

SELECTIVE INSURANCE GROUP INC

Form 10-Q

October 27, 2016

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: September 30, 2016  
or

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

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

Commission File Number: 001-33067

SELECTIVE INSURANCE GROUP, INC.

(Exact Name of Registrant as Specified in Its Charter)

New Jersey

(State or Other Jurisdiction of Incorporation or Organization)

22-2168890

(I.R.S. Employer Identification No.)

40 Wantage Avenue

Branchville, New Jersey

(Address of Principal Executive Offices)

07890

(Zip Code)

(973) 948-3000

(Registrant's Telephone Number, Including Area Code)

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

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

Yes ☒ No ☐

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

Yes ☒ No ☐

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

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

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

Yes ☐ No ☒

As of October 14, 2016, there were 57,856,321 shares of common stock, par value \$2.00 per share, outstanding.

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ITEM 1. FINANCIAL STATEMENTS.SELECTIVE INSURANCE GROUP, INC.  
CONSOLIDATED BALANCE SHEETS

|                                                                                                                           | Unaudited          |                   |
|---------------------------------------------------------------------------------------------------------------------------|--------------------|-------------------|
|                                                                                                                           | September 30, 2016 | December 31, 2015 |
| (\$ in thousands, except share amounts)                                                                                   |                    |                   |
| <b>ASSETS</b>                                                                                                             |                    |                   |
| Investments:                                                                                                              |                    |                   |
| Fixed income securities, held-to-maturity – at carrying value (fair value: \$136,094 – 2016; \$209,544 – 2015)            | \$ 130,472         | 201,354           |
| Fixed income securities, available-for-sale – at fair value (amortized cost: \$4,682,267 – 2016; \$4,352,514 – 2015)      | 4,832,532          | 4,408,203         |
| Equity securities, available-for-sale – at fair value (cost: \$122,981 – 2016; \$193,816 – 2015)                          | 147,304            | 207,051           |
| Short-term investments (at cost which approximates fair value)                                                            | 169,604            | 194,819           |
| Other investments                                                                                                         | 88,512             | 77,842            |
| Total investments (Note 4)                                                                                                | 5,368,424          | 5,089,269         |
| Cash                                                                                                                      | 1,493              | 898               |
| Interest and dividends due or accrued                                                                                     | 39,901             | 38,501            |
| Premiums receivable, net of allowance for uncollectible accounts of: \$5,907 – 2016; \$4,422 – 2015                       | 711,589            | 615,164           |
| Reinsurance recoverables, net of allowance for uncollectible accounts of: \$5,500 – 2016; \$5,700 – 2015                  | 640,012            | 561,968           |
| Prepaid reinsurance premiums                                                                                              | 151,981            | 140,889           |
| Deferred federal income tax                                                                                               | 41,656             | 92,696            |
| Property and equipment – at cost, net of accumulated depreciation and amortization of: \$198,171 – 2016; \$188,548 – 2015 | 69,812             | 65,701            |
| Deferred policy acquisition costs                                                                                         | 235,934            | 213,159           |
| Goodwill                                                                                                                  | 7,849              | 7,849             |
| Other assets                                                                                                              | 94,582             | 78,339            |
| Total assets                                                                                                              | \$ 7,363,233       | 6,904,433         |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                                                               |                    |                   |
| Liabilities:                                                                                                              |                    |                   |
| Reserve for loss and loss expenses                                                                                        | \$ 3,686,586       | 3,517,728         |
| Unearned premiums                                                                                                         | 1,306,255          | 1,169,710         |
| Short-term debt                                                                                                           | 45,000             | 60,000            |
| Long-term debt                                                                                                            | 378,551            | 328,192           |
| Current federal income tax                                                                                                | 6,509              | 7,442             |
| Accrued salaries and benefits                                                                                             | 103,583            | 167,336           |
| Other liabilities                                                                                                         | 261,845            | 255,984           |
| Total liabilities                                                                                                         | \$ 5,788,329       | 5,506,392         |
| Stockholders' Equity:                                                                                                     |                    |                   |
| Preferred stock of \$0 par value per share:                                                                               | \$ —               | —                 |
| Authorized shares 5,000,000; no shares issued or outstanding                                                              |                    |                   |
| Common stock of \$2 par value per share:                                                                                  |                    |                   |
| Authorized shares 360,000,000                                                                                             |                    |                   |

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|                                                                            |              |            |
|----------------------------------------------------------------------------|--------------|------------|
| Issued: 101,505,201 – 2016; 100,861,372 – 2015                             | 203,011      | 201,723    |
| Additional paid-in capital                                                 | 342,846      | 326,656    |
| Retained earnings                                                          | 1,538,928    | 1,446,192  |
| Accumulated other comprehensive income (loss) (Note 10)                    | 62,209       | (9,425 )   |
| Treasury stock – at cost<br>(shares: 43,653,034 – 2016; 43,500,642 – 2015) | (572,090 )   | (567,105 ) |
| Total stockholders' equity                                                 | \$ 1,574,904 | 1,398,041  |
| Commitments and contingencies                                              |              |            |
| Total liabilities and stockholders' equity                                 | \$ 7,363,233 | 6,904,433  |

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

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| SELECTIVE INSURANCE GROUP, INC.                                                                      |  | Quarter ended |         | Nine Months ended |           |
|------------------------------------------------------------------------------------------------------|--|---------------|---------|-------------------|-----------|
| UNAUDITED CONSOLIDATED STATEMENTS OF INCOME                                                          |  | September 30, |         | September 30,     |           |
| (\$ in thousands, except per share amounts)                                                          |  | 2016          | 2015    | 2016              | 2015      |
| Revenues:                                                                                            |  |               |         |                   |           |
| Net premiums earned                                                                                  |  | \$542,429     | 507,390 | 1,596,819         | 1,473,822 |
| Net investment income earned                                                                         |  | 33,375        | 32,061  | 95,326            | 91,208    |
| Net realized gains:                                                                                  |  |               |         |                   |           |
| Net realized investment gains                                                                        |  | 4,030         | 1,590   | 7,233             | 23,598    |
| Other-than-temporary impairments                                                                     |  | (342)         | (1,282) | (4,494)           | (7,827)   |
| Other-than-temporary impairments on fixed income securities recognized in other comprehensive income |  | —             | —       | 10                | —         |
| Total net realized gains                                                                             |  | 3,688         | 308     | 2,749             | 15,771    |
| Other income                                                                                         |  | 2,199         | 698     | 7,018             | 5,521     |
| Total revenues                                                                                       |  | 581,691       | 540,457 | 1,701,912         | 1,586,322 |
| Expenses:                                                                                            |  |               |         |                   |           |
| Loss and loss expense incurred                                                                       |  | 316,258       | 285,161 | 911,881           | 861,721   |
| Policy acquisition costs                                                                             |  | 193,835       | 174,802 | 567,793           | 509,295   |
| Interest expense                                                                                     |  | 5,714         | 5,610   | 16,940            | 16,826    |
| Other expenses                                                                                       |  | 10,441        | 9,045   | 35,669            | 29,586    |
| Total expenses                                                                                       |  | 526,248       | 474,618 | 1,532,283         | 1,417,428 |
| Income before federal income tax                                                                     |  | 55,443        | 65,839  | 169,629           | 168,894   |
| Federal income tax expense:                                                                          |  |               |         |                   |           |
| Current                                                                                              |  | 5,625         | 9,141   | 38,027            | 29,128    |
| Deferred                                                                                             |  | 11,316        | 9,702   | 12,467            | 19,294    |
| Total federal income tax expense                                                                     |  | 16,941        | 18,843  | 50,494            | 48,422    |
| Net income                                                                                           |  | \$38,502      | 46,996  | 119,135           | 120,472   |
| Earnings per share:                                                                                  |  |               |         |                   |           |
| Basic net income                                                                                     |  | \$0.66        | 0.82    | 2.06              | 2.11      |
| Diluted net income                                                                                   |  | \$0.66        | 0.81    | 2.03              | 2.08      |
| Dividends to stockholders                                                                            |  | \$0.15        | 0.14    | 0.45              | 0.42      |

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

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| SELECTIVE INSURANCE GROUP, INC.                                                                 |  | Quarter ended |        | Nine Months     |           |
|-------------------------------------------------------------------------------------------------|--|---------------|--------|-----------------|-----------|
| UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE                                              |  | September 30, |        | ended September |           |
| INCOME                                                                                          |  |               |        | 30,             |           |
| (\$ in thousands)                                                                               |  | 2016          | 2015   | 2016            | 2015      |
| Net income                                                                                      |  | \$38,502      | 46,996 | 119,135         | 120,472   |
| Other comprehensive (loss) income, net of tax:                                                  |  |               |        |                 |           |
| Unrealized (losses) gains on investment securities:                                             |  |               |        |                 |           |
| Unrealized holding (losses) gains arising during period                                         |  | (8,444 )      | 5,442  | 70,473          | (18,132 ) |
| Non-credit portion of other-than-temporary impairments recognized in other comprehensive income |  | —             | —      | (6 )            | —         |
| Amounts reclassified into net income:                                                           |  |               |        |                 |           |
| Held-to-maturity securities                                                                     |  | (9 )          | (63 )  | (68 )           | (353 )    |
| Non-credit other-than-temporary impairments                                                     |  | —             | —      | —               | 232       |
| Realized gains on available-for-sale securities                                                 |  | (2,395 )      | (199 ) | (1,786 )        | (10,906 ) |
| Total unrealized (losses) gains on investment securities                                        |  | (10,848 )     | 5,180  | 68,613          | (29,159 ) |
| Defined benefit pension and post-retirement plans:                                              |  |               |        |                 |           |
| Amounts reclassified into net income:                                                           |  |               |        |                 |           |
| Net actuarial loss                                                                              |  | 1,050         | 1,110  | 3,021           | 3,332     |
| Total defined benefit pension and post-retirement plans                                         |  | 1,050         | 1,110  | 3,021           | 3,332     |
| Other comprehensive (loss) income                                                               |  | (9,798 )      | 6,290  | 71,634          | (25,827 ) |
| Comprehensive income                                                                            |  | \$28,704      | 53,286 | 190,769         | 94,645    |

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



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| SELECTIVE INSURANCE GROUP, INC.                                                |  | Nine Months ended |            |
|--------------------------------------------------------------------------------|--|-------------------|------------|
| UNAUDITED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY                      |  | September 30,     |            |
| (\$ in thousands, except per share amounts)                                    |  | 2016              | 2015       |
| Common stock:                                                                  |  |                   |            |
| Beginning of year                                                              |  | \$201,723         | 199,896    |
| Dividend reinvestment plan (shares: 29,865 – 2016; 38,947 – 2015)              |  | 60                | 78         |
| Stock purchase and compensation plans (shares: 613,964 – 2016; 686,984 – 2015) |  | 1,228             | 1,374      |
| End of period                                                                  |  | 203,011           | 201,348    |
| Additional paid-in capital:                                                    |  |                   |            |
| Beginning of year                                                              |  | 326,656           | 305,385    |
| Dividend reinvestment plan                                                     |  | 1,035             | 1,014      |
| Stock purchase and compensation plans                                          |  | 15,155            | 14,588     |
| End of period                                                                  |  | 342,846           | 320,987    |
| Retained earnings:                                                             |  |                   |            |
| Beginning of year                                                              |  | 1,446,192         | 1,313,440  |
| Net income                                                                     |  | 119,135           | 120,472    |
| Dividends to stockholders (\$0.45 per share – 2016; \$0.42 per share – 2015)   |  | (26,399 )         | (24,376 )  |
| End of period                                                                  |  | 1,538,928         | 1,409,536  |
| Accumulated other comprehensive income (loss):                                 |  |                   |            |
| Beginning of year                                                              |  | (9,425 )          | 19,788     |
| Other comprehensive income (loss)                                              |  | 71,634            | (25,827 )  |
| End of period                                                                  |  | 62,209            | (6,039 )   |
| Treasury stock:                                                                |  |                   |            |
| Beginning of year                                                              |  | (567,105 )        | (562,923 ) |
| Acquisition of treasury stock (shares: 152,392 – 2016; 139,031 – 2015)         |  | (4,985 )          | (3,887 )   |
| End of period                                                                  |  | (572,090 )        | (566,810 ) |
| Total stockholders' equity                                                     |  | \$1,574,904       | 1,359,022  |

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

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

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| SELECTIVE INSURANCE GROUP, INC.                                                   |  | Nine Months ended |             |
|-----------------------------------------------------------------------------------|--|-------------------|-------------|
| UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOW                                    |  | September 30,     |             |
| (\$ in thousands)                                                                 |  | 2016              | 2015        |
| Operating Activities                                                              |  |                   |             |
| Net income                                                                        |  | \$ 119,135        | 120,472     |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |                   |             |
| Depreciation and amortization                                                     |  | 45,563            | 43,868      |
| Stock-based compensation expense                                                  |  | 8,950             | 7,626       |
| Undistributed losses of equity method investments                                 |  | 49                | 781         |
| Net realized gains                                                                |  | (2,749)           | (15,771)    |
| Changes in assets and liabilities:                                                |  |                   |             |
| Increase in reserve for loss and loss expenses, net of reinsurance recoverables   |  | 90,814            | 60,065      |
| Increase in unearned premiums, net of prepaid reinsurance                         |  | 125,453           | 121,424     |
| Decrease in net federal income taxes                                              |  | 11,534            | 27,980      |
| Increase in premiums receivable                                                   |  | (96,425)          | (95,188)    |
| Increase in deferred policy acquisition costs                                     |  | (22,775)          | (28,058)    |
| (Increase) decrease in interest and dividends due or accrued                      |  | (1,356)           | 979         |
| Decrease in accrued salaries and benefits                                         |  | (63,753)          | (338)       |
| Increase in other assets                                                          |  | (16,280)          | (13,888)    |
| (Decrease) increase in other liabilities                                          |  | (20,686)          | 29,081      |
| Net adjustments                                                                   |  | 58,339            | 138,561     |
| Net cash provided by operating activities                                         |  | 177,474           | 259,033     |
| Investing Activities                                                              |  |                   |             |
| Purchase of fixed income securities, available-for-sale                           |  | (842,253)         | (731,154)   |
| Purchase of fixed income securities, held-to-maturity                             |  | (4,235)           | —           |
| Purchase of equity securities, available-for-sale                                 |  | (24,747)          | (192,717)   |
| Purchase of other investments                                                     |  | (34,994)          | (6,589)     |
| Purchase of short-term investments                                                |  | (1,307,024)       | (1,084,794) |
| Sale of fixed income securities, available-for-sale                               |  | 33,448            | 22,323      |
| Sale of short-term investments                                                    |  | 1,332,239         | 1,090,911   |
| Redemption and maturities of fixed income securities, held-to-maturity            |  | 74,186            | 79,972      |
| Redemption and maturities of fixed income securities, available-for-sale          |  | 483,877           | 403,510     |
| Sale of equity securities, available-for-sale                                     |  | 99,420            | 148,228     |
| Distributions from other investments                                              |  | 18,512            | 22,038      |
| Purchase of property and equipment                                                |  | (13,421)          | (11,869)    |
| Net cash used in investing activities                                             |  | (184,992)         | (260,141)   |
| Financing Activities                                                              |  |                   |             |
| Dividends to stockholders                                                         |  | (24,885)          | (22,848)    |
| Acquisition of treasury stock                                                     |  | (4,985)           | (3,887)     |
| Net proceeds from stock purchase and compensation plans                           |  | 4,906             | 6,016       |
| Proceeds from borrowings                                                          |  | 105,000           | 15,000      |
| Repayments of borrowings                                                          |  | (70,000)          | —           |
| Excess tax benefits from share-based payment arrangements                         |  | 1,917             | 1,498       |
| Repayments of capital lease obligations                                           |  | (3,840)           | (3,517)     |
| Net cash provided by (used in) financing activities                               |  | 8,113             | (7,738)     |

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|                                 |          |          |
|---------------------------------|----------|----------|
| Net increase (decrease) in cash | 595      | (8,846 ) |
| Cash, beginning of year         | 898      | 23,959   |
| Cash, end of period             | \$ 1,493 | 15,113   |

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

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NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. Basis of Presentation

As used herein, the "Company," "we," "us," or "our" refers to Selective Insurance Group, Inc. (the "Parent"), and its subsidiaries, except as expressly indicated or unless the context otherwise requires. Our interim unaudited consolidated financial statements ("Financial Statements") have been prepared by us in conformity with U.S. generally accepted accounting principles ("GAAP") and the rules and regulations of the U.S. Securities and Exchange Commission ("SEC") regarding interim financial reporting. The preparation of the Financial Statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported financial statement balances, as well as the disclosure of contingent assets and liabilities. Actual results could differ from those estimates. All significant intercompany accounts and transactions between the Parent and its subsidiaries are eliminated in consolidation.

Certain amounts in our prior years' Financial Statements and related notes have been reclassified to conform to the 2016 presentation. Such reclassifications had no effect on our net income, stockholders' equity, or cash flows.

Our Financial Statements reflect all adjustments that, in our opinion, are normal, recurring, and necessary for a fair presentation of our results of operations and financial condition. Our Financial Statements cover the third quarters ended September 30, 2016 ("Third Quarter 2016") and September 30, 2015 ("Third Quarter 2015") and the nine-month periods ended September 30, 2016 ("Nine Months 2016") and September 30, 2015 ("Nine Months 2015"). The Financial Statements do not include all of the information and disclosures required by GAAP and the SEC for audited annual financial statements. Results of operations for any interim period are not necessarily indicative of results for a full year. Consequently, our Financial Statements should be read in conjunction with the consolidated financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2015 ("2015 Annual Report") filed with the SEC.

NOTE 2. Accounting Pronouncements

In June 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period ("ASU 2014-12"). ASU 2014-12 requires that performance targets that affect vesting and could be achieved after the requisite service period be treated as performance conditions. The adoption of ASU 2014-12 in the first quarter of 2016 did not affect us, as we record expense consistent with the requirements of this accounting update.

In February 2015, the FASB issued ASU 2015-02, Amendments to the Consolidation Analysis ("ASU 2015-02"). ASU 2015-02 affects the following areas: (i) limited partnerships and similar legal entities; (ii) the evaluation of fees paid to a decision maker or a service provider as a variable interest; (iii) the effect of fee arrangements on the primary beneficiary determination; (iv) the effect of related parties on the primary beneficiary determination; and (v) certain investment funds. We adopted this guidance in the first quarter of 2016. Under the new guidance, our limited partnership and tax credit investments are variable interest entities ("VIEs"); however, we are not the primary beneficiary of any of these investments. As such, the adoption had no impact on our financial condition or results of operations. The required disclosures related to our VIEs are included in Note 4. "Investments" below.

In April 2015, the FASB issued ASU 2015-05, Customer's Accounting for Fees Paid in a Cloud Computing Arrangement ("ASU 2015-05"). ASU 2015-05 provides guidance to customers with cloud computing arrangements that include a software license. If a cloud computing arrangement includes a software license, the customer's accounting for the software license element of the arrangement is consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer accounts for the arrangement as a service contract. We adopted this guidance in the first quarter of 2016, with prospective application. The impact of

this adoption did not have a material effect on our financial condition or results of operations.

In May 2015, the FASB issued ASU 2015-07, Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent) ("ASU 2015-07"). ASU 2015-07 provides that investments for which the practical expedient is used to measure fair value at net asset value per share ("NAV") must be removed from the fair value hierarchy. Instead, those investments must be included as a reconciling line item so that the total fair value amount of investments in the disclosure is consistent with the amount on the balance sheet. ASU 2015-07 also includes disclosure requirements for investments for which the NAV practical expedient was used to determine fair value. The adoption of this guidance in the first quarter of 2016 did not impact our financial condition or results of operations.

