technology project management consulting services to the rest of the organization. The EPMO, which includes senior management representatives from all major business areas, corporate functions and information technology, meets reguarly to review all major initiatives and receives reports on the status of other projects. We believe the EPMO is an important factor in the success of our technology implementation. Our technology operations are located in Branchville, New Jersey and Glastonbury, Connecticut. We also have agreements with multiple consulting, information technology, and managed services providers for supplemental staffing services. Collectively, these providers supply approximately 26% of our skilled technology capacity. We retain management oversight of all projects and ongoing information technology production operations. We believe we would be able to manage an efficient transition to new vendors without significant impact to our operations if we terminated an existing vendor.

In 2012, we continued our program to enhance our customers' experience with us by introducing several initiatives to bring service improvements to our customers, including: (i) expanding usage of the Customer Self Service portal; (ii) launching a mobile application to allow customers to receive service through their smart phones; and (iii) conducting customer surveys regarding billing and claims transactions.

Insurance Segments Competition

Market Competition

The commercial lines property and casualty market is highly competitive and market share is fragmented among many companies. Despite a slight economic improvement and some encouraging signs of price firming, A.M. Best maintains its negative outlook for the commercial lines segment for 2013. We compete with four types of companies, primarily on the basis of price, coverage terms, claims service, safety management services, ease of technology, and financial ratings:

- Regional insurers, such as Cincinnati Financial Corporation, Erie Indemnity Company, The Hanover Insurance Group, Inc., and United Fire Group, Inc., which offer commercial lines and personal lines products and services;
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National insurers, such as Liberty Mutual Group, The Travelers Companies, Inc., The Hartford Financial Services Group, Inc., Nationwide Mutual Insurance Company, and Zurich Insurance Group which offer commercial lines and personal lines products and services;

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

- E&S lines insurers, such as Scottsdale, Nautilus, Colony, Markel, Western World, Century Surety and Burlington, which offer a variety of property and casualty insurance products on an E&S basis. In addition, we also face competition from E&S lines insurers who work directly with retail agencies such as U.S. Liability Insurance. Our E&S business is typically small-to-medium sized accounts that are subject to a lower level of competition than larger accounts.

We also face competition in personal lines, although the market is less fragmented than commercial lines and carriers have been more successful at obtaining rate increases. The A.M. Best industry outlook for personal lines is stable, as the industry's auto line continues to perform well with generally adequate and stable returns. Our Personal Lines business faces competition primarily from the regional and national carriers noted above, as well as direct insurers such as GEICO and The Progressive Corporation, which primarily offer personal lines coverage and market through a direct response model.

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

Financial Ratings

Our Insurance Subsidiaries' ratings by major rating agencies, are as follows:

Rating Agency	Financial Strength Rating	Outlook
A.M. Best and Company	A	Stable
Standard & Poor's ("S&P")	A	Negative
Moody's Investors Service ("Moody's")	A2	Negative
Fitch Ratings ("Fitch")	A+	Stable

Because agent and customer concerns about an insurer's ability to pay claims in the future are such an important factor in our competitiveness, our financial ratings are important. Major financial rating agencies evaluate us on our financial strength, operating performance, strategic position, and ability to meet policyholder obligations. We believe that our ability to write insurance business is most significantly influenced by our rating from A.M. Best. We have been rated "A" or higher by A.M. Best for the past 82 years. In the second quarter of 2012, A.M. Best lowered our rating to "A (Excellent)", their third highest of 15 ratings, with a "Stable" outlook. In making this change, A.M. Best cited solid risk- adjusted capitalization, disciplined underwriting focus, increasing use of predictive modeling technology, and our strong independent retail agency relationships but stated our operating performance over the past five-year period was not as favorable as the commercial property casualty index and that we had been negatively impacted by record catastrophic and weather-related losses. A downgrade from A.M. Best to a rating below "A-" could: (i) affect our ability to write new business with customers and/or agents, some of whom are required (under various third-party agreements) to maintain insurance with a carrier that maintains a specified A.M. Best minimum rating; or (ii) be an event of default under our Line of Credit.

