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AMERICAN SAFETY INSURANCE GROUP LTD

Form 10-K

April 15, 2003

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-K

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

For The Fiscal Year Ended December 31, 2002

Commission File Number 1-14795

AMERICAN SAFETY INSURANCE GROUP, LTD.  
(Exact name of Registrant as specified in its charter)

Bermuda  
(State of incorporation  
or organization)

Not applicable  
(I.R.S. Employer  
Identification No.)

44 Church Street  
P.O. Box HM 2064  
Hamilton, Bermuda  
(Address of principal  
executive offices)

HM HX  
(Zip Code)

Registrant's telephone number: (441) 296-8560

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

Title of each class -----	Name of each exchange on which ----- registered -----
Common Stock, \$0.01 par value	New York Stock Exchange, Inc.

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

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

Indicate by check mark whether 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 Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No \_\_\_

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

Indicate by check mark whether the Registrant is an accelerated filer. Yes \_\_\_ No X

The aggregate market value of Registrant's voting common stock held by non-affiliates on June 28, 2002 was \$20,794,010. For the purposes of this computation shares held by directors, executive officers and affiliates of the

Registrant have been excluded.

The number of outstanding shares of Registrant's common stock on March 26, 2003 was 4,739,888.

Documents Incorporated by Reference: Part III of this Form 10-K incorporates by reference certain information from the Registrant's Proxy Statement for the 2003 Annual General Meeting of the Shareholders (the 2003 Proxy Statement).

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AMERICAN SAFETY INSURANCE GROUP, LTD.

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**PART I**

**Item 1. Business**

General

American Safety Insurance Group, Ltd. (the "Company" or "American Safety") is a specialty insurance holding company organized under the laws of Bermuda which, through its subsidiaries, develops, underwrites, manages and markets primary casualty insurance and reinsurance programs in the alternative insurance market in all 50 states for environmental remediation, contracting and other specialty risks. The Company is also the owner/developer of a residential condominium, marina, par 3 golf course and beach club development in Ponce Inlet, Florida. Unless the context indicates otherwise, all references to the "Company" or "American Safety" refer to American Safety Insurance Group, Ltd. and its subsidiaries.

American Safety was formed in Bermuda as a group captive insurance company in 1986 to provide stable, long term insurance protection for the asbestos abatement and environmental remediation industry in the United States, which had suffered from disruptive market cycles in the standard insurance market. The Company now provides specialty insurance coverages and services in all 50 states and markets its insurance programs through approximately 205 independent insurance agencies and brokerage firms.

The Company develops specialty insurance coverages and custom designed risk management programs not generally available in the standard insurance market. The Company's specialty insurance programs include coverages for general liability, pollution liability, professional liability, workers' compensation, surety, as well as custom designed risk management programs (including captive and rent-a-captive programs) for contractors, consultants and other businesses and property owners who are involved with environmental remediation, contracting and other specialty risks. The Company's managed premiums (i.e., insurance payments for which Company was involved through its various programs and subsidiaries) have grown from \$28 million in 1997 to \$164 million in 2002.

The Company insures and places risks through its two U.S. insurance subsidiaries, American Safety Casualty Insurance Company ("American Safety Casualty") and American Safety Indemnity Company ("American Safety Indemnity"), as well as its U.S. non-subsiary risk retention group affiliate, American Safety Risk Retention Group, Inc. ("American Safety RRG") and unaffiliated insurance companies. The Company also reinsures and places, through the Company's Bermuda reinsurance subsidiary, American Safety Reinsurance, Ltd. ("American Safety Re"), and unaffiliated reinsurers, a portion of the risks underwritten directly by its two U.S. insurance subsidiaries, its risk retention group affiliate and other insurers. Substantially all of the reinsurance business that the Company currently assumes is for primary insurance programs that the Company has developed and underwritten.

The Company also provides specialized insurance program development, underwriting, risk placement, reinsurance, program management, brokerage, loss control, claims administration and marketing services through American Safety Insurance Services, Inc. ("ASI Services"), its principal U.S. program development, underwriting, brokerage and administrative services subsidiary. The Company selects its roles as program developer, primary underwriter, reinsurer, program manager and broker based on its assessment of each risk profile. After determining its roles, the Company utilizes its insurance and reinsurance subsidiaries, its insurance brokerage and management services subsidiaries, and its risk retention group affiliate to generate risk premium revenues, program management fees, insurance and reinsurance commissions and investment income.