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Pronouncements to be effective in the future

In August 2014, the FASB issued ASU 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern ("ASU 2014-15"). ASU 2014-15 is intended to define management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and provide related footnote disclosures. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and interim periods within annual periods beginning after December 15, 2016. Early application is permitted. As the requirements of this literature are disclosure only, ASU 2014-15 will not impact our financial condition or results of operations.

In May 2015, the FASB issued ASU 2015-09, Disclosures about Short-Duration Contracts ("ASU 2015-09"). ASU 2015-09 requires companies that issue short duration contracts to disclose additional information, including: (i) incurred and paid claims development tables; (ii) frequency and severity of claims; and (iii) information about material changes in judgments made in calculating the liability for unpaid claim adjustment expenses, including reasons for the change and the effects on the financial statements. ASU 2015-09 is effective for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016. ASU 2015-09 is to be applied retrospectively by providing comparative disclosures for each period presented, except for those requirements that apply only to the current period. As the requirements of this literature are disclosure only, the application of this guidance will not impact our financial condition or results of operations.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments - Overall (Sub-topic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01"). ASU 2016-01 provides guidance to improve certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Specifically the guidance: (i) requires equity investments to be measured at fair value with changes in fair value recognized in earnings; (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (iii) eliminates the requirement to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost; (iv) requires the use of the exit price notion when measuring the fair value of financial instruments for disclosure purposes; and (v) clarifies that the need for a valuation allowance on a deferred tax asset related to an available-for-sale ("AFS") security should be evaluated with other deferred tax assets.

ASU 2016-01 is effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods. Early application to financial statements of annual or interim periods that have not yet been issued are permitted as of the beginning of the year of adoption, otherwise early adoption of ASU 2016-01 is not permitted. We are currently evaluating the impact of this guidance on our financial condition and results of operations.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) ("ASU 2016-02"). ASU 2016-02 requires all lessees to recognize a lease liability and a right-of-use asset, measured at the present value of the future minimum lease payments, at the lease commencement date. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim reporting periods within that fiscal year, with early adoption permitted. ASU 2016-02 requires the application of a modified retrospective approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. While we are currently evaluating ASU 2016-02, we do not expect a material impact on our financial condition or results of operations from the adoption of this guidance.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-based Payment Accounting ("ASU 2016-09"). ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions including: (i) income tax consequences; (ii) classification of awards as either equity or liabilities; (iii) forfeitures assumptions; and (iv) cash flow classification. ASU 2016-09 is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted. While we are currently evaluating ASU 2016-09, we do not expect a material impact on our

financial condition or results of operations.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (“ASU 2016-13”). ASU 2016-13 will change the way entities recognize impairment of financial assets by requiring immediate recognition of estimated credit losses expected to occur over the remaining life of many financial assets, including, among others, held-to-maturity debt securities, trade receivables, and reinsurance receivables. ASU 2016-13 requires a valuation allowance to be calculated on these financial assets and that they be presented on the financial statements net of the valuation allowance. The valuation allowance is a measurement of expected losses that is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. This methodology is referred to as the current expected credit loss model. ASU 2016-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those annual periods. Early adoption is permitted, but no earlier than fiscal years

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beginning after December 15, 2018. We are currently evaluating the impact of this guidance on our financial condition and results of operations.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows ("ASU 2016-15"). ASU 2016-15 adds or clarifies guidance on the classification of certain cash receipts and payments in the statement of cash flows including, but not limited to: (i) debt prepayment or debt extinguishment costs; (ii) proceeds from the settlement of corporate-owned life insurance policies including bank-owned life insurance policies; (iii) distributions received from equity method investees; and (iv) separately identifiable cash flows and application of the predominance principle. ASU 2016-15 is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted. We are currently evaluating the impact of this guidance on our statement of cash flows.

## NOTE 3. Statements of Cash Flow

Supplemental cash flow information is as follows:

|                                  | Nine Months<br>ended<br>September 30, |        |
|----------------------------------|---------------------------------------|--------|
| (\$ in thousands)                | 2016                                  | 2015   |
| Cash paid during the period for: |                                       |        |
| Interest                         | \$ 13,874                             | 13,843 |
| Federal income tax               | 36,405                                | 18,500 |

## Non-cash items:

|                                                                        |        |        |
|------------------------------------------------------------------------|--------|--------|
| Exchange of fixed income securities, AFS                               | 21,775 | 35,425 |
| Tax-free exchange of fixed income securities, held-to-maturity ("HTM") | —      | 10,045 |
| Corporate actions related to equity securities, AFS <sup>1</sup>       | 3,032  | 4,239  |
| Assets acquired under capital lease arrangements                       | 3,108  | 6,933  |
| Non-cash purchase of property and equipment                            | 648    | —      |

<sup>1</sup>Examples of such corporate actions include non-cash acquisitions and stock splits.

Included in "Other assets" on the Consolidated Balance Sheet was \$20.9 million at September 30, 2016 and \$9.9 million at September 30, 2015 of cash received from the National Flood Insurance Program ("NFIP"), which is restricted to pay flood claims under the Write Your Own ("WYO") program.

## NOTE 4. Investments

(a) Information regarding our HTM fixed income securities as of September 30, 2016 and December 31, 2015 was as follows:

September 30, 2016

| (\$ in thousands)                                | Amortized<br>Cost | Net<br>Unrealized<br>Gains<br>(Losses) | Carrying<br>Value | Unrecognized<br>Holding<br>Gains | Unrecognized<br>Holding<br>Losses | Fair<br>Value |
|--------------------------------------------------|-------------------|----------------------------------------|-------------------|----------------------------------|-----------------------------------|---------------|
| Obligations of states and political subdivisions | \$ 104,159        | 414                                    | 104,573           | 3,256                            | —                                 | 107,829       |
| Corporate securities                             | 23,722            | (165)                                  | 23,557            | 2,294                            | —                                 | 25,851        |
| Asset-backed securities ("ABS")                  | 51                | —                                      | 51                | —                                | —                                 | 51            |
| Commercial mortgage-backed securities ("CMBS")   | 2,346             | (55)                                   | 2,291             | 72                               | —                                 | 2,363         |
| Total HTM fixed income securities                | \$ 130,278        | 194                                    | 130,472           | 5,622                            | —                                 | 136,094       |

December 31, 2015



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| (\$ in thousands)                                | Amortized<br>Cost | Net<br>Unrealized<br>Gains<br>(Losses) | Carrying<br>Value | Unrecognized<br>Holding<br>Gains | Unrecognized<br>Holding<br>Losses | Fair<br>Value |
|--------------------------------------------------|-------------------|----------------------------------------|-------------------|----------------------------------|-----------------------------------|---------------|
| Obligations of states and political subdivisions | \$ 175,269        | 848                                    | 176,117           | 5,763                            | —                                 | 181,880       |
| Corporate securities                             | 20,228            | (185 )                                 | 20,043            | 1,972                            | —                                 | 22,015        |
| ABS                                              | 1,030             | (120 )                                 | 910               | 118                              | —                                 | 1,028         |
| CMBS                                             | 4,527             | (243 )                                 | 4,284             | 337                              | —                                 | 4,621         |
| Total HTM fixed income securities                | \$ 201,054        | 300                                    | 201,354           | 8,190                            | —                                 | 209,544       |

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Unrecognized holding gains and losses of HTM securities are not reflected in the Financial Statements, as they represent fair value fluctuations from the later of: (i) the date a security is designated as HTM; or (ii) the date that an other-than-temporary impairment (“OTTI”) charge is recognized on an HTM security, through the date of the balance sheet. Our HTM securities had an average duration of 1.6 years as of September 30, 2016.

(b) Information regarding our AFS securities as of September 30, 2016 and December 31, 2015 was as follows:  
September 30, 2016

| (\$ in thousands)                                | Cost/<br>Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Fair<br>Value |
|--------------------------------------------------|----------------------------|---------------------|----------------------|---------------|
| AFS fixed income securities:                     |                            |                     |                      |               |
| U.S. government and government agencies          | \$86,491                   | 3,400               | —                    | 89,891        |
| Foreign government                               | 9,041                      | 443                 | —                    | 9,484         |
| Obligations of states and political subdivisions | 1,376,245                  | 70,984              | (333)                | 1,446,896     |
| Corporate securities                             | 2,136,761                  | 60,784              | (1,427)              | 2,196,118     |
| ABS                                              | 282,558                    | 1,964               | (69)                 | 284,453       |
| CMBS                                             | 261,233                    | 5,634               | (93)                 | 266,774       |
| Residential mortgage-backed securities (“RMBS”)  | 529,938                    | 9,294               | (316)                | 538,916       |
| Total AFS fixed income securities                | 4,682,267                  | 152,503             | (2,238)              | 4,832,532     |
| AFS equity securities:                           |                            |                     |                      |               |
| Common stock                                     | 111,746                    | 24,832              | (1,089)              | 135,489       |
| Preferred stock                                  | 11,235                     | 580                 | —                    | 11,815        |
| Total AFS equity securities                      | 122,981                    | 25,412              | (1,089)              | 147,304       |
| Total AFS securities                             | \$4,805,248                | 177,915             | (3,327)              | 4,979,836     |

December 31, 2015

| (\$ in thousands)                                | Cost/<br>Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Fair<br>Value |
|--------------------------------------------------|----------------------------|---------------------|----------------------|---------------|
| AFS fixed income securities:                     |                            |                     |                      |               |
| U.S. government and government agencies          | \$99,485                   | 4,721               | (91)                 | 104,115       |
| Foreign government                               | 14,885                     | 298                 | (2)                  | 15,181        |
| Obligations of states and political subdivisions | 1,314,779                  | 44,523              | (160)                | 1,359,142     |
| Corporate securities                             | 1,892,296                  | 23,407              | (15,521)             | 1,900,182     |
| ABS                                              | 244,541                    | 531                 | (918)                | 244,154       |
| CMBS                                             | 245,252                    | 750                 | (2,410)              | 243,592       |
| RMBS                                             | 541,276                    | 4,274               | (3,713)              | 541,837       |
| Total AFS fixed income securities                | 4,352,514                  | 78,504              | (22,815)             | 4,408,203     |
| AFS equity securities:                           |                            |                     |                      |               |
| Common stock                                     | 181,991                    | 14,796              | (1,998)              | 194,789       |
| Preferred stock                                  | 11,825                     | 477                 | (40)                 | 12,262        |
| Total AFS equity securities                      | 193,816                    | 15,273              | (2,038)              | 207,051       |
| Total AFS securities                             | \$4,546,330                | 93,777              | (24,853)             | 4,615,254     |

Unrealized gains and losses of AFS securities represent fair value fluctuations from the later of: (i) the date a security is designated as AFS; or (ii) the date that an OTTI charge is recognized on an AFS security, through the date of the

balance sheet. These unrealized gains and losses are recorded in "Accumulated other comprehensive income (loss)" ("AOCI") on the Consolidated Balance Sheets.

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(c) The following tables provide information regarding our AFS securities in a net unrealized loss position at September 30, 2016 and December 31, 2015:

| September 30, 2016                               | Less than 12 months |                                | 12 months or longer |                                |
|--------------------------------------------------|---------------------|--------------------------------|---------------------|--------------------------------|
| (\$ in thousands)                                | Fair Value          | Unrealized Losses <sup>1</sup> | Fair Value          | Unrealized Losses <sup>1</sup> |
| AFS fixed income securities:                     |                     |                                |                     |                                |
| Obligations of states and political subdivisions | \$74,989            | (333 )                         | —                   | —                              |
| Corporate securities                             | 155,880             | (1,139 )                       | 30,469              | (288 )                         |
| ABS                                              | 21,766              | (66 )                          | 2,450               | (3 )                           |
| CMBS                                             | 24,633              | (59 )                          | 8,709               | (34 )                          |
| RMBS                                             | 13,674              | (40 )                          | 37,677              | (276 )                         |
| Total AFS fixed income securities                | 290,942             | (1,637 )                       | 79,305              | (601 )                         |
| AFS equity securities:                           |                     |                                |                     |                                |
| Common stock                                     | 12,528              | (1,089 )                       | —                   | —                              |
| Total AFS equity securities                      | 12,528              | (1,089 )                       | —                   | —                              |
| Total AFS                                        | \$303,470           | (2,726 )                       | 79,305              | (601 )                         |
|                                                  |                     |                                |                     |                                |
| December 31, 2015                                | Less than 12 months |                                | 12 months or longer |                                |
| (\$ in thousands)                                | Fair Value          | Unrealized Losses <sup>1</sup> | Fair Value          | Unrealized Losses <sup>1</sup> |
| AFS fixed income securities:                     |                     |                                |                     |                                |
| U.S. government and government agencies          | \$16,006            | (87 )                          | 396                 | (4 )                           |
| Foreign government                               | 1,067               | (2 )                           | —                   | —                              |
| Obligations of states and political subdivisions | 28,617              | (160 )                         | —                   | —                              |
| Corporate securities                             | 761,479             | (12,671 )                      | 50,382              | (2,850 )                       |
| ABS                                              | 197,477             | (807 )                         | 12,022              | (111 )                         |
| CMBS                                             | 146,944             | (2,196 )                       | 15,385              | (214 )                         |
| RMBS                                             | 264,914             | (1,992 )                       | 63,395              | (1,721 )                       |
| Total AFS fixed income securities                | 1,416,504           | (17,915 )                      | 141,580             | (4,900 )                       |
| AFS equity securities:                           |                     |                                |                     |                                |
| Common stock                                     | 31,148              | (1,998 )                       | —                   | —                              |
| Preferred stock                                  | 1,531               | (40 )                          | —                   | —                              |
| Total AFS equity securities                      | 32,679              | (2,038 )                       | —                   | —                              |
| Total AFS                                        | \$1,449,183         | (19,953 )                      | 141,580             | (4,900 )                       |

<sup>1</sup> Gross unrealized losses include non-OTTI unrealized amounts and OTTI losses recognized in AOCI.

There were no net unrealized/unrecognized losses on our HTM portfolio as of September 30, 2016. The table below provides our net unrealized/unrecognized loss positions by impairment severity for AFS securities as of September 30, 2016 and for both AFS and HTM securities as of December 31, 2015:

(\$ in thousands)

| September 30, 2016 |                 | December 31, 2015 |                              |
|--------------------|-----------------|-------------------|------------------------------|
| Number of Issues   | Unrealized Loss | Number of Issues  | Unrealized/Unrecognized Loss |
| 18080% - 99%       | \$ 3,327        | 60680% - 99%      | \$ 22,971                    |
| — 60% - 79%        | —               | 3 60% - 79%       | 1,888                        |
| — 40% - 59%        | —               | — 40% - 59%       | —                            |
| — 20% - 39%        | —               | — 20% - 39%       | —                            |

— 0% - 19%

—  
\$ 3,327

— 0% - 19%

—  
\$ 24,859

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We do not intend to sell any of the securities in the tables above, nor do we believe we will be required to sell any of these securities. We have also reviewed these securities under our OTTI policy, as described in Note 2. "Summary of Significant Accounting Policies" within Item 8. "Financial Statements and Supplementary Data." of our 2015 Annual Report, and have concluded that they are temporarily impaired. This conclusion reflects our current judgment as to the financial position and future prospects of the entity that issued the investment security and underlying collateral. Additionally, changes in market value due to interest rate fluctuations are considered temporary. If our judgment about an individual security changes in the future, we may ultimately record a credit loss after having originally concluded that one did not exist, which could have a material impact on our net income and financial position in future periods.

(d) Fixed income securities at September 30, 2016, by contractual maturity, are shown below. Mortgage-backed securities ("MBS") are included in the maturity tables using the estimated average life of each security. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations, with or without call or prepayment penalties.

Listed below are the contractual maturities of HTM fixed income securities at September 30, 2016:

| (\$ in thousands)                     | Carrying Value | Fair Value |
|---------------------------------------|----------------|------------|
| Due in one year or less               | \$59,074       | 59,671     |
| Due after one year through five years | 62,778         | 66,622     |
| Due after five years through 10 years | 8,620          | 9,801      |
| Total HTM fixed income securities     | \$130,472      | 136,094    |

Listed below are the contractual maturities of AFS fixed income securities at September 30, 2016:

| (\$ in thousands)                     | Fair Value  |
|---------------------------------------|-------------|
| Due in one year or less               | \$491,206   |
| Due after one year through five years | 2,403,246   |
| Due after five years through 10 years | 1,823,028   |
| Due after 10 years                    | 115,052     |
| Total AFS fixed income securities     | \$4,832,532 |

(e) We evaluate the alternative investments and tax credit investments included in our other investments portfolio to determine whether those investments are VIEs and if so, whether consolidation is required. A VIE is an entity that either has equity investors that lack certain essential characteristics of a controlling financial interest or lacks sufficient funds to finance its own activities without financial support provided by other entities. We consider several significant factors in determining if our investments are VIEs and if we are the primary beneficiary, including whether we have: (i) the power to direct activities of the VIE; (ii) the ability to remove the decision maker of the VIE; (iii) the ability to participate in making decisions that are significant to the VIE; and (iv) the obligation to absorb losses and the right to receive benefits that could potentially be significant to the VIE. We have determined that the investments in our other investment portfolio are VIEs, but that we are not the primary beneficiary and therefore, consolidation is not required.

The following table summarizes our other investment portfolio by strategy:

| Other Investments       | September 30, 2016 |                      |                                       | December 31, 2015 |                      |                                       |
|-------------------------|--------------------|----------------------|---------------------------------------|-------------------|----------------------|---------------------------------------|
| (\$ in thousands)       | Carrying Value     | Remaining Commitment | Maximum Exposure to Loss <sup>1</sup> | Carrying Value    | Remaining Commitment | Maximum Exposure to Loss <sup>1</sup> |
| Alternative Investments |                    |                      |                                       |                   |                      |                                       |
| Private equity          | \$35,444           | 57,793               | 93,237                                | 35,088            | 30,204               | 65,292                                |

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|                               |          |         |         |        |        |         |
|-------------------------------|----------|---------|---------|--------|--------|---------|
| Private credit                | 27,709   | 30,763  | 58,472  | 13,246 | 15,129 | 28,375  |
| Real assets                   | 15,329   | 22,922  | 38,251  | 19,500 | 25,820 | 45,320  |
| Total alternative investments | 78,482   | 111,478 | 189,960 | 67,834 | 71,153 | 138,987 |
| Other securities              | 10,030   | 22,611  | 32,641  | 10,008 | 3,200  | 13,208  |
| Total other investments       | \$88,512 | 134,089 | 222,601 | 77,842 | 74,353 | 152,195 |

<sup>1</sup>The maximum exposure to loss includes both the carry value of these investments and the related unfunded commitments. In addition, tax credits that have been previously recognized in Other securities are subject to the risk of recapture, which we do not consider significant.

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We do not have a future obligation to fund losses or debts on behalf of the investments above; however, we are contractually committed to make additional investments up to the remaining commitment outlined above. We have not provided any non-contractual financial support at any time during 2016 or 2015.

In addition to the strategy descriptions included in Note 5. "Investments" in Item 8. "Financial Statements and Supplementary Data." of our 2015 Annual Report, our private credit strategy now includes middle market lending, which is a strategy that provides privately negotiated loans to U.S. middle market companies. Typically, these are floating rate, senior secured loans diversified across industries. Loans can be made to private equity sponsor-backed companies or non-sponsored companies to finance leveraged buyouts, recapitalizations, and acquisitions.