Our "A" financial strength rating was reaffirmed in the third quarter of 2012 by S&P, which cited our strong competitive position in Mid-Atlantic markets, financial flexibility, and relationships with independent retail agents while our outlook was revised to "negative" reflecting a modest decline in available capital and increased charges for underwriting risk, asset risk, and property catastrophe exposure as measured by Standard & Poor's capital adequacy model. On February 4, 2013, Moody's cited our strong regional franchise with established independent retail agency support, along with good risk adjusted capitalization and strong invested asset quality to reaffirm our financial strength rating of "A2" but revised our outlook to negative, citing that our underwriting results have lagged similarly rated peers. Fitch reaffirmed our "A+" rating and stable outlook in the fourth quarter of 2012, citing our conservative balance sheet with solid capitalization and reserve strength, strong independent agency relationships, and improved diversification through our continued efforts to reduce our concentration in New Jersey.

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

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

Reinsurance

We use reinsurance to protect our capital resources and insure us against losses on property and casualty risks that we underwrite. We use two main reinsurance vehicles: (i) a reinsurance pooling agreement among our Insurance Subsidiaries in which each company agrees to share in premiums and losses based on certain specified percentages; and (ii) reinsurance contracts and arrangements with third parties that cover various policies that our insurance operations issue to insureds.

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

- Pool or share proportionately the underwriting profit and loss results of property and casualty insurance underwriting operations through reinsurance;

- Prevent any of our Insurance Subsidiaries from suffering undue loss;

- Reduce administration expenses; and

- Permit all of the Insurance Subsidiaries to obtain a uniform rating from A.M. Best.

We amended the Pooling Agreement twice in 2012: (i) to add MUSIC; and (ii) to add the formation of two new insurance companies, Selective Casualty Insurance Company ("SCIC") and Selective Fire and Casualty Insurance Company ("SFCIC").

The following illustrates the pooling percentages by company for the respective time frames throughout 2012:

Insurance Subsidiary	Pooling Percentage January 1 - June 30, 2012	Pooling Percentage July 1 - December 31, 2012
Selective Insurance Company of America ("SICA")	44.5%	32.0%
Selective Way Insurance Company ("SWIC")	21.0%	21.0%
Selective Insurance Company of South Carolina ("SICSC")	9.0%	9.0%
Selective Insurance Company of the Southeast ("SICSE")	7.0%	7.0%
Selective Insurance Company of New York ("SICNY")	7.0%	7.0%
SCIC	—%	7.0%
Selective Auto Insurance Company of New Jersey ("SAICNJ")	6.0%	6.0%
MUSIC	5.0%	5.0%
Selective Insurance Company of New England ("SICNE")	0.5%	3.0%
SFCIC	—%	3.0%

Reinsurance Treaties and Arrangements
By entering reinsurance treaties and arrangements, we are able to increase underwriting capacity and accept larger risks and a larger number of risks without directly increasing capital or surplus. All of our reinsurance treaties are for traditional reinsurance; we do not purchase finite reinsurance. Under our reinsurance treaties, the reinsurer generally assumes a portion of the losses we cede to them in exchange for a portion of the premium. Amounts not reinsured are known as retention. Reinsurance does not legally discharge us from liability under the terms and limits of our policies,

but it does make our reinsurer liable to us for the amount of liability we cede to them. Accordingly, we have counterparty credit risk to our reinsurers. We attempt to mitigate this credit risk by: (i) pursuing relationships with reinsurers rated “A-” or higher; and (ii) obtaining collateral to secure reinsurance obligations when possible. Some of our reinsurance contracts include provisions that permit us to terminate or commute the reinsurance treaty if the reinsurer's financial condition or rating deteriorates. We continuously monitor the financial condition of our reinsurers. We also continuously review the quality of reinsurance recoverables and reserves for uncollectible reinsurance.

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

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

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

- Protection provided under the Terrorism Risk Insurance Act of 2002 as modified and extended through December 31, 2014 by the Terrorism Risk Insurance Program Reauthorization Act of 2007 (collectively referred to as "TRIA"). Under TRIA, terrorism coverage is mandatory for all primary workers compensation policies. Insureds with non-workers compensation commercial policies, however, have the option to accept or decline our terrorism coverage or negotiate with us for other terms. Under TRIA, each participating insurer is responsible for paying a deductible of specified losses based on a percentage of the prior year's applicable commercial lines direct premiums earned before federal assistance is available. In 2013, our deductible is approximately $209 million. For losses above the deductible, the federal government will pay 85% and the insurer retains 15%. Although TRIA's provisions will mitigate our loss exposure to a large-scale terrorist attack, our deductible is substantial.