#### Industry Ratings

In September 2002, A.M. Best Company ("A.M. Best"), an independent, nationally recognized insurance industry rating service and publisher, reaffirmed a rating of "A (Excellent)" on a group basis to American Safety, as well as its U.S. insurance subsidiary, American Safety Casualty, its U.S. property and casualty excess and surplus lines insurance company, American Safety Indemnity, its Bermuda reinsurance subsidiary, American Safety Re, and its non-subsiary risk retention group affiliate, American Safety RRG. The rating of "A (Excellent)" is the third highest of A.M. Best's 16 letter ratings. A.M. Best's ratings represent an independent opinion of an insurer's ability to meet its obligations to policyholders, which opinion is of concern primarily to policyholders, insurance agents and brokers and should not be considered an investment recommendation. A.M. Best assigned a financial size rating (VII) on a group basis to American Safety representing capital and surplus in excess of \$50 million as a result of the Company's completion of its initial public offering in February 1998.

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#### Alternative Insurance Market

The alternative insurance market has developed over the past two decades to serve insureds whose insurance needs have not been adequately met by the standard insurance market. According to A.M. Best, the alternative

insurance market has grown to approximately 48% of the total U.S. commercial property and casualty insurance market.

Alternative insurance programs generally involve (i) the underwriting of risks which are characterized by the standard insurance market as difficult or which generate too little premium for standard insurance companies; and/or (ii) the design of specialized insurance programs, such as deductible or risk retention programs, and captive or rent-a-captive programs, which enable insureds to assume a portion of their own risks and share in the underwriting profitability or losses of the program. Originally developed to respond to the needs of insureds for adequate insurance coverage and affordable premium rates, the alternative insurance market also responds to strategic needs of insureds for better financial management, improved claims handling, more effective risk management, customized insurance programs, direct access to the worldwide reinsurance market and greater control over loss prevention. The benefits of such alternative insurance market techniques typically include more stable costs, greater control by the client of its risk management program and an increased emphasis within the client's organization on loss prevention and loss control.

### Business Strategy

The Company has developed extensive expertise in identifying insurable opportunities not addressed in the standard insurance market. Typically, the Company targets niche insurance markets that are under served because they: (i) are small in number of insureds or in the amount of coverage needed; (ii) need unique or unusual coverages; or (iii) have not yet been identified by competitors. For these markets, the Company is able to offer a broad array of innovative insurance products and services. A significant portion of the Company's new business comes through insurance agencies and brokerage firms who are aware of the Company's interest and ability to offer insurance for difficult risks in under served markets.

In these niche markets, the Company is able to select its role as program developer, primary underwriter, reinsurer or program manager. Depending upon the needs of the particular market, the Company has the ability to combine a commitment to superior service in order to fashion the insurance product lines that offer the Company a greater profit opportunity and, at the same time, fulfill the needs of the insurance agents, brokers and insureds. Depending upon the role selected, the Company seeks to generate underwriting profits, management fees or commissions.

A significant focus of the Company's business remains offering insurance products to the environmental mediation industry and to contractors that provided the impetus for the Company's formation in 1986. However, as the Company has grown, management has also diversified into other specialty insurance areas. Management intends to continue this diversification in the future.

The Company's objective is to concentrate on its most profitable opportunities in its core insurance business areas. Management has demonstrated its ability to execute on opportunities and at the same time exercise underwriting judgment and discipline. Management anticipates that this will allow the Company to generate profits, minimize losses, successfully identify and implement new opportunities, and stabilize the Company's operating results. This strategy is most clearly demonstrated through management's willingness to exit or reduce business lines - such as surety and workers' compensation - when they generate unacceptable claims experience or do not meet the Company's profitability goals. Management will continue to expand the Company's insurance lines and services, and will not be reluctant to exit insurance lines if the results do not meet management's expectations. Management believes that the Company is well positioned for continued success as it continues to implement the Company's business and growth strategies.