The following table sets forth gross summarized financial information for our other investments portfolio, including the portion not owned by us. The majority of these investments are carried under the equity method of accounting. The last line of the table below reflects our share of the aggregate income or loss, which is the portion included in our Financial Statements. As the majority of these investments report results to us on a one quarter lag, the summarized financial statement information for the three and nine-month periods ended June 30 is as follows:

| Income Statement Information<br>(\$ in millions)                  | Quarter ended<br>June 30, |         | Nine months ended<br>June 30, |           |
|-------------------------------------------------------------------|---------------------------|---------|-------------------------------|-----------|
|                                                                   | 2016                      | 2015    | 2016                          | 2015      |
| Net investment (loss) income                                      | \$(55.4)                  | 44.1    | 26.1                          | 139.6     |
| Realized gains                                                    | 245.6                     | 385.2   | 1,186.8                       | 977.7     |
| Net change in unrealized depreciation                             | 117.8                     | (222.2) | (1,132.8)                     | (1,089.0) |
| Net gain                                                          | \$308.0                   | 207.1   | 80.1                          | 28.3      |
| Selective's insurance subsidiaries' other investments gain (loss) | \$1.6                     | 1.3     | —                             | (0.8)     |

(f) We have pledged certain AFS fixed income securities as collateral related to our relationships with the Federal Home Loan Bank of Indianapolis ("FHLBI") and the Federal Home Loan Bank of New York ("FHLBNY"). In addition, certain securities were on deposit with various state and regulatory agencies at September 30, 2016 to comply with insurance laws. We retain all rights regarding all securities pledged as collateral.

The following table summarizes the market value of these securities at September 30, 2016:

| (\$ in millions)                        | FHLBI<br>Collateral | FHLBNY<br>Collateral | State and<br>Regulatory<br>Deposits | Total |
|-----------------------------------------|---------------------|----------------------|-------------------------------------|-------|
| U.S. government and government agencies | \$ 7.4              | —                    | 23.1                                | 30.5  |
| CMBS                                    | 1.0                 | —                    | —                                   | 1.0   |
| RMBS                                    | 53.1                | 64.4                 | —                                   | 117.5 |
| Total pledged as collateral             | \$ 61.5             | 64.4                 | 23.1                                | 149.0 |

(g) The Company did not have exposure to any credit concentration risk of a single issuer greater than 10% of the Company's stockholders' equity, other than certain U.S. government-backed investments, as of September 30, 2016 or December 31, 2015.

(h) The components of pre-tax net investment income earned for the periods indicated were as follows:

| (\$ in thousands)       | Quarter ended<br>September 30, |        | Nine Months<br>ended September<br>30, |        |
|-------------------------|--------------------------------|--------|---------------------------------------|--------|
|                         | 2016                           | 2015   | 2016                                  | 2015   |
| Fixed income securities | \$32,453                       | 30,601 | \$95,850                              | 92,227 |
| Equity securities       | 1,506                          | 2,370  | 5,940                                 | 6,546  |



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|                              |          |          |          |          |
|------------------------------|----------|----------|----------|----------|
| Short-term investments       | 192      | 24       | 493      | 72       |
| Other investments            | 1,628    | 1,337    | (49 )    | (781 )   |
| Investment expenses          | (2,404 ) | (2,271 ) | (6,908 ) | (6,856 ) |
| Net investment income earned | \$33,375 | 32,061   | \$95,326 | 91,208   |

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

| Third Quarter 2016                |         | Included in                        |                        |
|-----------------------------------|---------|------------------------------------|------------------------|
| (\$ in thousands)                 | Gross   | Other Comprehensive Income ("OCI") | Recognized in Earnings |
| AFS equity securities:            |         |                                    |                        |
| Common stock                      | \$ 342  | —                                  | 342                    |
| Total AFS equity securities       | 342     | —                                  | 342                    |
| Total OTTI losses                 | \$ 342  | —                                  | 342                    |
| Third Quarter 2015                |         | Included in                        |                        |
| (\$ in thousands)                 | Gross   | in OCI                             | Recognized in Earnings |
| AFS fixed income securities:      |         |                                    |                        |
| Corporate securities              | \$253   | —                                  | 253                    |
| Total AFS fixed income securities | 253     | —                                  | 253                    |
| AFS equity securities:            |         |                                    |                        |
| Common stock                      | 1,029   | —                                  | 1,029                  |
| Total AFS equity securities       | 1,029   | —                                  | 1,029                  |
| Total OTTI losses                 | \$1,282 | —                                  | 1,282                  |
| Nine Months 2016                  |         | Included in                        |                        |
| (\$ in thousands)                 | Gross   | in OCI                             | Recognized in Earnings |
| AFS fixed income securities:      |         |                                    |                        |
| Corporate securities              | \$1,077 | —                                  | 1,077                  |
| RMBS                              | 98      | 10                                 | 88                     |
| Total AFS fixed income securities | 1,175   | 10                                 | 1,165                  |
| AFS equity securities:            |         |                                    |                        |
| Common stock                      | 3,316   | —                                  | 3,316                  |
| Preferred stock                   | 3       | —                                  | 3                      |
| Total AFS equity securities       | 3,319   | —                                  | 3,319                  |
| Total OTTI losses                 | \$4,494 | 10                                 | 4,484                  |
| Nine Months 2015                  |         | Included in                        |                        |
| (\$ in thousands)                 | Gross   | in OCI                             | Recognized in Earnings |
| AFS fixed income securities:      |         |                                    |                        |
| Corporate securities              | \$1,445 | —                                  | 1,445                  |
| RMBS                              | 1       | —                                  | 1                      |
| Total AFS fixed income securities | 1,446   | —                                  | 1,446                  |
| AFS equity securities:            |         |                                    |                        |
| Common stock                      | 6,201   | —                                  | 6,201                  |
| Preferred stock                   | 180     | —                                  | 180                    |
| Total AFS equity securities       | 6,381   | —                                  | 6,381                  |
| Total OTTI losses                 | \$7,827 | —                                  | 7,827                  |

For a discussion of our evaluation for OTTI of fixed income securities, short-term investments, equity securities, and other investments, refer to Note 2. "Summary of Significant Accounting Policies" in Item 8. "Financial Statements and Supplementary Data." of our 2015 Annual Report.

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

|                                                   | Quarter ended<br>September 30, |       | Nine Months<br>ended<br>September 30, |          |
|---------------------------------------------------|--------------------------------|-------|---------------------------------------|----------|
| (\$ in thousands)                                 | 2016                           | 2015  | 2016                                  | 2015     |
| HTM fixed income securities                       |                                |       |                                       |          |
| Gains                                             | \$—                            | 3     | 3                                     | 5        |
| Losses                                            | —                              | —     | (1 )                                  | (1 )     |
| AFS fixed income securities                       |                                |       |                                       |          |
| Gains                                             | 2,204                          | 169   | 3,189                                 | 2,158    |
| Losses                                            | (40 )                          | —     | (81 )                                 | (130 )   |
| AFS equity securities                             |                                |       |                                       |          |
| Gains                                             | 1,863                          | 1,419 | 4,364                                 | 23,567   |
| Losses                                            | —                              | (1 )  | (240 )                                | (1,347 ) |
| Other investments                                 |                                |       |                                       |          |
| Gains                                             | 3                              | —     | 3                                     | —        |
| Losses                                            | —                              | —     | (4 )                                  | (654 )   |
| Total net realized gains (excluding OTTI charges) | \$4,030                        | 1,590 | 7,233                                 | 23,598   |

Realized gains and losses on the sale of investments are determined on the basis of the cost of the specific investments sold. Proceeds from the sale of AFS securities were \$27.0 million and \$12.7 million in Third Quarter 2016 and Third Quarter 2015, respectively, and \$132.9 million and \$170.6 million in Nine Months 2016 and Nine Months 2015, respectively. The \$23.6 million in net realized gains for Nine Months 2015 were primarily due to a change in our dividend equity strategy from a quantitative, model-driven stock selection strategy to a fundamentally-based stock selection approach that incorporates an assessment of the sustainability and growth rate of a company's dividends and future cash flow.

## NOTE 5. Indebtedness

During Nine Months 2016, Selective Insurance Company of America ("SICA") borrowed the following short-term funds from the FHLBNY:

\$25 million on February 26, 2016 at an interest rate of 0.59%, which was repaid on March 18, 2016;  
 \$15 million on April 7, 2016 at an interest rate of 0.52%, which was repaid on April 28, 2016; and  
 \$15 million on April 28, 2016 at an interest rate of 0.53%, which was repaid on May 19, 2016.

During Nine Months 2016, SICA borrowed the following long-term funds from the FHLBNY:

\$25 million on July 21, 2016 at an interest rate of 1.61%, which is due on July 21, 2021; and  
 \$25 million on August 15, 2016 at an interest rate of 1.56%, which is due on August 16, 2021.

Additionally, in Third Quarter 2016, Selective Insurance Company of the Southeast and Selective Insurance Company of South Carolina repaid their \$15 million outstanding aggregate borrowing from the FHLBI.

For further information on our indebtedness, see Note 10. "Indebtedness" in Item 8. "Financial Statements and Supplementary Data." of our 2015 Annual Report.

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## NOTE 6. Fair Value Measurements

The following table presents the carrying amounts and estimated fair values of our financial instruments as of September 30, 2016 and December 31, 2015:

| (\$ in thousands)               | September 30, 2016 |            | December 31, 2015 |            |
|---------------------------------|--------------------|------------|-------------------|------------|
|                                 | Carrying Amount    | Fair Value | Carrying Amount   | Fair Value |
| <b>Financial Assets</b>         |                    |            |                   |            |
| Fixed income securities:        |                    |            |                   |            |
| HTM                             | \$ 130,472         | 136,094    | 201,354           | 209,544    |
| AFS                             | 4,832,532          | 4,832,532  | 4,408,203         | 4,408,203  |
| Equity securities, AFS          | 147,304            | 147,304    | 207,051           | 207,051    |
| Short-term investments          | 169,604            | 169,604    | 194,819           | 194,819    |
| <b>Financial Liabilities</b>    |                    |            |                   |            |
| Short-term debt:                |                    |            |                   |            |
| 0.63% borrowings from FHLBI     | \$ —               | —          | 15,000            | 14,977     |
| 1.25% borrowings from FHLBI     | 45,000             | 45,072     | 45,000            | 45,083     |
| Total short-term debt           | \$ 45,000          | 45,072     | 60,000            | 60,060     |
| Long-term debt:                 |                    |            |                   |            |
| 7.25% Senior Notes              | \$ 49,900          | 60,682     | 49,898            | 56,929     |
| 6.70% Senior Notes              | 99,426             | 118,192    | 99,415            | 110,363    |
| 5.875% Senior Notes             | 185,000            | 194,324    | 185,000           | 192,474    |
| 1.61% borrowings from FHLBNY    | 25,000             | 25,048     | —                 | —          |
| 1.56% borrowings from FHLBNY    | 25,000             | 24,990     | —                 | —          |
| Subtotal long-term debt         | 384,326            | 423,236    | 334,313           | 359,766    |
| Unamortized debt issuance costs | (5,775 )           |            | (6,121 )          |            |
| Total long-term debt            | \$ 378,551         |            | 328,192           |            |

For a discussion of the fair value and hierarchy of the techniques used to value our financial assets and liabilities, refer to Note 2. "Summary of Significant Accounting Policies" in Item 8. "Financial Statements and Supplementary Data." of our 2015 Annual Report.

The following tables provide quantitative disclosures of our financial assets that were measured at fair value at September 30, 2016 and December 31, 2015:

| (\$ in thousands) | Assets Measured at Fair Value at 9/30/2016 | Fair Value Measurements Using                                               |                                                            |                                           |
|-------------------|--------------------------------------------|-----------------------------------------------------------------------------|------------------------------------------------------------|-------------------------------------------|
|                   |                                            | Quoted Prices in Active Markets for Identical Assets/ Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) <sup>1</sup> | Significant Unobservable Inputs (Level 3) |

Description

Measured on a recurring basis:

## AFS fixed income securities:

|                                                  |           |        |           |   |
|--------------------------------------------------|-----------|--------|-----------|---|
| U.S. government and government agencies          | \$89,891  | 35,147 | 54,744    | — |
| Foreign government                               | 9,484     | —      | 9,484     | — |
| Obligations of states and political subdivisions | 1,446,896 | —      | 1,446,896 | — |
| Corporate securities                             | 2,196,118 | —      | 2,196,118 | — |
| ABS                                              | 284,453   | —      | 284,453   | — |
| CMBS                                             | 266,774   | —      | 266,774   | — |
| RMBS                                             | 538,916   | —      | 538,916   | — |
| Total AFS fixed income securities                | 4,832,532 | 35,147 | 4,797,385 | — |

## AFS equity securities:

|                                     |             |         |           |       |
|-------------------------------------|-------------|---------|-----------|-------|
| Common stock                        | 135,489     | 127,813 | —         | 7,676 |
| Preferred stock                     | 11,815      | 11,815  | —         | —     |
| Total AFS equity securities         | 147,304     | 139,628 | —         | 7,676 |
| Total AFS securities                | 4,979,836   | 174,775 | 4,797,385 | 7,676 |
| Short-term investments              | 169,604     | 169,604 | —         | —     |
| Total assets measured at fair value | \$5,149,440 | 344,379 | 4,797,385 | 7,676 |

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December 31, 2015

| (\$ in thousands) | Assets Measured at Fair Value at 12/31/2015 | Fair Value Measurements Using                                                           |                                                            |                                           |
|-------------------|---------------------------------------------|-----------------------------------------------------------------------------------------|------------------------------------------------------------|-------------------------------------------|
|                   |                                             | Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1) <sup>1</sup> | Significant Other Observable Inputs (Level 2) <sup>1</sup> | Significant Unobservable Inputs (Level 3) |

## Description

Measured on a recurring basis:

AFS fixed income securities:

|                                                  |              |         |           |       |
|--------------------------------------------------|--------------|---------|-----------|-------|
| U.S. government and government agencies          | \$ 104,115   | 42,702  | 61,413    | —     |
| Foreign government                               | 15,181       | —       | 15,181    | —     |
| Obligations of states and political subdivisions | 1,359,142    | —       | 1,359,142 | —     |
| Corporate securities                             | 1,900,182    | —       | 1,900,182 | —     |
| ABS                                              | 244,154      | —       | 244,154   | —     |
| CMBS                                             | 243,592      | —       | 243,592   | —     |
| RMBS                                             | 541,837      | —       | 541,837   | —     |
| Total AFS fixed income securities                | 4,408,203    | 42,702  | 4,365,501 | —     |
| AFS equity securities:                           |              |         |           |       |
| Common stock                                     | 194,789      | 191,517 | —         | 3,272 |
| Preferred stock                                  | 12,262       | 12,262  | —         | —     |
| Total AFS equity securities                      | 207,051      | 203,779 | —         | 3,272 |
| Total AFS securities                             | 4,615,254    | 246,481 | 4,365,501 | 3,272 |
| Short-term investments                           | 194,819      | 194,819 | —         | —     |
| Total assets measured at fair value              | \$ 4,810,073 | 441,300 | 4,365,501 | 3,272 |

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

The following table provides a summary of the changes in the fair value of securities measured using Level 3 inputs and related

quantitative information for the nine-month period ended September 30, 2016:

|                                                      |          |
|------------------------------------------------------|----------|
| September 30, 2016                                   | Common   |
| (\$ in thousands)                                    | Stock    |
| Fair value, December 31, 2015                        | \$ 3,272 |
| Total net (losses) gains for the period included in: |          |
| OCI                                                  | —        |
| Net income                                           | —        |
| Purchases                                            | 6,204    |
| Sales                                                | (1,800 ) |
| Issuances                                            | —        |
| Settlements                                          | —        |
| Transfers into Level 3                               | —        |
| Transfers out of Level 3                             | —        |
| Fair value, September 30, 2016                       | \$ 7,676 |



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The following tables provide quantitative information regarding our financial assets and liabilities that were disclosed at fair value at September 30, 2016 and December 31, 2015:

| September 30, 2016                               | Assets/<br>Liabilities<br>Disclosed<br>at<br>Fair Value<br>at<br>9/30/2016  | Fair Value Measurements Using                                                                             |                                                           |                                                    |
|--------------------------------------------------|-----------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|
|                                                  |                                                                             | Quoted<br>Prices<br>in<br>Active<br>Markets<br>for<br>Identical<br>Assets/<br>Liabilities<br>(Level<br>1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| (\$ in thousands)                                |                                                                             |                                                                                                           |                                                           |                                                    |
| Financial Assets                                 |                                                                             |                                                                                                           |                                                           |                                                    |
| HTM:                                             |                                                                             |                                                                                                           |                                                           |                                                    |
| Obligations of states and political subdivisions | \$ 107,829                                                                  | —                                                                                                         | 107,829                                                   | —                                                  |
| Corporate securities                             | 25,851                                                                      | —                                                                                                         | 18,160                                                    | 7,691                                              |
| ABS                                              | 51                                                                          | —                                                                                                         | 51                                                        | —                                                  |
| CMBS                                             | 2,363                                                                       | —                                                                                                         | 2,363                                                     | —                                                  |
| Total HTM fixed income securities                | \$ 136,094                                                                  | —                                                                                                         | 128,403                                                   | 7,691                                              |
| Financial Liabilities                            |                                                                             |                                                                                                           |                                                           |                                                    |
| Short-term debt:                                 |                                                                             |                                                                                                           |                                                           |                                                    |
| 1.25% borrowings from FHLBI                      | \$ 45,072                                                                   | —                                                                                                         | 45,072                                                    | —                                                  |
| Total short-term debt                            | \$ 45,072                                                                   | —                                                                                                         | 45,072                                                    | —                                                  |
| Long-term debt:                                  |                                                                             |                                                                                                           |                                                           |                                                    |
| 7.25% Senior Notes                               | \$ 60,682                                                                   | —                                                                                                         | 60,682                                                    | —                                                  |
| 6.70% Senior Notes                               | 118,192                                                                     | —                                                                                                         | 118,192                                                   | —                                                  |
| 5.875% Senior Notes                              | 194,324                                                                     | 194,324                                                                                                   | —                                                         | —                                                  |
| 1.61% borrowings from FHLBNY                     | 25,048                                                                      | —                                                                                                         | 25,048                                                    | —                                                  |
| 1.56% borrowings from FHLBNY                     | 24,990                                                                      | —                                                                                                         | 24,990                                                    | —                                                  |
| Total long-term debt                             | \$ 423,236                                                                  | 194,324                                                                                                   | 228,912                                                   | —                                                  |
| December 31, 2015                                |                                                                             |                                                                                                           |                                                           |                                                    |
| December 31, 2015                                | Assets/<br>Liabilities<br>Disclosed<br>at<br>Fair Value<br>at<br>12/31/2015 | Fair Value Measurements Using                                                                             |                                                           |                                                    |
|                                                  |                                                                             | Quoted<br>Prices<br>in<br>Active<br>Markets<br>for<br>Identical<br>Assets/<br>Liabilities<br>(Level<br>1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| (\$ in thousands)                                |                                                                             |                                                                                                           |                                                           |                                                    |
| Financial Assets                                 |                                                                             |                                                                                                           |                                                           |                                                    |
| HTM:                                             |                                                                             |                                                                                                           |                                                           |                                                    |
| Obligations of states and political subdivisions | \$ 181,880                                                                  | —                                                                                                         | 181,880                                                   | —                                                  |



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|                                   |            |         |         |       |
|-----------------------------------|------------|---------|---------|-------|
| Corporate securities              | 22,015     | —       | 18,679  | 3,336 |
| ABS                               | 1,028      | —       | 1,028   | —     |
| CMBS                              | 4,621      | —       | 4,621   | —     |
| Total HTM fixed income securities | \$ 209,544 | —       | 206,208 | 3,336 |
| Financial Liabilities             |            |         |         |       |
| Short-term debt:                  |            |         |         |       |
| 0.63% borrowings from FHLBI       | \$ 14,977  | —       | 14,977  | —     |
| 1.25% borrowings from FHLBI       | 45,083     | —       | 45,083  | —     |
| Total short-term debt             | \$ 60,060  | —       | 60,060  | —     |
| Long-term debt:                   |            |         |         |       |
| 7.25% Senior Notes                | \$ 56,929  | —       | 56,929  | —     |
| 6.70% Senior Notes                | 110,363    | —       | 110,363 | —     |
| 5.875% Senior Notes               | 192,474    | 192,474 | —       | —     |
| Total long-term debt              | \$ 359,766 | 192,474 | 167,292 | —     |

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## NOTE 7. Reinsurance

The following table contains a listing of direct, assumed, and ceded reinsurance amounts for premiums written, premiums earned, and loss and loss expenses incurred for the periods indicated. For more information concerning reinsurance, refer to

Note 8. "Reinsurance" in Item 8. "Financial Statements and Supplementary Data." of our 2015 Annual Report.

|                                 | Quarter ended |           | Nine Months ended |            |
|---------------------------------|---------------|-----------|-------------------|------------|
|                                 | September 30, |           | September 30,     |            |
| (\$ in thousands)               | 2016          | 2015      | 2016              | 2015       |
| Premiums written:               |               |           |                   |            |
| Direct                          | \$669,844     | 631,429   | \$1,981,984       | 1,851,620  |
| Assumed                         | 7,644         | 6,099     | 21,752            | 17,140     |
| Ceded                           | (98,715 )     | (92,503 ) | (281,464 )        | (273,514 ) |
| Net                             | \$578,773     | 545,025   | \$1,722,272       | 1,595,246  |
| Premiums earned:                |               |           |                   |            |
| Direct                          | \$627,520     | 590,716   | \$1,846,587       | 1,728,865  |
| Assumed                         | 7,163         | 5,830     | 20,604            | 16,831     |
| Ceded                           | (92,254 )     | (89,156 ) | (270,372 )        | (271,874 ) |
| Net                             | \$542,429     | 507,390   | \$1,596,819       | 1,473,822  |
| Loss and loss expense incurred: |               |           |                   |            |
| Direct                          | \$428,520     | 306,635   | \$1,152,223       | 935,529    |
| Assumed                         | 5,929         | 4,224     | 18,424            | 13,114     |
| Ceded                           | (118,191 )    | (25,698 ) | (258,766 )        | (86,922 )  |
| Net                             | \$316,258     | 285,161   | \$911,881         | 861,721    |

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

|                                      | Quarter ended |           | Nine Months ended |            |
|--------------------------------------|---------------|-----------|-------------------|------------|
|                                      | September 30, |           | September 30,     |            |
| (\$ in thousands)                    | 2016          | 2015      | 2016              | 2015       |
| Ceded to NFIP                        |               |           |                   |            |
| Ceded premiums written               | \$(62,051 )   | (62,463 ) | \$(179,205 )      | (178,784 ) |
| Ceded premiums earned                | (56,505 )     | (58,340 ) | (169,986 )        | (176,119 ) |
| Ceded loss and loss expense incurred | (99,200 )     | (15,382 ) | (164,179 )        | (36,315 )  |

## NOTE 8. Segment Information

We classify our business into four reportable segments, which are as follows:

• **Standard Commercial Lines** - comprised of insurance products and services provided in the standard marketplace to commercial enterprises, which are typically businesses, non-profit organizations, and local government agencies.