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

PROPERTY REINSURANCE ON INSURANCE PRODUCTS

Treaty Name	Reinsurance Coverage	Terrorism Coverage
Property Excess of Loss (covers standard lines)	$38 million above $2 million retention in two layers. Losses other than TRIA certified losses are subject to the following reinstatements and annual aggregate limits: - $8 million in excess of $2 million layer provides an unlimited reinstatements; and - $30 million in excess of $10 million layer provides three reinstatements, $120 million in aggregate limits.	All nuclear, biological, chemical, and radioactive ("NBCR") losses are excluded regardless of whether or not they are certified under TRIA. For non-NBCR losses, the treaty distinguishes between acts certified under TRIA and those that are not. The treaty provides annual aggregate limits for TRIA certified (other than NBCR) acts of $24 million for the first layer and $60 million for the second layer. Non-certified terrorism losses (other than NBCR) are subject to the normal limits under the treaty.
Property Catastrophe Excess of Loss (covers both standard and E&S lines)	$585 million above $40 million retention in four layers: - 97% of losses in excess of $40 million up to $100 million; - 96% of losses in excess of $100 million up to $225 million; and - 95% of losses in excess of $225 million up to $475 million.	All nuclear, biological, and chemical ("NBC") losses are excluded regardless of whether or not they are certified under TRIA. TRIA losses related to foreign acts of terrorism are excluded from the treaty. Domestic terrorism is included regardless of whether it is certified under TRIA or not. Please see Item 1A. "Risk Factors." of this Form 10-K for further discussion regarding changes in TRIA.

	- 98% of losses in excess of $475 million up to $625 million. - The treaty provides one reinstatement per layer for the first three layers and no reinstatements on the fourth layer. The annual aggregate limit is $978.9 million, net of the Insurance Subsidiaries' co-participation.	
Flood	100% reinsurance by the federal government's WYO Program.	None

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

CASUALTY REINSURANCE ON INSURANCE PRODUCTS

Treaty Name	Reinsurance Coverage	Terrorism Coverage
Casualty Excess of Loss (covers standard lines)	There are six layers covering 100% of $88 million in excess of $2 million. Losses other than terrorism losses are subject to the following reinstatements and annual aggregate limits: - $3 million in excess of $2 million layer provides 23 reinstatements, $72 million net annual aggregate limit; - $7 million in excess of $5 million layer provides three reinstatements, $28 million annual aggregate limit; - $9 million in excess of $12 million layer provides two reinstatements, $27 million annual aggregate limit; - $9 million in excess of $21 million layer provides one reinstatement, $18 million annual aggregate limit; - $20 million in excess of $30 million layer provides one reinstatement, $40 million annual aggregate limit; and - $40 million in excess of $50 million layer provides one reinstatement, $80 million in net annual aggregate limit.	All NBCR losses are excluded. All other losses stemming from the acts of terrorism are subject to the following reinstatements and annual aggregate limits: . - $3 million in excess of $2 million layer provides four reinstatements for terrorism losses, $15 million net annual aggregate limit; - $7 million in excess of $5 million layer provides two reinstatements for terrorism losses, $21 million annual aggregate limit; - $9 million in excess of $12 million layer provides two reinstatements for terrorism losses, $27 million annual aggregate limit; - $9 million in excess of $21 million layer provides one reinstatement for terrorism losses, $18 million annual aggregate limit; - $20 million in excess of $30 million layer provides one reinstatement for terrorism losses, $40 million annual aggregate limit; and - $40 million in excess of $50 million layer provides one reinstatement for terrorism losses, $80 million in net annual aggregate limit.
Montpelier Re Quota Share and Loss Development Cover	As part of the acquisition of MUSIC we entered into several reinsurance agreements that together provide protection for losses on	Provides full terrorism coverage including NBCR.