The Company's real estate development subsidiary, Ponce Lighthouse Properties, Inc., is the owner/developer of a residential condominium, marina, par 3 golf course and beach club development known as the Harbour Village Golf and Yacht Club ("Harbour Village") in Ponce Inlet, Florida. The Company organized Rivermar Contracting Company, a subsidiary, to be the general contractor for the construction of the Harbour Village project. The Company acquired the property that is being developed as Harbour Village through foreclosure in April 1999. See Item 3. "Legal Proceedings" with respect to the settlement of recent material zoning litigation involving the Harbour Village project.

#### Insurance Program Development, Management and Administrative Operations

The Company's U.S. brokerage and management subsidiaries, in combination with the Company's primary insurance and reinsurance companies, provide a broad range of dedicated services in connection with the development and implementation of specialty risk insurance programs.

**Insurance Services.** American Safety Insurance Services, Inc. ("ASI Services") provides insurance program development, underwriting, reinsurance placement, program management, brokerage, loss control, claims administration, marketing, information technology and administrative services to the Company's U.S. insurance operations, its risk retention group affiliate, and unaffiliated insurers and reinsurers.

ASI Services identifies and evaluates potential new program business and also receives submissions for new programs from insurance brokers and other intermediaries throughout the United States. When a submission for a new program is received, ASI Services identifies the resources needed to evaluate and develop the program. In evaluating and developing a new program, ASI Services considers the following factors: (i) whether the submitting party will bear risk and the collateral security required; (ii) the analysis of historic loss data; (iii) the integrity and experience of the submitting party; (iv) the availability of reinsurance; and (v) the potential profitability of the program to the Company. If the prospects for a new program appear favorable, ASI Services designs the structure for the new program and determines what additional services, such as program management, brokerage, reinsurance, loss control, claims administration, marketing, or other services will be required. ASI Services determines which entities, both affiliated and unaffiliated, are best able to provide such services in a cost-effective manner in order to implement the program.

ASI Services has developed many of the Company's primary insurance and reinsurance programs. ASI Services also has served since 1990 as the program manager for the Company's risk retention group affiliate, American Safety RRG, providing program management, underwriting, loss control, brokerage, marketing and financial services pursuant to guidelines and procedures established by the board of directors of the risk retention group.

**Management and Administrative Services.** In the development and implementation of programs, ASI Services provides a number of fee and commission-based services. ASI Services provides (i) program management services for the overall management and administration of a program; (ii) underwriting services for evaluating individual risks or classes of risk; (iii) brokerage services for placing risks with affiliated or unaffiliated insurers; (iv) reinsurance intermediary services for placing ceded reinsurance for a program; (v) loss control services for evaluating the risks posed by a particular class of risk, as well as the ability of insureds to control their losses; (vi) claims administration services for the prompt reporting and handling of claims, and the supervision of claims adjusters and third party administrators; (vii) marketing services for designing and placing advertisements and other marketing materials, as well as marketing insurance programs to independent agents and brokers; and (viii) administrative services, including data processing, billing, collecting and reporting primary and reinsurance premiums, producing financial reports on programs and paying claims.

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**Other Insurance Service Subsidiaries.** The Company has four other U.S. subsidiaries engaged, under the direction of ASI Services, which provide various administrative and insurance agency services. American Safety Purchasing

Group, Inc. facilitates the provision of certain insurance coverages through a purchasing group (as defined by the Risk Retention Act) by licensed insurers. Environmental Claims Services, Inc. operates as a specialized claims administration facility engaged in the administration and analysis of environmental and other specialty program claims. Sureco Bond Services, Inc. is a surety bond agency authorized to write contract performance and payment bonds for unaffiliated insurers. American Safety ReSources, Inc. places reinsurance to be assumed by one of the Company's insurance subsidiaries or ceded to other unaffiliated reinsurers.

#### Primary Insurance Operations

The Company, through its two U.S. insurance subsidiaries and its risk retention group affiliate, provides primary casualty insurance in the alternative insurance market in all 50 states for environmental remediation, contracting, and other specialty risks. The Company's specialty insurance programs include coverages for general liability, pollution liability, professional liability, workers' compensation, surety, as well as custom designed risk management programs (including captive and rent-a-captive programs), for contractors, consultants, other businesses and property owners who are involved with environmental remediation, contracting and other specialty risks.