• **Standard Personal Lines** - comprised of insurance products and services, including flood insurance coverage, provided primarily to individuals acquiring coverage in the standard marketplace.

• **E&S Lines** - comprised of insurance products and services provided to customers who have not obtained coverage in the standard marketplace.

• **Investments** - invests the premiums collected by our insurance operations, as well as our earnings and amounts generated through our capital management strategies, which may include the issuance of debt and equity securities.

In computing the results of each segment, we do not make adjustments for interest expense or net general corporate expenses. While we do not fully allocate taxes to all segments, we do allocate taxes to our Investments segment as we manage that segment on after-tax results. We do not maintain separate investment portfolios for the segments and therefore, do not allocate assets to the segments.

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

| Revenue by Segment                      | Quarter ended<br>September 30, |         | Nine Months ended<br>September 30, |           |
|-----------------------------------------|--------------------------------|---------|------------------------------------|-----------|
| (\$ in thousands)                       | 2016                           | 2015    | 2016                               | 2015      |
| Standard Commercial Lines:              |                                |         |                                    |           |
| Net premiums earned:                    |                                |         |                                    |           |
| Commercial automobile                   | \$ 100,612                     | 90,758  | 294,927                            | 265,771   |
| Workers compensation                    | 78,596                         | 74,560  | 229,847                            | 213,991   |
| General liability                       | 133,981                        | 123,252 | 391,349                            | 357,430   |
| Commercial property                     | 74,052                         | 68,587  | 217,821                            | 199,699   |
| Businessowners' policies                | 24,461                         | 23,726  | 73,016                             | 69,603    |
| Bonds                                   | 5,795                          | 5,031   | 16,924                             | 15,137    |
| Other                                   | 4,089                          | 3,628   | 11,868                             | 10,649    |
| Miscellaneous income                    | 1,925                          | 448     | 6,182                              | 4,680     |
| Total Standard Commercial Lines revenue | 423,511                        | 389,990 | 1,241,934                          | 1,136,960 |
| Standard Personal Lines:                |                                |         |                                    |           |
| Net premiums earned:                    |                                |         |                                    |           |
| Personal automobile                     | 34,865                         | 36,623  | 106,526                            | 110,373   |
| Homeowners                              | 32,031                         | 33,670  | 98,342                             | 101,122   |
| Other                                   | 1,794                          | 1,795   | 4,851                              | 5,143     |
| Miscellaneous income                    | 275                            | 250     | 836                                | 841       |
| Total Standard Personal Lines revenue   | 68,965                         | 72,338  | 210,555                            | 217,479   |
| E&S Lines:                              |                                |         |                                    |           |
| Net premiums earned:                    |                                |         |                                    |           |
| General liability                       | 37,398                         | 32,395  | 108,372                            | 87,914    |
| Commercial property                     | 11,853                         | 11,309  | 35,013                             | 31,428    |
| Commercial automobile                   | 2,902                          | 2,056   | 7,963                              | 5,562     |
| Miscellaneous income                    | (1 )                           | —       | —                                  | —         |
| Total E&S Lines revenue                 | 52,152                         | 45,760  | 151,348                            | 124,904   |
| Investments:                            |                                |         |                                    |           |
| Net investment income                   | 33,375                         | 32,061  | 95,326                             | 91,208    |
| Net realized investment gains           | 3,688                          | 308     | 2,749                              | 15,771    |
| Total Investments revenue               | 37,063                         | 32,369  | 98,075                             | 106,979   |
| Total revenues                          | \$581,691                      | 540,457 | 1,701,912                          | 1,586,322 |
| Income Before Federal Income Tax        |                                |         |                                    |           |
|                                         | Quarter ended<br>September 30, |         | Nine Months<br>ended September 30, |           |
| (\$ in thousands)                       | 2016                           | 2015    | 2016                               | 2015      |
| Standard Commercial Lines:              |                                |         |                                    |           |
| Underwriting gain                       | \$30,124                       | 44,027  | 101,229                            | 109,304   |
| GAAP combined ratio                     | 92.9                           | % 88.7  | 91.8                               | 90.3      |
| Statutory combined ratio                | 92.0                           | 88.4    | 90.1                               | 89.4      |
| Standard Personal Lines:                |                                |         |                                    |           |
| Underwriting gain (loss)                | \$4,271                        | 2,826   | 19,001                             | (4,295 )  |
| GAAP combined ratio                     | 93.8                           | % 96.1  | 90.9                               | 102.0     |
| Statutory combined ratio                | 92.0                           | 95.0    | 90.7                               | 101.7     |

E&S Insurance Operations:

|                          |            |          |          |          |
|--------------------------|------------|----------|----------|----------|
| Underwriting loss        | \$(2,362 ) | (2,022 ) | (3,465 ) | (5,033 ) |
| GAAP combined ratio      | 104.5 %    | 104.4    | 102.3    | 104.0    |
| Statutory combined ratio | 101.4      | 101.1    | 100.9    | 101.8    |

Investments:

|                                                    |          |        |        |         |
|----------------------------------------------------|----------|--------|--------|---------|
| Net investment income                              | \$33,375 | 32,061 | 95,326 | 91,208  |
| Net realized investment gains                      | 3,688    | 308    | 2,749  | 15,771  |
| Total investment income, before federal income tax | 37,063   | 32,369 | 98,075 | 106,979 |
| Tax on investment income                           | 9,752    | 7,614  | 24,290 | 26,186  |
| Total investment income, after federal income tax  | \$27,311 | 24,755 | 73,785 | 80,793  |

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| Reconciliation of Segment Results to Income<br>Before Federal Income Tax | Quarter ended<br>September 30, |          | Nine Months<br>ended September<br>30, |           |
|--------------------------------------------------------------------------|--------------------------------|----------|---------------------------------------|-----------|
|                                                                          | 2016                           | 2015     | 2016                                  | 2015      |
| (\$ in thousands)                                                        |                                |          |                                       |           |
| Underwriting gain (loss), before federal income tax                      |                                |          |                                       |           |
| Standard Commercial Lines                                                | \$30,124                       | 44,027   | 101,229                               | 109,304   |
| Standard Personal Lines                                                  | 4,271                          | 2,826    | 19,001                                | (4,295 )  |
| E&S Lines                                                                | (2,362 )                       | (2,022 ) | (3,465 )                              | (5,033 )  |
| Investment income, before federal income tax                             | 37,063                         | 32,369   | 98,075                                | 106,979   |
| Total all segments                                                       | 69,096                         | 77,200   | 214,840                               | 206,955   |
| Interest expense                                                         | (5,714 )                       | (5,610 ) | (16,940 )                             | (16,826 ) |
| General corporate and other expenses                                     | (7,939 )                       | (5,751 ) | (28,271 )                             | (21,235 ) |
| Income before federal income tax                                         | \$55,443                       | 65,839   | 169,629                               | 168,894   |

## NOTE 9. Retirement Plans

SICA's primary pension plan is the Retirement Income Plan for Selective Insurance Company of America (the "Pension Plan"). SICA also sponsors the Supplemental Excess Retirement Plan (the "Excess Plan") and a life insurance benefit plan. All plans are closed to new entrants and benefits ceased accruing under the Pension Plan and the Excess Plan after March 31, 2016. For more information concerning SICA's retirement plans, refer to Note 14. "Retirement Plans" in Item 8. "Financial Statements and Supplementary Data." of our 2015 Annual Report.

The following tables provide information regarding the Pension Plan:

|                                                 | Pension Plan<br>Quarter ended<br>September 30, |         | Pension Plan<br>Nine Months<br>ended September<br>30, |          |
|-------------------------------------------------|------------------------------------------------|---------|-------------------------------------------------------|----------|
|                                                 | 2016                                           | 2015    | 2016                                                  | 2015     |
| (\$ in thousands)                               |                                                |         |                                                       |          |
| Net Periodic Benefit Cost:                      |                                                |         |                                                       |          |
| Service cost                                    | \$41                                           | 1,913   | 1,647                                                 | 5,738    |
| Interest cost                                   | 3,049                                          | 3,409   | 9,252                                                 | 10,225   |
| Expected return on plan assets                  | (5,006)                                        | (3,991) | (12,982)                                              | (11,972) |
| Amortization of unrecognized net actuarial loss | 1,763                                          | 1,643   | 4,724                                                 | 4,930    |
| Total net periodic cost                         | \$(153)                                        | 2,974   | 2,641                                                 | 8,921    |

As of December 31, 2015, we anticipated contributing \$11.7 million to the Pension Plan for full year 2016. Actual contributions amounted to \$54.5 million in Nine Months 2016 and we do not anticipate any additional funding this year. The decrease in net periodic cost in Third Quarter 2016 reflects lower expense as a result of the contributions that were higher than our original expectation.

|                                                          | Pension Plan<br>Nine Months<br>ended<br>September 30, |       |
|----------------------------------------------------------|-------------------------------------------------------|-------|
|                                                          | 2016                                                  | 2015  |
| Weighted-Average Expense Assumptions:                    |                                                       |       |
| Discount rate                                            | 4.69%                                                 | 4.29% |
| Effective interest rate for calculation of service cost  | 4.89%                                                 | — %   |
| Effective interest rate for calculation of interest cost | 4.02%                                                 | — %   |
| Expected return on plan assets                           | 6.37%                                                 | 6.27% |
| Rate of compensation increase <sup>1</sup>               | n/a                                                   | 4.00% |

<sup>1</sup>This assumption was 4.0% through March 31, 2016, the date after which benefits ceased accruing for all participants of the Pension Plan.

Effective January 1, 2016, the approach used to calculate the service and interest components of net periodic benefit cost for the Pension Plan was changed to provide a more precise measurement of these costs. Historically, we calculated the service and interest components utilizing a single weighted-average discount rate derived from the yield curve used to measure the benefit obligation at the beginning of the period. On January 1, 2016, we elected to utilize an approach that discounts the individual expected cash flows using the applicable spot rates derived from the yield curve over the projected cash flow period. We accounted for this change prospectively as a change in accounting estimate. The decrease in service cost reflected in the table above is attributable to the discontinuation of benefit accruals for existing participants as of March 31, 2016.

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## NOTE 10. Comprehensive Income

The components of comprehensive income, both gross and net of tax, for Third Quarter and Nine Months 2016 and 2015 were as follows:

## Third Quarter 2016

| (\$ in thousands)                                       | Gross     | Tax      | Net       |
|---------------------------------------------------------|-----------|----------|-----------|
| Net income                                              | \$55,443  | 16,941   | 38,502    |
| Components of OCI:                                      |           |          |           |
| Unrealized losses on investment securities:             |           |          |           |
| Unrealized holding losses during period                 | (12,992 ) | (4,548 ) | (8,444 )  |
| Amounts reclassified into net income:                   |           |          |           |
| HTM securities                                          | (13 )     | (4 )     | (9 )      |
| Realized gains on AFS securities                        | (3,684 )  | (1,289 ) | (2,395 )  |
| Total unrealized losses on investment securities        | (16,689 ) | (5,841 ) | (10,848 ) |
| Defined benefit pension and post-retirement plans:      |           |          |           |
| Amounts reclassified into net income:                   |           |          |           |
| Net actuarial loss                                      | 1,615     | 565      | 1,050     |
| Total defined benefit pension and post-retirement plans | 1,615     | 565      | 1,050     |
| Other comprehensive loss                                | (15,074 ) | (5,276 ) | (9,798 )  |
| Comprehensive income                                    | \$40,369  | 11,665   | 28,704    |

## Third Quarter 2015

| (\$ in thousands)                                       | Gross    | Tax    | Net    |
|---------------------------------------------------------|----------|--------|--------|
| Net income                                              | \$65,839 | 18,843 | 46,996 |
| Components of OCI:                                      |          |        |        |
| Unrealized gains on investment securities:              |          |        |        |
| Unrealized holding gains during period                  | 8,371    | 2,929  | 5,442  |
| Amounts reclassified into net income:                   |          |        |        |
| HTM securities                                          | (97 )    | (34 )  | (63 )  |
| Realized gains on AFS securities                        | (305 )   | (106 ) | (199 ) |
| Total unrealized gains on investment securities         | 7,969    | 2,789  | 5,180  |
| Defined benefit pension and post-retirement plans:      |          |        |        |
| Amounts reclassified into net income:                   |          |        |        |
| Net actuarial loss                                      | 1,709    | 599    | 1,110  |
| Total defined benefit pension and post-retirement plans | 1,709    | 599    | 1,110  |
| Other comprehensive income                              | 9,678    | 3,388  | 6,290  |
| Comprehensive income                                    | \$75,517 | 22,231 | 53,286 |

## Nine Months 2016

| (\$ in thousands)                                  | Gross     | Tax    | Net      |
|----------------------------------------------------|-----------|--------|----------|
| Net income                                         | \$169,629 | 50,494 | 119,135  |
| Components of OCI:                                 |           |        |          |
| Unrealized gains on investment securities:         |           |        |          |
| Unrealized holding gains during period             | 108,420   | 37,947 | 70,473   |
| Non-credit portion of OTTI recognized in OCI       | (10 )     | (4 )   | (6 )     |
| Amounts reclassified into net income:              |           |        |          |
| HTM securities                                     | (104 )    | (36 )  | (68 )    |
| Realized gains on AFS securities                   | (2,747 )  | (961 ) | (1,786 ) |
| Total unrealized gains on investment securities    | 105,559   | 36,946 | 68,613   |
| Defined benefit pension and post-retirement plans: |           |        |          |
| Amounts reclassified into net income:              |           |        |          |



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|                                                         |           |        |         |
|---------------------------------------------------------|-----------|--------|---------|
| Net actuarial loss                                      | 4,648     | 1,627  | 3,021   |
| Total defined benefit pension and post-retirement plans | 4,648     | 1,627  | 3,021   |
| Other comprehensive income                              | 110,207   | 38,573 | 71,634  |
| Comprehensive income                                    | \$279,836 | 89,067 | 190,769 |

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## Nine Months 2015

| (\$ in thousands)                                       | Gross      | Tax       | Net       |
|---------------------------------------------------------|------------|-----------|-----------|
| Net income                                              | \$ 168,894 | 48,422    | 120,472   |
| Components of OCI:                                      |            |           |           |
| Unrealized losses on investment securities:             |            |           |           |
| Unrealized holding losses during period                 | (27,896 )  | (9,764 )  | (18,132 ) |
| Amounts reclassified into net income:                   |            |           |           |
| HTM securities                                          | (543 )     | (190 )    | (353 )    |
| Non-credit OTTI                                         | 357        | 125       | 232       |
| Realized gains on AFS securities                        | (16,778 )  | (5,872 )  | (10,906 ) |
| Total unrealized losses on investment securities        | (44,860 )  | (15,701 ) | (29,159 ) |
| Defined benefit pension and post-retirement plans:      |            |           |           |
| Amounts reclassified into net income:                   |            |           |           |
| Net actuarial loss                                      | 5,127      | 1,795     | 3,332     |
| Total defined benefit pension and post-retirement plans | 5,127      | 1,795     | 3,332     |
| Other comprehensive loss                                | (39,733 )  | (13,906 ) | (25,827 ) |
| Comprehensive income                                    | \$ 129,161 | 34,516    | 94,645    |

The balances of, and changes in, each component of AOCI (net of taxes) as of September 30, 2016 were as follows:  
September 30, 2016

| (\$ in thousands)              | Net Unrealized Gain on Investment Securities |             |           |                      | Defined Benefit Pension and Post-Retirement Plans | Total AOCI |
|--------------------------------|----------------------------------------------|-------------|-----------|----------------------|---------------------------------------------------|------------|
|                                | OTTI Related                                 | HTM Related | All Other | Investments Subtotal |                                                   |            |
| Balance, December 31, 2015     | \$(282)                                      | 194         | 45,083    | 44,995               | (54,420 )                                         | (9,425 )   |
| OCI before reclassifications   | (6 )                                         | —           | 70,473    | 70,467               | —                                                 | 70,467     |
| Amounts reclassified from AOCI | —                                            | (68 )       | (1,786 )  | (1,854 )             | 3,021                                             | 1,167      |
| Net current period OCI         | (6 )                                         | (68 )       | 68,687    | 68,613               | 3,021                                             | 71,634     |
| Balance, September 30, 2016    | \$(288)                                      | 126         | 113,770   | 113,608              | (51,399 )                                         | 62,209     |