(covers E&S lines)	policies written prior to the acquisition and any development on reserves established by MUSIC as of the date of acquisition. The reinsurance recoverables under these treaties are 100% collateralized.

We also have other reinsurance treaties that we do not consider core to our reinsurance program for our standard insurance products, such as our Surety and Fidelity Excess of Loss Reinsurance Treaty, National Workers Compensation Reinsurance Pool ("NWCRP") that covers business assumed from the involuntary workers compensation pool, and our Equipment Breakdown Coverage Reinsurance Treaty. In addition, we have Property and Casualty Excess of Loss Reinsurance Treaties providing coverage on our E&S business. For further discussion on reinsurance, see the “Reinsurance” section of Item 7. “Management's Discussion and Analysis of Financial Condition and Results of Operations.” of this Form 10-K.

Claims Reserves

Net Loss and Loss Expense Reserves
We establish loss and loss expense reserves that are estimates of the amounts we will need to pay in the future for claims and related expenses for insured losses that have already occurred. Estimating reserves as of any date involves a considerable degree of judgment by management and is inherently uncertain. We regularly review our reserving techniques and our overall amount of reserves. We also review:

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

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

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

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

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

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

- Section IV shows the re-estimated gross liability and re-estimated reinsurance recoverables through December 31, 2012.

- Section V shows the cumulative net (deficiency)/redundancy representing the aggregate change in the liability from the original balance sheet dates and the re-estimated liability through December 31, 2012.

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

($ in millions)	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
I. Gross reserves for unpaid losses and loss expenses at December 31	$1,403.4	1,587.8	1,835.2	2,084.0	2,288.8	2,542.5	2,641.0	2,745.8	2,830.1	3,144.9	4,068.9
Reinsurance recoverables on unpaid losses and loss expenses at December 31	$(160.4)	(184.6)	(218.8)	(218.2)	(199.7)	(227.8)	(224.2)	(271.6)	(313.7)	(549.5)	(1,409.7)
Net reserves for unpaid losses and loss expenses at December 31	$1,243.1	1,403.2	1,616.4	1,865.8	2,089.0	2,314.7	2,416.8	2,474.2	2,516.3	2,595.4	2,659.2
II. Net reserves estimate as of:											
One year later	$1,258.1	1,408.1	1,621.5	1,858.5	2,070.2	2,295.4	2,387.4	2,430.6	2,477.6	2,569.8	
Two years later	1,276.3	1,452.3	1,637.3	1,845.1	2,024.0	2,237.8	2,324.6	2,368.1	2,428.6		
Three years later	1,344.6	1,491.1	1,643.7	1,825.2	1,982.4	2,169.7	2,286.0	2,315.0			
Four years later	1,371.5	1,522.9	1,649.8	1,808.9	1,931.1	2,155.8	2,264.9				
Five years later	1,413.8	1,529.2	1,653.6	1,780.7	1,916.0	2,151.5					
Six years later	1,420.8	1,538.4	1,639.5	1,777.3	1,924.4						
Seven years later	1,428.7	1,535.6	1,638.7	1,789.3							
Eight years later	1,430.0	1,539.1	1,648.0								
Nine years later	1,435.7	1,546.6									
Ten years later	1,445.1										

Cumulative net redundancy (deficiency)	(202.1)	(143.4)	(31.6)	76.5	164.7	163.2	151.9	159.2	87.7	25.6
III. Cumulative amount of net reserves paid through:										
One year later	$384.0	414.5	422.4	468.6	469.4	579.4	584.5	561.3	569.9	632.7
Two years later	653.3	691.4	729.5	775.0	841.3	945.5	966.8	936.7	990.8	
Three years later	836.3	903.7	942.4	1,026.9	1,080.0	1,201.6	1,238.3	1,235.8		
Four years later	966.2	1,033.5	1,101.0	1,174.2	1,235.2	1,388.7	1,439.5			
Five years later	1,044.6	1,128.4	1,189.2	1,267.1	1,347.0	1,513.0				
Six years later	1,110.0	1,184.5	1,245.4	1,341.8	1,426.8					
Seven years later	1,151.8	1,225.3	1,294.2	1,399.6						
Eight years later	1,183.0	1,262.5	1,333.8							
Nine years later	1,213.4	1,291.1								
Ten years later	1,235.4									
IV. Re-estimated gross liability	1,736.9	1,853.6	1,961.5	2,116.2	2,206.4	2,429.1	2,547.9	2,609.8	2,750.2	3,098.7
Re-estimated reinsurance recoverables	(291.8)	(307.0)	(313.5)	(326.9)	(282.1)	(277.5)	(283.0)	(294.9)	(321.6)	(528.9)
Re-estimated net liability	1,445.1	1,546.6	1,648.0	1,789.3	1,924.4	2,151.5	2,264.9	2,315.0	2,428.6	2,569.8
V. Cumulative gross redundancy (deficiency)	(333.5)	(265.8)	(126.3)	(32.2)	82.4	113.4	93.1	136.0	79.9	46.2
Cumulative net redundancy (deficiency)	(202.1)	(143.4)	(31.6)	76.5	164.7	163.2	151.9	159.2	87.7	25.6

Note: Some amounts may not foot due to rounding.

In light of the many uncertainties associated with establishing the estimates and making the assumptions necessary to establish reserve levels, we review our reserve estimates on a regular basis and make adjustments in the period that the need for such adjustment is determined. These reviews could result in the identification of information and trends that would require us to increase some reserves and/or decrease other reserves for prior periods and could also lead to additional increases in loss and loss expense reserves, which could have a material adverse effect on our results of operations, equity, insurer financial strength, and debt ratings.

In 2012, we experienced overall favorable loss development of approximately $26 million compared to $39 million in 2011 and $44 million in 2010. The following table summarizes the prior year development by line of business:

Favorable/(Unfavorable) Prior Year Development

($ in millions)	2012	2011	2010
General Liability	$(3)	12	26
Commercial Automobile	9	13	28
Workers' Compensation	(2)	(7)	(22)
Business Owners' Policies	9	11	3
Commercial Property	3	6	3
Homeowners	9	4	6
Personal Automobile	—	(1)	(2)
Other	1	1	2
Total	$26	39	44

For a qualitative discussion of our prior year development, see Note 9. "Reserves for Losses and Loss Expenses" in Item 8. "Financial Statements and Supplementary Data." of this Form 10-K.

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

($ in thousands)	2012	2011
Statutory losses and loss expense reserves	$2,654,418	2,591,570
Provision for uncollectible reinsurance	4,800	3,900
Other	(32)	(36)
GAAP losses and loss expense reserves – net	2,659,186	2,595,434
Reinsurance recoverables on unpaid losses and loss expenses	1,409,755	549,490
GAAP losses and loss expense reserves – gross	$4,068,941	3,144,924

Asbestos and Environmental Reserves

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

“Asbestos claims” are claims for bodily injury alleged to have occurred from exposure to asbestos-containing products. Our primary exposure arises from insuring various distributors of asbestos-containing products, such as electrical and plumbing materials. At December 31, 2012, asbestos claims constituted 28% of our $27.8 million net asbestos and environmental reserves compared to 24% of our $27.9 million net asbestos and environmental reserves at December 31, 2011.

“Environmental claims” are claims alleging bodily injury or property damage from pollution or other environmental contaminants other than asbestos. These claims include landfills and leaking underground storage tanks. Our landfill exposure lies largely in policies written on municipal governments, in their operation or maintenance of certain public lands. In addition to landfill exposures, in recent years, we have experienced a relatively consistent level of reported losses in the homeowners line of business related to claims for groundwater contamination from leaking underground heating oil storage tanks in New Jersey. In 2007, we instituted a fuel oil system exclusion on our New Jersey homeowners policies that limits our exposure to leaking underground storage tanks for certain customers. At that time, existing insureds were offered a one-time opportunity to buy back oil tank liability coverage. The exclusion applies to all new homeowners policies in New Jersey. These customers are eligible for the buy-back option only if the tank meets specific eligibility criteria.