The reclassifications out of AOCI were as follows:

| (\$ in thousands)                                      | Quarter ended September 30, |        | Nine Months ended September 30, |        | Affected Line Item in the Unaudited Consolidated Statement of Income |
|--------------------------------------------------------|-----------------------------|--------|---------------------------------|--------|----------------------------------------------------------------------|
|                                                        | 2016                        | 2015   | 2016                            | 2015   |                                                                      |
| OTTI related                                           |                             |        |                                 |        |                                                                      |
| Non-credit OTTI on disposed securities                 | \$—                         | —      | —                               | 357    | Net realized gains                                                   |
|                                                        | —                           | —      | —                               | 357    | Income before federal income tax                                     |
|                                                        | —                           | —      | —                               | (125 ) | Total federal income tax expense                                     |
|                                                        | —                           | —      | —                               | 232    | Net income                                                           |
| HTM related                                            |                             |        |                                 |        |                                                                      |
| Unrealized losses on HTM disposals                     | 73                          | 121    | 161                             | 258    | Net realized gains                                                   |
| Amortization of net unrealized gains on HTM securities | (86 )                       | (218 ) | (265 )                          | (801 ) | Net investment income earned                                         |
|                                                        | (13 )                       | (97 )  | (104 )                          | (543 ) | Income before federal income tax                                     |
|                                                        | 4                           | 34     | 36                              | 190    | Total federal income tax expense                                     |
|                                                        | (9 )                        | (63 )  | (68 )                           | (353 ) | Net income                                                           |

Realized losses (gains) on AFS and  
OTTI

|                                                      |        |        |           |          |                                  |
|------------------------------------------------------|--------|--------|-----------|----------|----------------------------------|
| Realized losses (gains) on AFS<br>disposals and OTTI | (3,684 | ) (305 | ) (2,747) | (16,778) | Net realized gains               |
|                                                      | (3,684 | ) (305 | ) (2,747) | (16,778) | Income before federal income tax |
|                                                      | 1,289  | 106    | 961       | 5,872    | Total federal income tax expense |
|                                                      | (2,395 | ) (199 | ) (1,786) | (10,906) | Net income                       |

Defined benefit pension and  
post-retirement life plans

|                                                           |       |        |           |        |                                    |
|-----------------------------------------------------------|-------|--------|-----------|--------|------------------------------------|
| Net actuarial loss                                        | 351   | 371    | 1,009     | 1,114  | Loss and loss expense incurred     |
|                                                           | 1,264 | 1,338  | 3,639     | 4,013  | Policy acquisition costs           |
| Total defined benefit pension and<br>post-retirement life | 1,615 | 1,709  | 4,648     | 5,127  | Income before federal income tax   |
|                                                           | (565  | ) (599 | ) (1,627) | (1,795 | ) Total federal income tax expense |
|                                                           | 1,050 | 1,110  | 3,021     | 3,332  | Net income                         |

Total reclassifications for the period \$(1,354) 848 1,167 (7,695 ) Net income

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NOTE 11. Litigation

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

Our insurance subsidiaries are also from time to time involved in other legal actions, some of which assert claims for substantial amounts. These actions include, among others, putative class actions seeking certification of a state or national class. Such putative class actions have alleged, for example, improper reimbursement of medical providers paid under workers compensation and personal and commercial automobile insurance policies. Our insurance subsidiaries also are involved from time to time in individual actions in which extra-contractual damages, punitive damages, or penalties are sought, such as claims alleging bad faith in the handling of insurance claims. We believe that we have valid defenses to these cases. We expect that the ultimate liability, if any, with respect to such lawsuits, after consideration of provisions made for estimated losses, will not be material to our consolidated financial condition. Nonetheless, given the large or indeterminate amounts sought in certain of these actions, and the inherent unpredictability of litigation, an adverse outcome in certain matters could, from time to time, have a material adverse effect on our consolidated results of operations or cash flows in particular quarterly or annual periods. As of September 30, 2016, we do not believe the Company was involved in any legal action that could have a material adverse effect on our consolidated financial condition, results of operations, or cash flows.

NOTE 12. Subsequent Events

Hurricane Matthew impacted the Southern United States in October 2016. We currently estimate catastrophe losses from this event to range from \$10 million to \$14 million in the fourth quarter of 2016. In addition, we currently estimate a partial offset of approximately \$1 million related to the servicing of policies impacted by this event through our participation in the NFIP.

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

Forward-Looking Statements

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

Introduction

The Parent, through its insurance subsidiaries, offers property and casualty insurance products in the standard and excess and surplus ("E&S") marketplaces. We classify our business into four reportable segments, which are as follows:

Standard Commercial Lines - which represents 79% of our combined insurance segments' net premiums written ("NPW"), sells commercial lines insurance products and services to businesses, non-profit organizations, and local government agencies located primarily in 22 states in the Eastern and Midwestern U.S. and the District of Columbia through approximately 1,160 distribution partners in the standard marketplace.

Standard Personal Lines - which includes our flood business, represents approximately 12% of our combined insurance segments' NPW and sells personal lines insurance products and services to individuals located primarily in 13 states through approximately 700 distribution partners in the standard marketplace. In addition, we have approximately 5,000 distribution partners selling our flood business.

E&S Lines - which represents 9% of our combined insurance segments' NPW, sells commercial lines insurance products and services in all 50 states and the District of Columbia through approximately 80 distribution partners. Insurance policies in this segment are sold to customers that typically have business risks with unique characteristics, such as the nature of the business or its claim history and cannot obtain coverage in the standard marketplace. E&S insurers have more flexibility in coverage terms and rates compared to standard market insurers, generally resulting in policies with higher rates and terms and conditions that are more narrowly customized for specific risks.

Investments - invests the premiums collected by our Standard Commercial Lines, Standard Personal Lines, and E&S Lines, as well as our earnings and amounts generated through our capital management strategies, which may include the issuance of debt and equity securities.

Our Standard Commercial and Standard Personal Lines products and services are written through our nine insurance subsidiaries, some of which write flood business through the Write Your Own ("WYO") program of the National Flood Insurance Program ("NFIP").

Our E&S products and services are written through one subsidiary, Mesa Underwriters Specialty Insurance Company ("MUSIC"). This subsidiary provides us with a nationally-authorized non-admitted platform to offer insurance products and services to customers who have not obtained coverage in the standard marketplace.

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

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The following is Management's Discussion and Analysis ("MD&A") of the consolidated results of operations and financial condition, as well as known trends and uncertainties, that may have a material impact in future periods. Consequently, investors should read the MD&A in conjunction with the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2015 ("2015 Annual Report") filed with the U.S. Securities and Exchange Commission ("SEC").

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

• Critical Accounting Policies and Estimates;

Financial Highlights of Results for the third quarters ended September 30, 2016 ("Third Quarter 2016") and September 30, 2015 ("Third Quarter 2015") and the nine-month periods ended September 30, 2016 ("Nine Months 2016") and September 30, 2015 ("Nine Months 2015");

• Results of Operations and Related Information by Segment;

• Federal Income Taxes;

• Financial Condition, Liquidity, and Capital Resources;

• Ratings;

• Off-Balance Sheet Arrangements; and

• Contractual Obligations, Contingent Liabilities, and Commitments.

### Critical Accounting Policies and Estimates

Our unaudited interim consolidated financial statements include amounts based on our informed estimates and judgments for those transactions that are not yet complete. Such estimates and judgments affect the reported amounts in the consolidated financial statements. Those estimates and judgments most critical to the preparation of the consolidated financial statements involve the following: (i) reserves for loss and loss expenses; (ii) pension and post-retirement benefit plan actuarial assumptions; (iii) other-than-temporary investment impairments ("OTTI"); and (iv) reinsurance. These estimates and judgments require the use of assumptions about matters that are highly uncertain and, therefore, are subject to change as facts and circumstances develop. If different estimates and judgments had been applied, materially different amounts might have been reported in the financial statements. For additional information regarding our critical accounting policies, refer to pages 36 through 47 of our 2015 Annual Report.

### Financial Highlights of Results for Third Quarter and Nine Months 2016 and Third Quarter and Nine Months 2015<sup>1</sup>

|                                                             | Quarter ended<br>September 30, |         | Change         |       | Nine Months ended<br>September 30, |           | Change         |       |
|-------------------------------------------------------------|--------------------------------|---------|----------------|-------|------------------------------------|-----------|----------------|-------|
| (\$ and shares in thousands, except per share amounts)      | 2016                           | 2015    | % or<br>Points |       | 2016                               | 2015      | % or<br>Points |       |
| Generally Accepted Accounting Principles ("GAAP") measures: |                                |         |                |       |                                    |           |                |       |
| Revenues                                                    | \$581,691                      | 540,457 | 8              | %     | \$1,701,912                        | 1,586,322 | 7              | %     |
| Net investment income earned                                | 33,375                         | 32,061  | 4              |       | 95,326                             | 91,208    | 5              |       |
| Income before federal income tax                            | 55,443                         | 65,839  | (16)           | )     | 169,629                            | 168,894   | —              |       |
| Net income                                                  | 38,502                         | 46,996  | (18)           | )     | 119,135                            | 120,472   | (1)            | )     |
| Diluted net income per share                                | 0.66                           | 0.81    | (19)           | )     | 2.03                               | 2.08      | (2)            | )     |
| Diluted weighted-average outstanding shares                 | 58,731                         | 57,984  | 1              |       | 58,612                             | 57,838    | 1              |       |
| GAAP combined ratio                                         | 94.1                           | % 91.2  | 2.9            | pts   | 92.7                               | % 93.2    | (0.5)          | ) pts |
| Statutory combined ratio                                    | 92.9                           | 90.5    | 2.4            |       | 91.2                               | 92.3      | (1.1)          | )     |
| Invested assets per dollar of stockholders' equity          | \$3.41                         | 3.69    | (8)            | ) %   | \$3.41                             | 3.69      | (8)            | ) %   |
| After-tax yield on investments                              | 1.9                            | % 2.0   | (0.1)          | ) pts | 1.8                                | % 1.9     | (0.1)          | ) pts |
| Annualized return on average equity ("ROE")                 | 9.8                            | 14.1    | (4.3)          | )     | 10.7                               | 12.2      | (1.5)          | )     |
| Non-GAAP measures:                                          |                                |         |                |       |                                    |           |                |       |

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|                                                 |          |        |       |        |           |         |   |                 |
|-------------------------------------------------|----------|--------|-------|--------|-----------|---------|---|-----------------|
| Operating income <sup>2</sup>                   | \$36,104 | 46,796 | (23 ) | %      | \$117,348 | 110,221 | 6 | %               |
| Diluted operating income per share <sup>2</sup> | 0.62     | 0.81   | (23 ) |        | 2.00      | 1.90    | 5 |                 |
| Annualized operating ROE <sup>2</sup>           | 9.2      | %      | 14.0  | (4.8 ) | pts       | 10.5    | % | 11.2 (0.7 ) pts |

<sup>1</sup> Refer to the Glossary of Terms attached to our 2015 Annual Report as Exhibit 99.1 for definitions of terms used in this Form 10-Q.

<sup>2</sup> Operating income is used as an important financial measure by us, analysts, and investors, because the realization of investment gains and losses on sales in any given period is largely discretionary as to timing. In addition, these realized investment gains and losses, as well as OTTI that are charged to earnings and the results of discontinued operations, could distort the analysis of trends. See below for a reconciliation of operating income to net income in accordance with GAAP. Annualized operating ROE is calculated by dividing annualized operating income by average stockholders' equity.



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

|                                             | Quarter ended<br>September 30, |        | Nine Months<br>ended September<br>30, |         |
|---------------------------------------------|--------------------------------|--------|---------------------------------------|---------|
| (\$ in thousands, except per share amounts) | 2016                           | 2015   | 2016                                  | 2015    |
| Operating income                            | \$36,104                       | 46,796 | \$117,348                             | 110,221 |
| Net realized gains, net of tax              | 2,398                          | 200    | 1,787                                 | 10,251  |
| Net income                                  | \$38,502                       | 46,996 | \$119,135                             | 120,472 |
| <br>                                        |                                |        |                                       |         |
| Diluted operating income per share          | \$0.62                         | 0.81   | \$2.00                                | 1.90    |
| Diluted net realized gains per share        | 0.04                           | —      | 0.03                                  | 0.18    |
| Diluted net income per share                | \$0.66                         | 0.81   | \$2.03                                | 2.08    |

It is our goal to generate an annualized operating ROE that is 300 basis points in excess of our weighted average cost of capital. At September 30, 2016, our weighted-average cost of capital was 7.9%. Our annualized ROE contributions by component were as follows:

| ROE                             | Quarter<br>ended<br>September<br>30, |       | Nine Months<br>ended<br>September<br>30, |       |
|---------------------------------|--------------------------------------|-------|------------------------------------------|-------|
|                                 | 2016                                 | 2015  | 2016                                     | 2015  |
| Insurance segments              | 5.3 %                                | 8.7   | 6.8 %                                    | 6.6   |
| Investment income <sup>1</sup>  | 6.4                                  | 7.4   | 6.5                                      | 7.1   |
| Other                           | (2.5)                                | (2.1) | (2.8)                                    | (2.5) |
| Annualized operating ROE        | 9.2                                  | 14.0  | 10.5                                     | 11.2  |
| Net realized gains <sup>1</sup> | 0.6                                  | 0.1   | 0.2                                      | 1.0   |
| Annualized ROE                  | 9.8 %                                | 14.1  | 10.7 %                                   | 12.2  |

<sup>1</sup> Investment segment results are the combination of "Net investment income earned" and "Net realized gains".

**Insurance Segments**

The key metric in understanding our insurance segments' contribution to annualized operating ROE is the GAAP combined ratio. The following table provides a quantitative foundation for analyzing this ratio:

| All Lines                          | Quarter ended<br>September 30, |         | Change<br>% or<br>Points | Nine Months ended<br>September 30, |           | Change<br>% or<br>Points |
|------------------------------------|--------------------------------|---------|--------------------------|------------------------------------|-----------|--------------------------|
| (\$ in thousands)                  | 2016                           | 2015    |                          | 2016                               | 2015      |                          |
| GAAP Insurance Operations Results: |                                |         |                          |                                    |           |                          |
| NPW                                | \$578,773                      | 545,025 | 6 %                      | \$1,722,272                        | 1,595,246 | 8 %                      |
| Net premiums earned ("NPE")        | 542,429                        | 507,390 | 7                        | 1,596,819                          | 1,473,822 | 8                        |
| Less:                              |                                |         |                          |                                    |           |                          |
| Loss and loss expense incurred     | 316,258                        | 285,161 | 11                       | 911,881                            | 861,721   | 6                        |
| Net underwriting expenses incurred | 193,597                        | 175,477 | 10                       | 564,361                            | 506,835   | 11                       |
| Dividends to policyholders         | 541                            | 1,921   | (72 )                    | 3,812                              | 5,290     | (28 )                    |
| Underwriting gain                  | \$32,033                       | 44,831  | (29 ) %                  | \$116,765                          | 99,976    | 17 %                     |
| GAAP Ratios:                       |                                |         |                          |                                    |           |                          |
| Loss and loss expense ratio        | 58.3                           | %56.2   | 2.1 pts                  | 57.1                               | %58.5     | (1.4 ) pts               |
| Underwriting expense ratio         | 35.7                           | 34.6    | 1.1                      | 35.4                               | 34.3      | 1.1                      |
| Dividends to policyholders ratio   | 0.1                            | 0.4     | (0.3 )                   | 0.2                                | 0.4       | (0.2 )                   |
| Combined ratio                     | 94.1                           | 91.2    | 2.9                      | 92.7                               | 93.2      | (0.5 )                   |
| Statutory Ratios:                  |                                |         |                          |                                    |           |                          |

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|                                  |      |       |         |      |       |            |
|----------------------------------|------|-------|---------|------|-------|------------|
| Loss and loss expense ratio      | 58.3 | 56.1  | 2.2     | 57.0 | 58.5  | (1.5 )     |
| Underwriting expense ratio       | 34.5 | 34.0  | 0.5     | 34.0 | 33.4  | 0.6        |
| Dividends to policyholders ratio | 0.1  | 0.4   | (0.3 )  | 0.2  | 0.4   | (0.2 )     |
| Combined ratio                   | 92.9 | %90.5 | 2.4 pts | 91.2 | %92.3 | (1.1 ) pts |

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The GAAP combined ratio increased 2.9 points in Third Quarter 2016 compared to the same period last year, driven primarily by higher property losses, which were partially offset by favorable prior year casualty reserve development, as illustrated in the table below:

| (\$ in millions)                                  | Third Quarter<br>2016              |                                          |                                 | Third Quarter<br>2015              |                                          |                                 | Change<br>in<br>Ratio |
|---------------------------------------------------|------------------------------------|------------------------------------------|---------------------------------|------------------------------------|------------------------------------------|---------------------------------|-----------------------|
|                                                   | Loss<br>and<br>Expense<br>Incurred | Impact<br>on<br>Loss<br>Expense<br>Ratio | and<br>Loss<br>Expense<br>Ratio | Loss<br>and<br>Expense<br>Incurred | Impact<br>on<br>Loss<br>Expense<br>Ratio | and<br>Loss<br>Expense<br>Ratio |                       |
| Catastrophe losses                                | \$10.4                             | 1.9                                      | pts                             | \$6.9                              | 1.3                                      | pts                             | 0.6 pts               |
| Non-catastrophe property losses                   | 78.5                               | 14.5                                     |                                 | 65.2                               | 12.9                                     |                                 | 1.6                   |
| Favorable prior year casualty reserve development | (19.0)                             | (3.5)                                    | )                               | (15.0)                             | (3.0)                                    | )                               | (0.5)                 |

The GAAP combined ratio improved by 0.5 points in Nine Months 2016 compared to the same period last year, driven by lower property losses, as last year was heavily impacted by severe winter weather and Midwest storms. These lower property losses were partially offset by lower favorable prior year casualty development. Quantitative details are as follows:

| (\$ in millions)                                  | Nine Months<br>2016                |                                          |                                 | Nine Months<br>2015                |                                          |                                 | Change<br>in<br>Ratio |
|---------------------------------------------------|------------------------------------|------------------------------------------|---------------------------------|------------------------------------|------------------------------------------|---------------------------------|-----------------------|
|                                                   | Loss<br>and<br>Expense<br>Incurred | Impact<br>on<br>Loss<br>Expense<br>Ratio | and<br>Loss<br>Expense<br>Ratio | Loss<br>and<br>Expense<br>Incurred | Impact<br>on<br>Loss<br>Expense<br>Ratio | and<br>Loss<br>Expense<br>Ratio |                       |
| Catastrophe losses                                | \$33.2                             | 2.1                                      | pts                             | \$56.1                             | 3.8                                      | pts                             | (1.7) pts             |
| Non-catastrophe property losses                   | 209.2                              | 13.1                                     |                                 | 206.7                              | 14.0                                     |                                 | (0.9)                 |
| Favorable prior year casualty reserve development | (46.0)                             | (2.9)                                    | )                               | (55.0)                             | (3.8)                                    | )                               | 0.9                   |

Favorable prior year casualty reserve development by line of business is as follows:  
(Favorable)/Unfavorable Prior Year Casualty Reserve Development

| (\$ in millions)                                          | Quarter ended<br>September 30, |          | Nine Months<br>ended<br>September<br>30, |        |
|-----------------------------------------------------------|--------------------------------|----------|------------------------------------------|--------|
|                                                           | 2016                           | 2015     | 2016                                     | 2015   |
| General liability                                         | \$(11.0)                       | (5.0)    | (33.0)                                   | (41.0) |
| Commercial automobile                                     | 7.0                            | —        | 20.0                                     | 3.0    |
| Workers compensation                                      | (15.0)                         | (14.0)   | (36.0)                                   | (27.0) |
| Businessowners' policies                                  | —                              | —        | —                                        | 4.0    |
| Total Standard Commercial Lines                           | (19.0)                         | (19.0)   | (49.0)                                   | (61.0) |
| E&S                                                       | —                              | 4.0      | 3.0                                      | 6.0    |
| Total (favorable) prior year casualty reserve development | \$(19.0)                       | (15.0)   | (46.0)                                   | (55.0) |
| (Favorable) impact on loss ratio                          | (3.5)                          | pts(3.0) | (2.9)                                    | (3.8)  |

For a qualitative discussion of this reserve development, please refer to the respective insurance segment section below in

"Results of Operations and Related Information by Segment."

Also impacting the GAAP combined ratio was an increase in the underwriting expense ratio that was driven by higher supplemental commission expense to our agents, due to improved profitability, which increased the ratio by 0.7 points in Third Quarter 2016 and 0.8 points in Nine Months 2016 compared to the same periods last year.

#### Investments Segment

In total, our investment segment contributed 7.0 points to our overall annualized ROE in Third Quarter 2016, compared to 7.5 points in Third Quarter 2015, and 6.7 points in Nine Months 2016, compared to 8.1 points in Nine Months 2015. The primary driver of the 1.4-point decrease for the year-to-date period was a \$13.0 million decrease in pre-tax net realized gains this year compared to last, the timing of which is largely subjective from one period to the next.

#### Other

Our other expenses, which are primarily comprised of expenses at the holding company level, reduced our overall annualized ROE by 2.5 points in Third Quarter 2016 compared to 2.1 points in Third Quarter 2015 and by 2.8 points in Nine Months 2016 compared to 2.5 points in Nine Months 2015. The increase in corporate expenses was driven by higher long-term stock-compensation expense to employees, which reflects the Company's improved profitability and the continued strong stock price of the Parent. Long-term stock compensation expense amounted to \$6.6 million in Third Quarter 2016 compared to \$4.7 million in Third Quarter 2015 and \$22.7 million in Nine Months 2016 compared to \$15.8 million in Nine Months 2015.

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## Outlook

A.M. Best Company, Inc. ("A.M. Best") projected a 2016 industry statutory combined ratio of 99.2% in their Review & Preview Report issued in February 2016. This projection included industry catastrophe losses of 4.7 points and favorable reserve development of 1.7 points. A.M. Best also projected decreasing investment yields to continue into 2016.

In 2016, we celebrated our 90<sup>th</sup> year of business and our pillars of success continue to be: (i) our unique field model combined with sophisticated underwriting and claims capabilities; (ii) true franchise value with our "ivy league" distribution partners; and (iii) delivering a superior customer experience with our "best in class" employees. We plan to leverage our competitive advantages by: (i) increasing our share of wallet with existing agents while adding agents in areas with strong new business opportunities; and (ii) exploring geographic expansion beginning with Arizona and New Hampshire, which are expected to be operational by the end of 2017 for our standard commercial lines operations.

We remain focused on becoming a more customer-centric company. In 2015, we made key strategic investments in technology as part of our efforts to deliver a superior customer experience across all interactions. In 2016, we continued to roll out self-servicing capabilities via our mobile application, mobile web, and on the desktop, and we relaunched our public website with simplified navigation, richer content, and responsive capabilities. These investments have enabled us to provide our customers with 24/7 access to transactional capabilities and information. We are also working to identify points of friction in the customer's experience between us and our distribution partners. These friction points provide opportunities for us to increase efficiency and improve the customer's impression of both us and our distribution partner. Customers expect this level of service and access from every company with which they conduct business. We view omni-channel service delivery as a key to future success in our industry and we continue to focus our efforts in this area.

For Nine Months 2016, our statutory combined ratio was 91.2%, which included 2.1 points of catastrophe losses and 2.9 points of favorable prior year casualty reserve development. Based on these results and our expectations for the remainder of the year, we provide the following guidance for full-year 2016:

• An ex-catastrophe combined ratio of approximately 89.5%. This assumes no additional prior year casualty reserve development in the fourth quarter;

• 3.0 points of catastrophe losses, down from our previous guidance of 3.5 points;

• After-tax investment income of approximately \$95 million; and

• Weighted average shares of approximately 58.5 million.

Our goal is to generate an annualized operating ROE that is 300 basis points in excess of our weighted average cost of capital. Our weighted average cost of capital was 7.9% as of September 30, 2016. In Nine Months 2016, our annualized operating ROE was 10.5%.

## Results of Operations and Related Information by Segment

## Standard Commercial Lines

|                                    | Quarter ended<br>September 30, |         |                          |   | Nine Months ended<br>September 30, |           |                          |   |
|------------------------------------|--------------------------------|---------|--------------------------|---|------------------------------------|-----------|--------------------------|---|
| (\$ in thousands)                  | 2016                           | 2015    | Change<br>% or<br>Points |   | 2016                               | 2015      | Change<br>% or<br>Points |   |
| GAAP Insurance Operations Results: |                                |         |                          |   |                                    |           |                          |   |
| NPW                                | \$449,544                      | 414,031 | 9                        | % | \$1,353,615                        | 1,240,110 | 9                        | % |
| NPE                                | 421,586                        | 389,542 | 8                        |   | 1,235,752                          | 1,132,280 | 9                        |   |
| Less:                              |                                |         |                          |   |                                    |           |                          |   |
| Loss and loss expense incurred     | 238,215                        | 203,621 | 17                       |   | 683,183                            | 619,857   | 10                       |   |
| Net underwriting expenses incurred | 152,706                        | 139,973 | 9                        |   | 447,528                            | 397,829   | 12                       |   |

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|                                  |          |        |         |           |         |         |
|----------------------------------|----------|--------|---------|-----------|---------|---------|
| Dividends to policyholders       | 541      | 1,921  | (72 )   | 3,812     | 5,290   | (28 )   |
| Underwriting gain                | \$30,124 | 44,027 | (32 ) % | \$101,229 | 109,304 | (7 ) %  |
| GAAP Ratios:                     |          |        |         |           |         |         |
| Loss and loss expense ratio      | 56.5     | % 52.3 | 4.2 pts | 55.3      | % 54.7  | 0.6 pts |
| Underwriting expense ratio       | 36.3     | 35.9   | 0.4     | 36.2      | 35.1    | 1.1     |
| Dividends to policyholders ratio | 0.1      | 0.5    | (0.4 )  | 0.3       | 0.5     | (0.2 )  |
| Combined ratio                   | 92.9     | 88.7   | 4.2     | 91.8      | 90.3    | 1.5     |
| Statutory Ratios:                |          |        |         |           |         |         |
| Loss and loss expense ratio      | 56.5     | 52.2   | 4.3     | 55.2      | 54.7    | 0.5     |
| Underwriting expense ratio       | 35.4     | 35.7   | (0.3 )  | 34.6      | 34.2    | 0.4     |
| Dividends to policyholders ratio | 0.1      | 0.5    | (0.4 )  | 0.3       | 0.5     | (0.2 )  |
| Combined ratio                   | 92.0     | % 88.4 | 3.6 pts | 90.1      | % 89.4  | 0.7 pts |

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The increases in NPW in Third Quarter and Nine Months 2016 compared to Third Quarter and Nine Months 2015 were driven by: (i) increases in direct new business; (ii) renewal pure price increases; and (iii) strong retention.

|                              | Quarter ended September 30, |      | Nine Months ended September 30, |       |
|------------------------------|-----------------------------|------|---------------------------------|-------|
| (\$ in millions)             | 2016                        | 2015 | 2016                            | 2015  |
| Retention                    | 84                          | % 84 | 83                              | % 83  |
| Renewal pure price increases | 2.5                         | 2.8  | 2.6                             | 3.1   |
| Direct new business          | \$89.2                      | 83.9 | \$272.4                         | 262.3 |

The NPE increases in Third Quarter and Nine Months 2016 compared to Third Quarter and Nine Months 2015 were consistent with the fluctuation in NPW for the twelve-month period ended September 30, 2016 compared with the twelve-month period ended September 30, 2015.

The GAAP loss and loss expense ratio increased 4.2 points in Third Quarter 2016 compared to Third Quarter 2015 and 0.6 points in Nine Months 2016 compared to Nine Months 2015. Information regarding these drivers is as follows:

|                                                   | Third Quarter 2016             |                                       |     | Third Quarter 2015             |                                       |     |                 |
|---------------------------------------------------|--------------------------------|---------------------------------------|-----|--------------------------------|---------------------------------------|-----|-----------------|
| (\$ in millions)                                  | Loss and Loss Expense Incurred | Impact on Loss and Loss Expense Ratio |     | Loss and Loss Expense Incurred | Impact on Loss and Loss Expense Ratio |     | Change in Ratio |
| Catastrophe losses                                | \$6.2                          | 1.5                                   | pts | \$0.7                          | 0.2                                   | pts | 1.3             |
| Non-catastrophe property losses                   | 51.6                           | 12.2                                  |     | 37.9                           | 9.7                                   |     | 2.5             |
| Favorable prior year casualty reserve development | (19.0)                         | (4.5)                                 | )   | (19.0)                         | (4.9)                                 | )   | 0.4             |

|                                                   | Nine Months 2016               |                                       |     | Nine Months 2015               |                                       |     |                 |
|---------------------------------------------------|--------------------------------|---------------------------------------|-----|--------------------------------|---------------------------------------|-----|-----------------|
| (\$ in millions)                                  | Loss and Loss Expense Incurred | Impact on Loss and Loss Expense Ratio |     | Loss and Loss Expense Incurred | Impact on Loss and Loss Expense Ratio |     | Change in Ratio |
| Catastrophe losses                                | \$21.5                         | 1.7                                   | pts | \$33.0                         | 2.9                                   | pts | (1.2)           |
| Non-catastrophe property losses                   | 136.8                          | 11.1                                  |     | 120.8                          | 10.7                                  |     | 0.4             |
| Favorable prior year casualty reserve development | (49.0)                         | (4.0)                                 | )   | (61.0)                         | (5.4)                                 | )   | 1.4             |

For additional information regarding the favorable prior year casualty reserve development by line of business, see the "Financial Highlights" section above and the line of business discussions below.

The increases in the GAAP underwriting expense ratio in the quarter and year-to-date periods of 0.4 points and 1.1 points, respectively, were primarily attributable to higher supplemental commission expense to our distribution partners of approximately 0.9 and 1.0 points, respectively.

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The following is a discussion of our most significant Standard Commercial Lines of business and their respective statutory results:

General Liability

| (\$ in thousands)                                  | Quarter ended<br>September 30, |         | Change<br>% or<br>Points | Nine Months ended<br>September 30, |         | Change<br>% or<br>Points |
|----------------------------------------------------|--------------------------------|---------|--------------------------|------------------------------------|---------|--------------------------|
|                                                    | 2016                           | 2015    |                          | 2016                               | 2015    |                          |
| Statutory NPW                                      | \$141,556                      | 130,722 | 8 %                      | \$431,751                          | 395,840 | 9 %                      |
| Direct new business                                | 25,646                         | 24,739  | 4                        | 80,622                             | 77,144  | 5                        |
| Retention                                          | 84                             | % 84    | — pts                    | 83                                 | % 83    | — pts                    |
| Renewal pure price increases                       | 1.7                            | 2.3     | (0.6 )                   | 1.8                                | 2.8     | (1.0 )                   |
| Statutory NPE                                      | \$133,981                      | 123,252 | 9 %                      | \$391,349                          | 357,430 | 9 %                      |
| Statutory combined ratio                           | 84.7                           | % 89.1  | (4.4 ) pts               | 83.9                               | % 80.0  | 3.9 pts                  |
| % of total statutory Standard Commercial Lines NPW | 31                             | 32      |                          | 32                                 | 32      |                          |



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The statutory combined ratio decrease in Third Quarter 2016 compared to Third Quarter 2015 was driven by favorable prior year casualty reserve development as illustrated in the tables below:

|                                                   | Third Quarter 2016                               | Third Quarter 2015                               |                  |
|---------------------------------------------------|--------------------------------------------------|--------------------------------------------------|------------------|
| (\$ in millions)                                  | (Benefit) Impact on<br>Expense Combined<br>Ratio | (Benefit) Impact on<br>Expense Combined<br>Ratio | Change<br>Points |
| Favorable prior year casualty reserve development | \$(11.0)(8.2 ) pts                               | \$(5.0)(4.1 ) pts                                | (4.1 ) pts       |
|                                                   | Nine Months 2016                                 | Nine Months 2015                                 |                  |
| (\$ in millions)                                  | (Benefit) Impact on<br>Expense Combined<br>Ratio | (Benefit) Impact on<br>Expense Combined<br>Ratio | Change<br>Points |
| Favorable prior year casualty reserve development | \$(33.0)(8.4 ) pts                               | \$(41.0)(11.5 ) pts                              | 3.1 pts          |

The significant drivers of the development were as follows:

Third Quarter and Nine Months 2016: Development was primarily attributable to lower severities in the 2008 through 2014 accident years.

Third Quarter and Nine Months 2015: Development was primarily attributable to lower claims frequencies and severities in the 2009 through 2013 accident years.

### Commercial Automobile

|                                                    | Quarter ended<br>September 30,<br>2016 | 2015    | Change<br>% or<br>Points |  | Nine Months ended<br>September 30,<br>2016 | 2015    | Change<br>% or<br>Points |
|----------------------------------------------------|----------------------------------------|---------|--------------------------|--|--------------------------------------------|---------|--------------------------|
| (\$ in thousands)                                  |                                        |         |                          |  |                                            |         |                          |
| Statutory NPW                                      | \$108,655                              | 97,941  | 11 %                     |  | \$325,751                                  | 291,547 | 12 %                     |
| Direct new business                                | 18,953                                 | 17,345  | 9                        |  | 58,225                                     | 54,200  | 7                        |
| Retention                                          | 85                                     | % 85    | — pts                    |  | 84                                         | % 84    | — pts                    |
| Renewal pure price increases                       | 4.8                                    | 3.7     | 1.1                      |  | 4.9                                        | 3.7     | 1.2                      |
| Statutory NPE                                      | \$100,612                              | 90,758  | 11 %                     |  | \$294,927                                  | 265,771 | 11 %                     |
| Statutory combined ratio                           | 114.5                                  | % 104.5 | 10.0 pts                 |  | 108.9                                      | % 101.5 | 7.4 pts                  |
| % of total statutory Standard Commercial Lines NPW | 24                                     | 24      |                          |  | 24                                         | 24      |                          |

The 10.0-point increase in the statutory combined ratio in Third Quarter 2016 compared to Third Quarter 2015, and the 7.4-point increase in the statutory combined ratio in Nine Months 2016 compared to Nine Months 2015, were primarily due to: (i) higher unfavorable prior year casualty reserve development; (ii) an increase in the current year loss reserve estimate; and (iii) higher non-catastrophe property losses.

Quantitative information regarding the development and non-catastrophe property losses is as follows:

|                                                     | Third Quarter<br>2016                 | Third<br>Quarter<br>2015              |                       |
|-----------------------------------------------------|---------------------------------------|---------------------------------------|-----------------------|
| (\$ in millions)                                    | Impact<br>Losses<br>Incurred<br>Ratio | Impact<br>Losses<br>Incurred<br>Ratio | Change<br>in<br>Ratio |
| Unfavorable prior year casualty reserve development | \$7.07.0 pts                          | \$— pts                               | 7.0 pts               |
| Increase in current year casualty reserve estimate  | 7.0 7.0                               | 3.0 3.0                               | 3.7                   |

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|                                                     |             |      |             |       |        |         |
|-----------------------------------------------------|-------------|------|-------------|-------|--------|---------|
| Non-catastrophe property losses                     | 16.6        | 16.5 | 14.2        | 14.6  | 0.9    |         |
|                                                     | Nine Months |      | Nine Months |       |        |         |
|                                                     | 2016        |      | 2015        |       |        |         |
|                                                     | Impact      |      | Impact      |       | Change |         |
|                                                     | Losses on   |      | Losses on   |       | in     |         |
| (\$ in millions)                                    | Incurred    |      | Incurred    |       | Ratio  |         |
|                                                     | Ratio       |      | Ratio       |       |        |         |
| Unfavorable prior year casualty reserve development | \$20.0      | 6.8  | pts         | \$3.0 | 1.1    | pts 5.7 |
| Increase in current year casualty reserve estimate  | 7.0         | 2.4  |             | 3.0   | 1.1    | 1.3     |
| Non-catastrophe property losses                     | 46.4        | 15.7 |             | 40.1  | 15.1   | 0.6     |

Unfavorable prior year casualty reserve development in Third Quarter and Nine Months 2016 was primarily due to higher severities in the 2013 and 2014 accident years coupled with higher claims frequencies in the 2015 accident year. The increase in the current year casualty reserve estimate in Third Quarter and Nine Months 2016 was driven by higher than expected claim frequencies.

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## Workers Compensation

| (\$ in thousands)                                  | Quarter ended<br>September 30, |        |       | Change<br>% or<br>Points | Nine Months ended<br>September 30, |         |       | Change<br>% or<br>Points |
|----------------------------------------------------|--------------------------------|--------|-------|--------------------------|------------------------------------|---------|-------|--------------------------|
|                                                    | 2016                           | 2015   |       |                          | 2016                               | 2015    |       |                          |
| Statutory NPW                                      | \$81,646                       | 74,446 | 10    | %                        | \$252,032                          | 233,722 | 8     | %                        |
| Direct new business                                | 17,952                         | 17,116 | 5     |                          | 52,763                             | 55,394  | (5)   | )                        |
| Retention                                          | 85                             | %84    | 1     | pts                      | 84                                 | %83     | 1     | pts                      |
| Renewal pure price increases                       | 0.9                            | 2.5    | (1.6) | )                        | 1.3                                | 2.9     | (1.6) | )                        |
| Statutory NPE                                      | \$78,596                       | 74,560 | 5     | %                        | \$229,847                          | 213,991 | 7     | %                        |
| Statutory combined ratio                           | 80.2                           | %84.0  | (3.8) | ) pts                    | 82.8                               | %87.7   | (4.9) | ) pts                    |
| % of total statutory Standard Commercial Lines NPW | 18                             | 18     |       |                          | 19                                 | 19      |       |                          |

The decrease in the statutory combined ratio in Third Quarter and Nine Months 2016 compared to the same prior year periods were due to favorable prior year casualty reserve development, as illustrated in the tables below, and policyholder dividends that were down 2.3 points in the quarter and 1.4 points in the year-to-date period, compared to the same periods last year.

Information regarding prior year casualty reserve development is as follows:

|                                                   | Third Quarter 2016   |                                |     | Third Quarter 2015   |                                |     |                  |
|---------------------------------------------------|----------------------|--------------------------------|-----|----------------------|--------------------------------|-----|------------------|
| (\$ in millions)                                  | (Benefit)<br>Expense | Impact on<br>Combined<br>Ratio |     | (Benefit)<br>Expense | Impact on<br>Combined<br>Ratio |     | Change<br>Points |
| Favorable prior year casualty reserve development | \$(15.0)             | (19.1 )                        | pts | \$(14.0)             | (18.8 )                        | pts | (0.3 ) pts       |
|                                                   | Nine Months 2016     |                                |     | Nine Months 2015     |                                |     |                  |
| (\$ in millions)                                  | (Benefit)<br>Expense | Impact on<br>Combined<br>Ratio |     | (Benefit)<br>Expense | Impact on<br>Combined<br>Ratio |     | Change<br>Points |
| Favorable prior year casualty reserve development | \$(36.0)             | (15.7 )                        | pts | \$(27.0)             | (12.6 )                        | pts | (3.1 ) pts       |

Favorable prior year casualty reserve development in the quarter and year-to-date periods related primarily to lower severities in accident years 2014 and prior. We believe these claim outcome improvements are due, in part, to lower medical inflation than originally anticipated and the various claims initiatives that we have implemented, including, but not limited to, the centralization of workers compensation claims handling, the implementation of a strategic case management unit for the handling of workers compensation claims with high exposure and/or significant escalation risk, and more proactive case management in the areas of medical, pharmaceutical, and physical therapy treatments. For more information regarding the initiatives that we have undertaken regarding this line of business, refer to the Standard Market Workers Compensation Line of Business discussion within the Reserves for Losses and Loss Expenses section of "Critical Accounting Policies and Estimates" of our 2015 Annual Report.