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

Estimating IBNR reserves for asbestos and environmental claims is difficult because of the delayed and inconsistent reporting patterns associated with these claims. In addition, there are significant uncertainties associated with estimating critical assumptions, such as average clean-up costs, third-party costs, potentially responsible party shares, allocation of damages, litigation and coverage costs, and potential state and federal legislative changes. Normal historically based actuarial approaches cannot be applied to environmental claims because past loss history is not indicative of future potential loss emergence. In addition, while certain alternative models can be applied, such models can produce significantly different results with small changes in assumptions. As a result, we do not calculate an asbestos and environmental loss range. Historically, our asbestos and environmental claims have been significantly lower in volume, with less volatility and uncertainty than many of our competitors in the commercial lines industry. This is due to the nature of the risks we insured, and the fact that we are the primary insurance carrier on the majority of these exposures, which provides more certainty in our reserve position compared to others in the insurance marketplace.

Measure of Insurance Segments Profitability

We manage and evaluate the performance and profitability of our Standard and E&S Insurance Operations segments in accordance with SAP, which differs from GAAP. Our rating agencies use SAP information to evaluate our performance, including measuring our performance against our industry peers. We base our incentive compensation to our independent retail agents and our wholesale general agents on the SAP results of our Standard Insurance Operations segment and our E&S Insurance Operations segment, respectively. In addition, we use the SAP results of our combined insurance operations as a basis for incentive compensation to employees.

We measure our statutory underwriting performance by four different ratios:

1. The loss and loss expense ratio, which is calculated by dividing incurred loss and loss expenses by NPE;

2. The underwriting expense ratio, which is calculated by dividing all expenses related to the issuance of insurance policies by NPW;

3. The dividend ratio, which is calculated by dividing policyholder dividends by NPE; and

4. The combined ratio, which is the sum of the loss and loss expense ratio, the underwriting expense ratio, and the dividend ratio.

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

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

- With regard to certain income:

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

Deferred taxes are recognized in our Consolidated Statements of Income as either a deferred tax expense or a deferred tax benefit under GAAP; whereas they are recorded directly to surplus under SAP.

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

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

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

Regarding unrealized gains and losses on fixed maturity securities:

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

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

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

Regarding recognition of the liability for our defined benefit plan:

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

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

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

	Year Ended December 31,		
($ in thousands)	2012	2011	2010
Insurance Operations Results			
NPW	$1,666,633	1,485,349	1,388,556
NPE	$1,583,869	1,439,313	1,414,612
Losses and loss expenses incurred	1,120,185	1,074,446	980,534
Net underwriting expenses incurred	542,335	470,892	445,172
Policyholders' dividends	3,449	5,284	3,878

Underwriting loss	$(82,100)	(111,309)	(14,972)
Ratios:			
Loss and loss expense ratio	70.7%	74.6	69.3
Underwriting expense ratio	32.6	31.7	32.0
Policyholders' dividends ratio	0.2	0.4	0.3
Statutory Combined ratio	103.5%	106.7	101.6
GAAP combined ratio	104.0%	107.2	101.4

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

	Simple Average of All Periods Presented	2012	2011	2010	2009	2008
Insurance Operations Ratios:[1]						
Loss and loss expense	69.9	70.7	74.6	69.3	67.9	67.2
Underwriting expense	32.1	32.6	31.7	32.0	32.3	31.7
Policyholders’ dividends	0.3	0.2	0.4	0.3	0.3	0.3
Statutory combined ratio	102.3	103.5	106.7	101.6	100.5	99.2
Growth in NPW	1.5	12.2	7.0	(2.4)	(4.7)	(4.5)
Industry Ratios:[1, 2]						
Loss and loss expense	74.4	78.0	77.9	72.1	70.8	73.1
Underwriting expense	27.9	27.7	28.0	28.3	28.1	27.5
Policyholders’ dividends	0.6	0.6	0.6	0.7	0.6	0.6
Statutory combined ratio	102.9	106.2	106.5	101.0	99.5	101.2
Growth in NPW	0.7	4.9	3.5	1.0	(3.8)	(1.9)
Favorable (Unfavorable) to Industry:						
Statutory combined ratio	0.6	2.7	(0.2)	(0.6)	(1.0)	2.0
Growth in NPW	0.8	7.3	3.5	(3.4)	(0.9)	(2.6)

[1]The ratios and percentages are based on SAP prescribed or permitted by state insurance departments in the states in which the Insurance Subsidiaries are domiciled.
[2]Source: A.M. Best. The industry ratios for 2012 have been estimated by A.M. Best.