## Commercial Property

| (\$ in thousands)   | Quarter ended<br>September 30, |        |   | Change<br>% or<br>Points | Nine Months ended<br>September 30, |         |   | Change<br>% or<br>Points |
|---------------------|--------------------------------|--------|---|--------------------------|------------------------------------|---------|---|--------------------------|
|                     | 2016                           | 2015   |   |                          | 2016                               | 2015    |   |                          |
| Statutory NPW       | \$82,695                       | 77,674 | 6 | %                        | \$237,693                          | 219,308 | 8 | %                        |
| Direct new business | 18,743                         | 17,730 | 6 |                          | 56,892                             | 54,457  | 4 |                          |

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|                                                    |          |        |        |     |           |         |        |     |
|----------------------------------------------------|----------|--------|--------|-----|-----------|---------|--------|-----|
| Retention                                          | 82       | %83    | (1 )   | pts | 82        | %82     | —      | pts |
| Renewal pure price increases                       | 2.0      | 2.7    | (0.7 ) |     | 2.3       | 2.8     | (0.5 ) |     |
| Statutory NPE                                      | \$74,052 | 68,587 | 8      | %   | \$217,821 | 199,699 | 9      | %   |
| Statutory combined ratio                           | 85.2     | %67.8  | 17.4   | pts | 85.0      | %86.9   | (1.9 ) | pts |
| % of total statutory Standard Commercial Lines NPW | 18       | 19     |        |     | 18        | 18      |        |     |

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The fluctuations in the statutory combined ratio in Third Quarter 2016 compared to Third Quarter 2015 and in Nine Months 2016 compared to Nine Months 2015 were driven by the following:

|                                 | Third Quarter 2016 |                | Third Quarter 2015 |                | Change     |        |
|---------------------------------|--------------------|----------------|--------------------|----------------|------------|--------|
| (\$ in millions)                | (Benefit)          | Impact on      | (Benefit)          | Impact on      | % or       | Points |
|                                 | Expense            | Combined Ratio | Expense            | Combined Ratio |            |        |
| Catastrophe losses              | \$3.44.5           |                | pts \$(0.5)(0.8 )  |                | pts 5.3    | pts    |
| Non-catastrophe property losses | 27.7 37.4          |                | 17.4 25.3          |                | 12.1       |        |
|                                 | Nine Months 2016   |                | Nine Months 2015   |                | Change     |        |
| (\$ in millions)                | (Benefit)          | Impact on      | (Benefit)          | Impact on      | % or       | Points |
|                                 | Expense            | Combined Ratio | Expense            | Combined Ratio |            |        |
| Catastrophe losses              | \$16.57.6          |                | pts \$25.6 12.8    |                | pts (5.2 ) | pts    |
| Non-catastrophe property losses | 74.0 34.0          |                | 62.6 31.3          |                | 2.7        |        |

The increase in non-catastrophe property losses in Third Quarter 2016 was driven by higher fire and weather-related losses than in Third Quarter 2015, reflecting volatility from period to period that is normally associated with our commercial property line of business.

## Standard Personal Lines

|                                    | Quarter ended<br>September 30, |        |                          | Nine Months ended<br>September 30, |          |                          |
|------------------------------------|--------------------------------|--------|--------------------------|------------------------------------|----------|--------------------------|
| (\$ in thousands)                  | 2016                           | 2015   | Change<br>% or<br>Points | 2016                               | 2015     | Change<br>% or<br>Points |
| GAAP Insurance Operations Results: |                                |        |                          |                                    |          |                          |
| NPW                                | \$76,225                       | 76,927 | (1 ) %                   | \$213,770                          | 217,937  | (2 ) %                   |
| NPE                                | 68,690                         | 72,088 | (5 )                     | 209,719                            | 216,638  | (3 )                     |
| Less:                              |                                |        |                          |                                    |          |                          |
| Loss and loss expense incurred     | 41,582                         | 49,588 | (16 )                    | 123,489                            | 156,490  | (21 )                    |
| Net underwriting expenses incurred | 22,837                         | 19,674 | 16                       | 67,229                             | 64,443   | 4                        |
| Underwriting gain (loss)           | \$4,271                        | 2,826  | 51 %                     | \$19,001                           | (4,295 ) | 542 %                    |
| GAAP Ratios:                       |                                |        |                          |                                    |          |                          |
| Loss and loss expense ratio        | 60.5                           | % 68.8 | (8.3 ) pts               | 58.9                               | % 72.2   | (13.3 ) pts              |
| Underwriting expense ratio         | 33.3                           | 27.3   | 6.0                      | 32.0                               | 29.8     | 2.2                      |
| Combined ratio                     | 93.8                           | 96.1   | (2.3 )                   | 90.9                               | 102.0    | (11.1 )                  |
| Statutory Ratios:                  |                                |        |                          |                                    |          |                          |
| Loss and loss expense ratio        | 60.7                           | 68.7   | (8.0 )                   | 58.9                               | 72.4     | (13.5 )                  |
| Underwriting expense ratio         | 31.3                           | 26.3   | 5.0                      | 31.8                               | 29.3     | 2.5                      |
| Combined ratio                     | 92.0                           | % 95.0 | (3.0 ) pts               | 90.7                               | % 101.7  | (11.0 ) pts              |

The NPW in Third Quarter 2016 was flat compared to Third Quarter 2015, while on a year-to-date basis new business was not sufficient to compensate for the attrition reflected in the 2016 retention ratios illustrated in the table below.

|                  | Quarter<br>ended<br>September<br>30, |      | Nine Months<br>ended<br>September<br>30, |      |
|------------------|--------------------------------------|------|------------------------------------------|------|
| (\$ in millions) | 2016                                 | 2015 | 2016                                     | 2015 |
| New business     | \$12.0                               | 9.1  | \$29.0                                   | 25.0 |

|                              |     |      |     |      |
|------------------------------|-----|------|-----|------|
| Retention                    | 83  | % 83 | 82  | % 82 |
| Renewal pure price increases | 4.7 | 5.4  | 5.0 | 6.3  |

The NPE decreases in Third Quarter and Nine Months 2016 compared to Third Quarter and Nine Months 2015 were consistent with the fluctuations in NPW for the twelve-month period ended September 30, 2016 compared with the twelve-month period ended September 30, 2015.

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The GAAP loss and loss expense ratio decreased 8.3 points in Third Quarter 2016 compared to Third Quarter 2015 and 13.3 points in Nine Months 2016 compared to Nine Months 2015. These decreases were driven by lower property losses and flood claims handling fees related to the flooding in Louisiana in Third Quarter 2016. The quantitative breakout of these drivers were as follows:

| (\$ in millions)                | Third Quarter<br>2016              |                                          |     | Third Quarter<br>2015              |                                          |     | Change<br>in<br>Ratio |
|---------------------------------|------------------------------------|------------------------------------------|-----|------------------------------------|------------------------------------------|-----|-----------------------|
|                                 | Loss<br>and<br>Expense<br>Incurred | Impact<br>on<br>Loss<br>Expense<br>Ratio | and | Loss<br>and<br>Expense<br>Incurred | Impact<br>on<br>Loss<br>Expense<br>Ratio | and |                       |
| Catastrophe losses              | \$2.5                              | 3.6                                      | pts | \$5.8                              | 8.0                                      | pts | (4.4 ) pts            |
| Non-catastrophe property losses | 18.9                               | 27.6                                     |     | 21.0                               | 29.1                                     |     | (1.5 )                |
| Flood claims handling fees      | (2.0 )                             | (2.9 )                                   | )   | (0.8 )                             | (1.1 )                                   | )   | (1.8 )                |
| (\$ in millions)                | Nine Months<br>2016                |                                          |     | Nine Months<br>2015                |                                          |     | Change<br>in<br>Ratio |
|                                 | Loss<br>and<br>Expense<br>Incurred | Impact<br>on<br>Loss<br>Expense<br>Ratio | and | Loss<br>and<br>Expense<br>Incurred | Impact<br>on<br>Loss<br>Expense<br>Ratio | and |                       |
| Catastrophe losses              | \$6.8                              | 3.2                                      | pts | 20.4                               | 9.4                                      | pts | (6.2 ) pts            |
| Non-catastrophe property losses | 53.6                               | 25.6                                     |     | 68.0                               | 31.4                                     |     | (5.8 )                |
| Flood claims handling fees      | (4.0 )                             | (1.9 )                                   | )   | (2.0 )                             | (0.9 )                                   | )   | (1.0 )                |

The increase in the GAAP underwriting expense ratio in the quarter and year-to-date periods was primarily driven by increased costs associated with: (i) capital technology improvements; (ii) underwriting expenses from third-party data vendors; and (iii) higher supplemental commission expense to our distribution partners. Additionally, the GAAP underwriting expense ratio increased in Third Quarter 2016 compared to Third Quarter 2015, due to a year-to-date reallocation of overhead expenses to Standard Commercial Lines to match actual production in the Third Quarter 2015.

## E&amp;S Insurance Operations

|                                    | Quarter ended<br>September 30, |          |                          | Nine Months ended<br>September 30, |          |                          |     |
|------------------------------------|--------------------------------|----------|--------------------------|------------------------------------|----------|--------------------------|-----|
| (\$ in thousands)                  | 2016                           | 2015     | Change<br>% or<br>Points | 2016                               | 2015     | Change<br>% or<br>Points |     |
| GAAP Insurance Operations Results: |                                |          |                          |                                    |          |                          |     |
| NPW                                | \$53,004                       | 54,067   | (2 ) %                   | \$154,887                          | 137,199  | 13                       | %   |
| NPE                                | 52,153                         | 45,760   | 14                       | 151,348                            | 124,904  | 21                       |     |
| Less:                              |                                |          |                          |                                    |          |                          |     |
| Loss and loss expense incurred     | 36,461                         | 31,952   | 14                       | 105,209                            | 85,374   | 23                       |     |
| Net underwriting expenses incurred | 18,054                         | 15,830   | 14                       | 49,604                             | 44,563   | 11                       |     |
| Underwriting loss                  | \$(2,362 )                     | (2,022 ) | (17 ) %                  | \$(3,465 )                         | (5,033 ) | 31                       | %   |
| GAAP Ratios:                       |                                |          |                          |                                    |          |                          |     |
| Loss and loss expense ratio        | 69.9                           | %69.8    | 0.1 pts                  | 69.5                               | %68.4    | 1.1                      | pts |

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|                             |       |         |     |           |         |            |
|-----------------------------|-------|---------|-----|-----------|---------|------------|
| Underwriting expense ratio  | 34.6  | 34.6    | —   | 32.8      | 35.6    | (2.8 )     |
| Combined ratio              | 104.5 | 104.4   | 0.1 | 102.3     | 104.0   | (1.7 )     |
| Statutory Ratios:           |       |         |     |           |         |            |
| Loss and loss expense ratio | 70.0  | 69.9    | 0.1 | 69.5      | 68.3    | 1.2        |
| Underwriting expense ratio  | 31.4  | 31.2    | 0.2 | 31.4      | 33.5    | (2.1 )     |
| Combined ratio              | 101.4 | % 101.1 | 0.3 | pts 100.9 | % 101.8 | (0.9 ) pts |

We continue to focus on profitability drivers in our E&S operations and have achieved price increases of 5.8% in the quarter and 4.8% in the year-to-date period. In this competitive marketplace, this focus has put pressure on NPW, which was down 2%, to \$53 million, in the quarter and up 13%, to \$154.9 million, in the year-to-date period.

Quantitative information is as follows:

|                     | Quarter<br>ended<br>September<br>30, |      | Nine<br>Months<br>ended<br>September<br>30, |       |
|---------------------|--------------------------------------|------|---------------------------------------------|-------|
| (\$ in millions)    | 2016                                 | 2015 | 2016                                        | 2015  |
| Direct new business | \$24.2                               | 27.1 | 72.1                                        | 74.2  |
| Price increases     | 5.8                                  | %3.4 | 4.8                                         | % 1.8 |



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The NPE increases in Third Quarter and Nine Months 2016, compared to Third Quarter and Nine Months 2015, were consistent with the fluctuations in NPW for the twelve-month period ended September 30, 2016 compared with the twelve-month period ended September 30, 2015.

The GAAP loss and loss expense ratio remained flat in Third Quarter 2016 and increased 1.1 points in Nine Months 2016 compared to the same prior year periods. Both periods included a 3.7-point increase in current year loss costs, as well as the following:

| (\$ in millions)                            | Third Quarter 2016                                                              |      | Third Quarter 2015                                                              |      | Change<br>in<br>Ratio |     |
|---------------------------------------------|---------------------------------------------------------------------------------|------|---------------------------------------------------------------------------------|------|-----------------------|-----|
|                                             | Loss<br>and Impact on<br>Loss Loss and Loss Expense<br>ExpenseRatio<br>Incurred |      | Loss<br>and Impact on<br>Loss Loss and Loss Expense<br>ExpenseRatio<br>Incurred |      |                       |     |
| Non-catastrophe property losses             | \$7.9                                                                           | 15.2 | pts \$6.3                                                                       | 13.7 | pts 1.5               | pts |
| Unfavorable prior year casualty development | —                                                                               | —    | 4.0                                                                             | 8.6  | (8.6 )                |     |
| Catastrophe losses                          | 1.7                                                                             | 3.3  | 0.3                                                                             | 0.7  | 2.6                   |     |
| (\$ in millions)                            | Nine Months 2016                                                                |      | Nine Months 2015                                                                |      | Change<br>in<br>Ratio |     |
|                                             | Loss<br>and Impact on<br>Loss Loss and Loss Expense<br>ExpenseRatio<br>Incurred |      | Loss<br>and Impact on<br>Loss Loss and Loss Expense<br>ExpenseRatio<br>Incurred |      |                       |     |
| Non-catastrophe property losses             | \$18.8                                                                          | 12.4 | pts \$18.0                                                                      | 14.4 | pts (2.0 )            | pts |
| Unfavorable prior year casualty development | 3.0                                                                             | 2.0  | 6.0                                                                             | 4.8  | (2.8 )                |     |
| Catastrophe losses                          | 4.9                                                                             | 3.2  | 2.8                                                                             | 2.2  | 1.0                   |     |

The GAAP underwriting expense ratio decreased 2.8 points in Nine Months 2016, compared to Nine Months 2015, primarily due to the following:

- 1.8-point reduction in Nine Months 2016 from a lower annual cash incentive plan payment for employees in this segment based on 2015 underwriting results; and
- 0.7-point decrease in Nine Months 2016 from lower commission expenses to our distribution partners reflecting a change in the mix of business written in this segment, as well as lower supplemental commission expense.

We are working to improve the results in this segment of our business by implementing targeted price increases, underwriting changes, and the integration of claims handling functions into our corporate operations to improve claims outcomes. For more information regarding the initiatives that we have undertaken, refer to the E&S Lines discussion within the Reserves for Losses and Loss Expenses section of "Critical Accounting Policies and Estimates" of our 2015 Annual Report. We believe these initiatives will position this segment for improved results in the coming years.

#### Reinsurance

We have successfully completed negotiations of our July 1, 2016 excess of loss treaties, which provide coverage for our Standard Commercial Lines, Standard Personal Lines, and E&S Lines. The renewal of these treaties included some enhancements in terms and conditions, with the same structure as the expiring treaties as follows:

#### Property Excess of Loss

The property excess of loss treaty ("Property Treaty") provides \$58.0 million of coverage in excess of a \$2.0 million retention:

- The per occurrence cap on the first and second layers is \$84.0 million.
- The first layer has unlimited reinstatements and a limit of \$8.0 million in excess of \$2.0 million.
- The annual aggregate limit for the \$30.0 million in excess of \$10.0 million second layer is \$120.0 million.
- A third layer has a limit of \$20.0 million excess of \$40.0 million with an annual aggregate limit of approximately \$70.0 million.
- The Property Treaty excludes nuclear, biological, chemical, and radiological ("NBCR") terrorism losses.

Table of Contents**Casualty Excess of Loss**

The casualty excess of loss treaty ("Casualty Treaty") provides \$88.0 million of coverage in excess of a \$2.0 million retention:

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

• The Casualty Treaty includes a \$25.0 million limit, per life, on our workers compensation business, which is a \$4.0 million increase from the prior treaty.

• The Casualty Treaty excludes NBCR terrorism losses and has annual aggregate non-NBCR terrorism limits of \$208.0 million.

**Investments**

Our investment philosophy includes certain return and risk objectives for the fixed income, equity, and other investment portfolios. After-tax yield and income generation are key drivers to our investment strategy, which has historically been balanced with a long-term "buy-and-hold," low turnover approach.

In the fourth quarter of 2016, we will be implementing a change to our fixed income strategy to more actively manage the portfolio to maximize after-tax income and total return, while maintaining a similar level of credit quality and duration risk. We have evaluated our existing strategy in the context of the current market environment, and concluded that this change was necessary to more effectively navigate and manage the portfolio in response to the persistently low interest rate environment.

**Total Invested Assets**

| (\$ in thousands)                                  | September 30,<br>2016 | December 31,<br>2015 | Change<br>% or<br>Points |       |
|----------------------------------------------------|-----------------------|----------------------|--------------------------|-------|
| Total invested assets                              | \$5,368,424           | 5,089,269            | 5                        | %     |
| Unrealized gain – before tax                       | 174,781               | 69,224               | 152                      |       |
| Unrealized gain – after tax                        | 113,608               | 44,996               | 152                      |       |
| Invested assets per dollar of stockholders' equity | 3.41                  | 3.64                 | (6                       | )     |
| Annualized after-tax yield on investment portfolio | 1.8                   | % 1.9                | (0.1                     | ) pts |
| Annualized ROE                                     | 6.5                   | 7.0                  | (0.5                     | )     |

The increase in invested assets at September 30, 2016 compared to December 31, 2015 was driven by higher unrealized gains, primarily on our fixed income securities portfolio, as well as operating cash flow of \$177.5 million. During Nine Months 2016, interest rates on the 10-year U.S. Treasury Note fell by 68 basis points, which drove a \$105.6 million increase in unrealized gains on the fixed income securities portfolio. While the low interest rate environment favorably impacts our unrealized position, it presents a challenge to us in generating after-tax return, as new purchase yields are below the average yield on bonds that are currently maturing. Additionally, the increase in unrealized gains resulted in an \$0.08 reduction in our invested assets per dollar of stockholders' equity in Nine Months 2016.

**Fixed Income Securities**

At September 30, 2016, our fixed income securities portfolio represented 92% of our total invested assets, compared to our December 31, 2015 allocation of 91%. The average duration of the fixed income securities portfolio as of September 30, 2016 was 3.7 years, including short-term investments, compared to the Insurance Subsidiaries' liability duration of approximately 4.3 years. The current duration of the fixed income securities portfolio is within our historical range, and is monitored and managed to maximize yield while managing interest rate risk at an acceptable level. We maintain a well-diversified portfolio across sectors, credit quality, and maturities that affords us ample liquidity. Every purchase or sale is made with the intent of maximizing risk-adjusted investment returns in the current market environment while balancing capital preservation. Our fixed income securities portfolio had a weighted average credit rating of "AA-" as of both September 30, 2016 and December 31, 2015.

The sector composition and credit quality of our major asset categories within our fixed income securities portfolio did not significantly change from December 31, 2015. Our top 10 state exposures represented 54% of the total municipal bond portfolio as of September 30, 2016 and had an average rating of "AA." A portion of our municipal bond portfolio contains insurance enhancements; however, the ratings of the securities with and without insurance remained unchanged as we generally purchase securities based on their underlying credit quality. For details regarding this credit quality information, see Item 7A. "Quantitative and Qualitative Disclosures About Market Risk." of our 2015 Annual Report.

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## Net Investment Income

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

|                                                       | Quarter ended<br>September 30, |          | Nine Months<br>ended September<br>30, |           |
|-------------------------------------------------------|--------------------------------|----------|---------------------------------------|-----------|
| (\$ in thousands)                                     | 2016                           | 2015     | 2016                                  | 2015      |
| Fixed income securities                               | \$32,453                       | 30,601   | 95,850                                | 92,227    |
| Equity securities                                     | 1,506                          | 2,370    | 5,940                                 | 6,546     |
| Short-term investments                                | 192                            | 24       | 493                                   | 72        |
| Other investments                                     | 1,628                          | 1,337    | (49 )                                 | (781 )    |
| Investment expenses                                   | (2,404 )                       | (2,271 ) | (6,908 )                              | (6,856 )  |
| Net investment income earned – before tax             | 33,375                         | 32,061   | 95,326                                | 91,208    |
| Net investment income tax expense                     | (8,462 )                       | (7,506 ) | (23,328 )                             | (20,666 ) |
| Net investment income earned – after tax              | \$24,913                       | 24,555   | 71,998                                | 70,542    |
| Effective tax rate                                    | 25.4 %                         | 23.4     | 24.5                                  | 22.7      |
| Annualized after-tax yield on fixed income securities | 2.0                            | 2.1      | 2.0                                   | 2.1       |
| Annualized after-tax yield on investment portfolio    | 1.9                            | 2.0      | 1.8                                   | 1.9       |

Income on our fixed income securities portfolio increased in both Third Quarter and Nine Months 2016, reflecting a higher asset base in this portfolio.

## Realized Gains and Losses

Our general philosophy for sales of securities is to reduce our exposure to securities and sectors based on economic evaluations and when the fundamentals for that security or sector have deteriorated, or to opportunistically trade out of securities to other securities with better economic return characteristics. Net realized gains for the indicated periods were as follows:

|                                    | Quarter ended<br>September 30, |          | Nine Months<br>ended<br>September 30, |          |
|------------------------------------|--------------------------------|----------|---------------------------------------|----------|
| (\$ in thousands)                  | 2016                           | 2015     | 2016                                  | 2015     |
| Net realized gains, excluding OTTI | \$4,030                        | 1,590    | 7,233                                 | 23,598   |
| OTTI                               | (342 )                         | (1,282 ) | (4,484 )                              | (7,827 ) |
| Total net realized gains (losses)  | 3,688                          | 308      | 2,749                                 | 15,771   |

Net realized gains excluding OTTI in Nine Months 2015 reflect the sale of AFS equity securities related to a change in our dividend strategy from a quantitative, model-driven stock selection strategy to a fundamentally-based stock selection approach.

For further discussion of our realized gains and losses, as well as our OTTI methodology, see Note 2. "Summary of Significant Accounting Policies" in Item 8. "Financial Statements and Supplementary Data." of our 2015 Annual Report. For additional information about our OTTI charges, see Note 4. "Investments" in Item 1. "Financial Statements." of this Form 10-Q.

## Federal Income Taxes

The following table provides information regarding federal income taxes:

| Quarter ended<br>September 30, | Nine<br>Months<br>ended |
|--------------------------------|-------------------------|
|--------------------------------|-------------------------|

|                            |         |      | September<br>30, |      |
|----------------------------|---------|------|------------------|------|
| (\$ in millions)           | 2016    | 2015 | 2016             | 2015 |
| Federal income tax expense | \$ 16.9 | 18.8 | 50.5             | 48.4 |
| Effective tax rate         | 31      | % 29 | 30               | 29   |

The effective tax rate remained relatively stable with the comparable prior year periods, as tax-advantaged income remained flat compared to the fluctuation in overall pre-tax income. The effective federal income tax rate differs from the normal statutory rate primarily as a result of recurring non-taxable items, such as tax-advantaged interest and dividends received deduction.

We believe that our future effective tax rate will continue to be impacted by similar items, assuming no significant changes to tax laws occur that would impact our tax-advantaged investments.

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### Financial Condition, Liquidity, and Capital Resources

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

### Liquidity

We manage liquidity with a focus on generating sufficient cash flows to meet the short-term and long-term cash requirements of our business operations. Our cash and short-term investment position of \$171 million at September 30, 2016 was comprised of \$23 million at the Parent and \$148 million at the Insurance Subsidiaries. Short-term investments are generally maintained in "AAA" rated money market funds approved by the National Association of Insurance Commissioners. The Parent maintains a fixed income security investment portfolio containing high-quality, highly-liquid government and corporate fixed income securities. This portfolio amounted to \$75 million at September 30, 2016, compared to \$62 million at December 31, 2015.

### Sources of Liquidity

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

### Insurance Subsidiary Dividends

We currently anticipate that the Insurance Subsidiaries will pay \$61 million in total dividends to the Parent in 2016. Cash dividends of \$46 million were paid during Nine Months 2016. As of December 31, 2015, our allowable ordinary maximum dividend was \$178 million for 2016.

Any dividends to the Parent are subject to the approval and/or review of the insurance regulators in the respective Insurance Subsidiaries' domiciliary states and are generally payable only from earned surplus as reported in the statutory annual statements of those subsidiaries as of the preceding December 31. Although past dividends have historically been met with regulatory approval, there is no assurance that future dividends that may be declared will be approved. Indiana state regulators passed legislation revising the calculation to determine an extraordinary dividend, which became effective on July 1, 2016. For additional information regarding dividend restrictions, refer to Note 19. "Statutory Financial Information, Capital Requirements, and Restrictions on Dividends and Transfers of Funds" in Item 8. "Financial Statements and Supplementary Data." of our 2015 Annual Report.

The Insurance Subsidiaries generate liquidity through insurance float, which is created by collecting premiums and earning investment income before losses are paid. The period of the float can extend over many years. Our investment portfolio consists of maturity dates that continually provide a source of cash flows for claims payments in the ordinary course of business. The duration of the fixed income securities portfolio, including short-term investments, was 3.7 years as of September 30, 2016, while the liabilities of the Insurance Subsidiaries have a duration of 4.3 years. As protection for the capital resources at the Insurance Subsidiaries, we purchase reinsurance coverage for any significantly large claims or catastrophes that may occur during the year.

### Line of Credit

The Parent's line of credit with Wells Fargo Bank, National Association, as administrative agent, and Branch Banking and Trust Company (BB&T) (referred to as our "Line of Credit"), was renewed effective December 1, 2015 with a borrowing capacity of \$30 million, which can be increased to \$50 million with the approval of both lending partners. This Line of Credit expires on December 1, 2020 and has an interest rate which varies and is based on, among other factors, the Parent's debt ratings. There were no balances outstanding under the Line of Credit at September 30, 2016 or at any time during 2016.

The Line of Credit agreement contains representations, warranties, and covenants that are customary for credit facilities of this type, including, without limitation, financial covenants under which we are obligated to maintain a minimum consolidated net worth, a minimum combined statutory surplus, and a maximum ratio of consolidated debt to total capitalization, as well as covenants limiting our ability to: (i) merge or liquidate; (ii) incur debt or liens; (iii) dispose of assets; (iv) make certain investments and acquisitions; and (v) engage in transactions with affiliates.



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

|                                           | Required as of September 30, 2016 | Actual as of September 30, 2016 |
|-------------------------------------------|-----------------------------------|---------------------------------|
| Consolidated net worth                    | \$1.0 billion                     | \$1.6 billion                   |
| Statutory surplus                         | Not less than \$750 million       | \$1.6 billion                   |
| Debt-to-capitalization ratio <sup>1</sup> | Not to exceed 35%                 | 21.5%                           |
| A.M. Best financial strength rating       | Minimum of A-                     | A                               |

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

Several of our Insurance Subsidiaries are members of certain branches of the Federal Home Loan Bank, which provides those subsidiaries with additional access to liquidity. Membership is as follows:

| Branch                                           | Insurance Subsidiary Member                                                                                                                 |
|--------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------|
| Federal Home Loan Bank of Indianapolis ("FHLBI") | Selective Insurance Company of South Carolina ("SICSC") <sup>1</sup><br>Selective Insurance Company of the Southeast ("SICSE") <sup>1</sup> |
| Federal Home Loan Bank of New York ("FHLBNY")    | Selective Insurance Company of America ("SICA")<br>Selective Insurance Company of New York ("SICNY")                                        |

<sup>1</sup>These subsidiaries are jointly referred to as the "Indiana Subsidiaries" as they are domiciled in Indiana.

The Line of Credit permits aggregate borrowings from the FHLBI and the FHLBNY up to 10% of the respective member company's admitted assets for the previous year. Additionally, the FHLBNY limits borrowings by SICA and SICNY to 5% of admitted assets for the previous year. All borrowings from both the FHLBI and the FHLBNY are required to be secured by investments pledged as collateral. For additional information regarding collateral outstanding, refer to Note 4. "Investments" in Item 1. "Financial Statements." of this Form 10-Q. The following table provides information on the remaining capacity for Federal Home Loan Bank borrowings based on these restrictions, as well as the amount of additional stock that would need to be purchased to allow these member companies to borrow their remaining capacity:

| (\$ in millions)         | Admitted Assets as of December 31, 2015 | Borrowing Limitation | Amount Borrowed | Remaining Capacity | Additional Stock Requirements |
|--------------------------|-----------------------------------------|----------------------|-----------------|--------------------|-------------------------------|
| As of September 30, 2016 |                                         |                      |                 |                    |                               |
| SICSC                    | \$ 594.3                                | \$ 59.4              | 27.0            | 32.4               | 1.2                           |
| SICSE                    | 461.8                                   | 46.2                 | 18.0            | 28.2               | 0.8                           |
| SICA                     | 2,140.7                                 | 107.0                | 50.0            | 57.0               | 2.6                           |
| SICNY                    | 403.4                                   | 20.2                 | —               | 20.2               | 0.9                           |
| Total                    |                                         | \$ 232.8             | 95.0            | 137.8              | 5.5                           |

## Intercompany Loan Agreements

The Parent has lending agreements with the Indiana Subsidiaries that have been approved by the Indiana Department of Insurance, which provide additional liquidity to the Parent. Similar to the Line of Credit agreement, these lending agreements limit borrowings by the Parent from the Indiana Subsidiaries to 10% of the admitted assets of the respective Indiana Subsidiary. The following table provides information on the Parent's borrowings and remaining borrowing capacity from the Indiana Subsidiaries:

| (\$ in millions)         | Admitted Assets as of December 31, 2015 | Borrowing Limitation | Amount Borrowed | Remaining Capacity |
|--------------------------|-----------------------------------------|----------------------|-----------------|--------------------|
| As of September 30, 2016 |                                         |                      |                 |                    |
| SICSC                    | \$ 594.3                                | \$ 59.4              | 28.3            | 31.1               |
| SICSE                    | 461.8                                   | 46.2                 | 18.2            | 28.0               |

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|       |          |      |      |
|-------|----------|------|------|
| Total | \$ 105.6 | 46.5 | 59.1 |
|-------|----------|------|------|

Short-term Borrowings

In Nine Months 2016, SICA borrowed an aggregate of \$105 million from the FHLB NY, of which \$55 million has already matured and has been paid. The remaining \$50 million is due in 2021. For further information regarding these and other borrowings, see Note 5. "Indebtedness" in Item 1. "Financial Statements." of this Form 10-Q.

Capital Market Activities

The Parent had no private or public issuances of stock or debt instruments during Nine Months 2016.

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### Uses of Liquidity

The liquidity generated from the sources discussed above is used, among other things, to pay dividends to our shareholders. Dividends on shares of the Parent's common stock are declared and paid at the discretion of the Board of Directors based on our operating results, financial condition, capital requirements, contractual restrictions, and other relevant factors. On October 26, 2016, our Board of Directors declared, for stockholders of record as of November 15, 2016, a \$0.16 per share dividend to be paid on December 1, 2016. This is a 7% increase compared with the dividend declared on July 27, 2016.

Our ability to meet our interest and principal repayment obligations on our debt, as well as our ability to continue to pay dividends to our stockholders, is dependent on liquidity at the Parent coupled with the ability of the Insurance Subsidiaries to pay dividends, if necessary, and/or the availability of other sources of liquidity to the Parent. We have a scheduled repayment of our \$45 million outstanding borrowing from the FHLBI in December 2016, which we anticipate refinancing. Subsequent to that payment, our next principal debt repayment is due in 2021.

Restrictions on the ability of the Insurance Subsidiaries to declare and pay dividends, without alternative liquidity options, could materially affect our ability to service debt and pay dividends on common stock.

### Capital Resources

Capital resources provide protection for policyholders, furnish the financial strength to support the business of underwriting insurance risks, and facilitate continued business growth. At September 30, 2016, we had statutory surplus of \$1.6 billion and GAAP stockholders' equity of \$1.6 billion. With total debt of \$424 million, our debt-to-capital ratio was approximately 21%.

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

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

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

Book value per share increased to \$27.22 as of September 30, 2016, up from \$24.37 as of December 31, 2015, due to \$2.03 in net income and \$1.19 in unrealized gains on our investment portfolio, partially offset by \$0.45 in dividends to our shareholders.

### Ratings

We are rated by major rating agencies that issue opinions on our financial strength, operating performance, strategic position, and ability to meet policyholder obligations. We believe that our ability to write insurance business is most influenced by our rating from A.M. Best. We have been rated "A" or higher by A.M. Best for the past 86 years. A downgrade from A.M. Best to a rating below "A-" is an event of default under our Line of Credit and could affect our

ability to write new business with customers and/or distribution partners, 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.

On October 25, 2016, S&P Global Ratings ("S&P") upgraded our financial strength rating to "A" from "A-" with a stable outlook. This rating reflects S&P's view of our strong business risk profile and strong financial risk profile, built on our strong competitive position and very strong capital and earnings. In addition, our stable outlook reflects S&P's expectation that we will sustain our strong competitive position and operating performance.

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Our other ratings have not changed from those reported in our "Ratings" section of Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations." in our 2015 Annual Report and continue to be as follows:

|                                       | Financial Strength Rating | Outlook |
|---------------------------------------|---------------------------|---------|
| NRSRO                                 |                           |         |
| A.M. Best                             | A                         | Stable  |
| Moody's Investor Services ("Moody's") | A2                        | Stable  |
| Fitch Ratings ("Fitch")               | A+                        | Stable  |

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

### Off-Balance Sheet Arrangements

At September 30, 2016 and December 31, 2015, we did not have any material relationships with unconsolidated entities or financial partnerships, also referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or for other contractually narrow or limited purposes. As such, we are not exposed to any material financing, liquidity, market, or credit risk that could arise if we had engaged in such relationships.

### Contractual Obligations, Contingent Liabilities, and Commitments

Our future cash payments associated with: (i) loss and loss expense reserves; (ii) contractual obligations pursuant to operating leases for office space and equipment; and (iii) notes payable have not materially changed since December 31, 2015. As of September 30, 2016, we had contractual obligations that expire at various dates through 2030 that may require us to invest up to an additional \$134 million in alternative and other investments. There is no certainty that any such additional investment will be required. Additionally, as of September 30, 2016, we had contractual obligations that expire in 2019 to invest \$12.9 million in a non-publicly traded common stock within our AFS portfolio. We expect to have the capacity to repay and/or refinance these obligations as they come due.

We have issued no material guarantees on behalf of others and have no trading activities involving non-exchange traded contracts accounted for at fair value. We have no material transactions with related parties other than those disclosed in Note 16. "Related Party Transactions" included in Item 8. "Financial Statements and Supplementary Data." of our 2015 Annual Report.

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

There have been no material changes in the information about market risk set forth in our 2015 Annual Report.

### ITEM 4. CONTROLS AND PROCEDURES.

Our management, with the participation of our Chief Executive Officer and Chief Accounting Officer, who has assumed certain additional responsibilities related to disclosure controls and procedures in the absence of a sitting Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended ("Exchange Act")), as of the end of the period covered by this report. In performing this evaluation, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control – Integrated Framework ("COSO Framework") in 2013. Based on this evaluation, our Chief Executive Officer and Chief Accounting Officer have concluded that, as of the end of such period, our disclosure controls and procedures are: (i) effective in recording, processing, summarizing, and reporting information on a timely basis that we are required to disclose in the reports that we file or submit under the Exchange Act; and (ii) effective in ensuring that information

that we are required to disclose in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Accounting Officer, as appropriate, to allow timely decisions regarding required disclosure. No changes in our internal control over financial reporting (as such term is defined in Rule 13a-15(f) of the Exchange Act) occurred during Nine Months 2016 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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## PART II. OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS.

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

Our Insurance Subsidiaries are also from time to time involved in other legal actions, some of which assert claims for substantial amounts. These actions include, among others, putative class actions seeking certification of a state or national class. Such putative class actions have alleged, for example, improper reimbursement of medical providers paid under workers compensation and personal and commercial automobile insurance policies. Our Insurance Subsidiaries are also involved from time to time in individual actions in which extra-contractual damages, punitive damages, or penalties are sought, such as claims alleging bad faith in the handling of insurance claims. We believe that we have valid defenses to these cases. We expect that the ultimate liability, if any, with respect to such lawsuits, after consideration of provisions made for estimated losses, will not be material to our consolidated financial condition. Nonetheless, given the large or indeterminate amounts sought in certain of these actions, and the inherent unpredictability of litigation, an adverse outcome in certain matters could, from time to time, have a material adverse effect on our consolidated results of operations or cash flows in particular quarterly or annual periods. As of September 30, 2016, we do not believe the Company was involved in any legal action that could have a material adverse effect on our consolidated financial condition, results of operations, or cash flows.

## ITEM 1A. RISK FACTORS.

Certain risk factors exist that can have a significant impact on our business, liquidity, capital resources, results of operations, financial condition, and debt ratings. The impact of these risk factors also could impact certain actions that we take as part of our long-term capital strategy, including but not limited to, contributing capital to any or all of the Insurance Subsidiaries, issuing additional debt and/or equity securities, repurchasing our equity securities, redeeming our fixed income securities, or increasing or decreasing stockholders dividends. We operate in a continually changing business environment and new risk factors emerge from time to time. Consequently, we can neither predict such new risk factors nor assess the potential future impact, if any, they might have on our business. There have been no material changes from the risk factors disclosed in Item 1A. "Risk Factors." in our 2015 Annual Report.

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

The following table provides information regarding our purchases of our common stock in Third Quarter 2016:

| Period                 | Total<br>Number of<br>Shares<br>Purchased <sup>1</sup> | Average<br>Price<br>Paid per<br>Share | Total<br>Number of<br>Shares<br>Purchased<br>as Part of<br>Publicly<br>Announced<br>Programs | Maximum<br>Number of<br>Shares that<br>May Yet<br>Be<br>Purchased<br>Under the<br>Announced<br>Programs |
|------------------------|--------------------------------------------------------|---------------------------------------|----------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------|
| July 1 – 31, 2016      | —                                                      | \$ —                                  | —                                                                                            | —                                                                                                       |
| August 1 - 31, 2016    | —                                                      | —                                     | —                                                                                            | —                                                                                                       |
| September 1 - 30, 2016 | 14,385                                                 | 39.35                                 | —                                                                                            | —                                                                                                       |

|       |        |          |   |   |
|-------|--------|----------|---|---|
| Total | 14,385 | \$ 39.35 | — | — |
|-------|--------|----------|---|---|

<sup>1</sup>During Third Quarter 2016, 14,385 shares were purchased from employees in connection with the vesting of restricted stock units. These repurchases were made to satisfy tax withholding obligations with respect to those employees. These shares were not purchased as part of any publicly announced program. The shares that were purchased in connection with the vesting of restricted stock units were purchased at fair market value as defined in the Selective Insurance Group, Inc. 2014 Omnibus Stock Plan and the Selective Insurance Group, Inc. 2005 Omnibus Stock Plan As Amended and Restated Effective as of May 1, 2010.

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## Exhibit No.

- \* Filed herewith.

\*\* Furnished and not filed herewith.

## SIGNATURES

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

SELECTIVE INSURANCE GROUP, INC.

Registrant

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

By: /s/ Anthony D. Harnett  
Anthony D. Harnett  
Senior Vice President and Chief Accounting Officer  
(principal accounting officer)