Insurance Regulation

Primary Oversight from the States in Which We Operate

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

Our various state insurance regulators are members of the NAIC. The NAIC has codified SAP and other accounting reporting formats and drafts model insurance laws and regulations governing insurance companies. An NAIC model only becomes law when the various state legislatures enact it. The adoption of certain NAIC model laws and regulations, however, is a key aspect of the NAIC Financial Regulations Standards and Accreditation Program, which also sets forth minimum staffing and resource levels for state insurance departments. The NAIC recently adopted a model law changing reinsurance collateral requirements for reinsurers not domiciled in the United States. The adoption of the model law by states in which we operate will likely impact our ability to obtain collateral from foreign reinsurers in the future.

NAIC Monitoring Tools

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

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

- Risk-Based Capital. Risk-based capital is measured by four major areas of risk to which property and casualty insurers are exposed: (i) asset risk; (ii) credit risk; (iii) underwriting risk; and (iv) off-balance sheet risk. Insurers with total adjusted capital that is two times or less than their calculated “Authorized Control Level,” are subject to different levels of regulatory intervention and action. Based upon the 2012 statutory financial statements, which have been prepared in accordance with NAIC statutory accounting principles, the total adjusted capital for each of our Insurance Subsidiaries substantially exceeded two times their Authorized Control Level.

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

- Own Risk Solvency Assessment ("ORSA") Model Law. ORSA requires insurers to maintain a framework for identifying, assessing, monitoring, managing and reporting on the “material and relevant risks” associated with the insurer's (or insurance group's) current and future business plans. ORSA, which is currently being considered for adoption by state insurance regulators, requires companies to file an internal assessment of their solvency with insurance regulators annually beginning in 2015. Although no specific capital adequacy standard is currently articulated in ORSA, it is possible that such standard will be developed over time and may increase insurers' minimum capital requirements which could adversely impact our growth and return on equity.

Federal Regulation

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

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

- The establishment of the Federal Insurance Office (“FIO”);
- Federal Reserve oversight of financial services firms designated as systemically significant; and
- Corporate governance reforms for publicly traded companies.

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

Investment Segment

Like many other property and casualty insurance companies, we depend on income from our investment portfolio for a significant portion of our revenues and earnings. We are exposed to significant financial and capital markets risks, primarily relating to interest rates, credit spreads, equity prices, and the change in market value of our alternative investment portfolio. A decline in both income and our investment portfolio asset values could occur as a result of, among other things, volatile interest rates, a decrease in market liquidity, decreased dividend payment rates, negative market perception of credit risk with respect to types of securities in our portfolio, a decline in the performance of the underlying collateral of our structured securities, reduced returns on our alternative investment portfolio, or general market conditions.

Our Investment segment invests the premiums collected by our Standard Insurance Operations and E&S Insurance Operations to satisfy our equity and debt obligations and generate investment income. At December 31, 2012, our investment portfolio consisted of the following:

Category of Investment ($ in millions)	Carrying Value	% of Investment Portfolio
Fixed maturities	$3,850.1	89
Equities	151.4	3
Short-term investments	214.4	5
Other investments, including alternatives	114.1	3
Total	$4,330.0	100

Our investment strategy includes setting certain return and risk objectives for the fixed maturity, equity and other investment portfolios. The primary fixed maturity portfolio return objective is to maximize after-tax investment yield and income while balancing risk. A secondary objective is to meet or exceed a weighted-average benchmark of public fixed maturity indices. Within the equity portfolio, the high dividend yield equities strategy is designed to generate consistent dividend income while maintaining an expected tracking error to the S&P 500 Index. Additional equity strategies are focused on meeting or exceeding strategy specific benchmarks of public equity indices. Although yield and income generation remain the key drivers to our investment strategy, our overall philosophy is to invest with a long-term horizon along with a predominantly “buy-and-hold” approach. The return objective of the other investment portfolio, which includes alternative investments, is to meet or exceed the S&P 500 Index.

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

Executive Officers of the Registrant

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

Name, Age, Title	Occupation and Background
Gregory E. Murphy, 57 Chairman, President, and Chief Executive Officer	· Present position since May 2000 · President, Chief Executive Officer, and Director, Selective, 1999 – 2000 · President, Chief Operating Officer, and Director, Selective, 1997 – 1999 · Other senior executive, management, and operational positions, Selective, since 1980 · Certified Public Accountant (New Jersey) (Inactive) · Trustee, Newton Medical Center Foundation, since 1999 · Director, Property Casualty Insurers Association of America, since 2008 · Director, Insurance Information Institute, since 2000 · Trustee, The Institutes, since June 2001 · Graduate of Boston College (B.S. Accounting) · Harvard University (Advanced Management Program) · M.I.T. Sloan School of Management
Dale A. Thatcher, 51 Executive Vice President and Chief Financial Officer	· Present position since April 2010 · Executive Vice President, Chief Financial Officer and Treasurer, 2003 – 2010 · Senior Vice President, Chief Financial Officer and Treasurer, Selective, 2000 – 2003 · Certified Public Accountant (Ohio) (Inactive) · Chartered Property and Casualty Underwriter (CPCU) · Chartered Life Underwriter (CLU) · Member, American Institute of Certified Public Accountants · Member, Ohio Society of Certified Public Accountants · Member, Financial Executives Institute · Member, Insurance Accounting and Systems Association · University of Cincinnati (B.B.A. Accounting; M.B.A. Finance) · Harvard University (Advanced Management Program)
Ronald J. Zaleski Sr., 58 Executive Vice President and Chief Actuary	· Present position since February 2003 · Senior Vice President and Chief Actuary, Selective, 2000 – 2003 · Vice President and Chief Actuary, Selective, 1999 – 2000 · Fellow of Casualty Actuarial Society · Member, American Academy of Actuaries · Loyola College (B.A. Mathematics)
Michael H. Lanza, 51 Executive Vice President, General Counsel, and Chief Compliance Officer	· Present position since October 2007 · Senior Vice President and General Counsel, Selective, 2004 – 2007 · Member, Society of Corporate Secretaries and Corporate Governance Professionals · Member, National Investor Relations Institute · University of Connecticut (B.A.) (Honors Scholar in Political Science) · University of Connecticut School of Law (J.D.)
John J. Marchioni, 43 Executive Vice President, Insurance Operations	· Present position since February 2010 · Executive Vice President, Chief Underwriting and Field Operations Officer, 2008 – February 2010 · Executive Vice President, Chief Field Operations Officer, Selective 2007 – 2008 · Senior Vice President, Director of Personal Lines, Selective 2005 – 2007

	· Various insurance operation and government affairs positions, Selective, 1998 – 2005 · Director, Consumer Agent Portal, LLC, since September 2011 · Chartered Property Casualty Underwriter (CPCU) · Princeton University (B.A. History) · Harvard University (Advanced Management Program)
Ronald E. St. Clair, 48 Executive Vice President and Chief Information Officer	· Present position since April 2011 · IT Executive, Enterprise Resource Organization, Progressive Casualty Insurance, 2008 – March 2011 · IT Executive, Progressive Commercial Auto, Progressive Casualty Insurance, 2006 – 2008 · Harding University (B.S. Computer Science) · Case Western Reserve University (M.B.A.)
Kimberly Burnett, 55 Executive Vice President and Chief Human Resources Officer	· Present position since February 2012 · Vice President, Human Resources Operations, 2006 – 2012 · Various human resources and other operational positions, Selective, 1989-2006 · Senior Professional in Human Resources (SPHR) · Member, Society for Human Resource Management · The Ohio State University (B.A.) · Fairleigh Dickinson University, Human Resources Professional Development Certificate

Information about our Board is in our definitive Proxy Statement for the 2013 Annual Meeting of Stockholders to be held on April 24, 2013, in "Information About Proposal 1, Election of Directors," and is also incorporated by reference into Part III of this Form 10-K.

Reports to Security Holders

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

Item 1A. Risk Factors

Any of the following risk factors could cause our actual results to differ materially from historical or anticipated results. They also could have a significant impact on our business, liquidity, capital resources, results of operations, financial condition, and debt ratings. These risk factors also might affect, alter, or change actions that we might take in executing our long-term capital strategy, including but not limited to, contributing capital to any or all of the Insurance Subsidiaries, issuing additional debt and/or