#### Environmental Insurance Programs.

The Company has developed specialty insurance programs for a broad range of environmental concerns and believes that its disciplined underwriting, dedicated loss control and claims management, and commitment to superior service orientation will enable it to expand its insurance program base to other environmental coverages not currently being provided. Since 1986, the Company's insurance programs have helped asbestos abatement and other environmental remediation contractors and consultants, as well as property owners, perform remediation work in schools, hospitals, commercial, industrial and other project sites.

The Company's in-house underwriting department consists of trained environmental and other specialty risk underwriters. The underwriting staff analyzes loss histories of prospective insureds, as well as the insureds' technical capabilities and experience with similar projects to those for which insurance is being requested. The underwriting staff may also request references and financial information. Some of the underwriters have technical backgrounds and experience in various environmental fields. The Company's in-house loss control department may also be involved in the underwriting process, in reviewing technical work guidelines provided by applicants, such as safety and health practices and procedures, as well as inspecting environmental remediation project sites and recordkeeping of insureds throughout the United States.

The Company's general and pollution liability policies for environmental risks cover bodily injury and property damage to third parties arising out of the operations of insureds, which may include losses arising from exposure to specific hazardous substances that are released during a remediation project. Coverages provided for professional liability protect insureds against claims arising out of bodily injury or property damage and/or negligent acts, errors or omissions which occur as a result of the performance of professional consulting, testing, laboratory and similar services, such as the failure to detect hazardous materials in connection with assessments, or the failure to properly design or monitor performance on remediation projects in accordance with contracts entered into by such insureds. The Company also provides workers' compensation coverage for contractors involved in environmental remediation, which may include risks such as occupational diseases from exposure to hazardous substances.

The Company provides insurance coverage for a broad range of environmental risks, including:

**Asbestos Abatement.** Asbestos is a fibrous mineral which has been commercially produced for, among other things, insulation and reduction of fire and heat in buildings and products. In spite of the usefulness of asbestos, health problems have arisen with its use. In response to the need for detection, abatement and removal of asbestos, the asbestos abatement industry developed in the mid-1980's and sought insurance for risks involved with its business. The Company has provided general liability, pollution liability and professional liability coverages as well as workers'

compensation coverage for contractors, consultants, other businesses and property owners involved with asbestos abatement.

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**Lead Abatement.** The Company provides general liability, pollution liability and professional liability coverages and workers' compensation coverage for lead paint abatement contractors, consultants and property owners in connection with the abatement of lead paint from both public and private facilities, including housing authority sites.

**Underground Storage Tank Removal.** The Company provides general liability, pollution liability and professional liability coverages as well as workers' compensation coverage to contractors and consultants for the removal and replacement of underground storage tanks, including associated soil remediation activities attributed to leaking underground storage tanks.

**Other Hazardous Substances.** The Company provides general liability, pollution liability and professional liability coverages, and workers' compensation coverage in connection with the removal and remediation of other hazardous substances, including hazardous wastes, polychlorinated biphenyls (PCBs) and various petroleum products.

**Other Environmental Risks and Programs.** The Company provides environmental insurance coverages that offer protection on an individual risk or program basis against environmental exposures arising from general business or fixed site operations. Environmental impairment liability insurance is offered for varied purposes such as facilitating the financing of real estate transactions, transferring real estate and protecting against the release of hazardous substances from treatment and disposal sites. Dry cleaner's pollution liability insurance is offered on a program basis for the pollution risks of the dry cleaning industry.

#### Specialty Insurance Programs.

The Company also provides insurance coverage for a broad range of specialty risks, including:

**Excess and Surplus Lines.** The Company's U.S. insurance subsidiary, American Safety Indemnity, a licensed and approved excess and surplus lines insurer in 39 states plus the District of Columbia, writes excess and surplus lines insurance through certain surplus lines brokers for commercial casualty risks (generally construction and products liability). These risks are generally of a specialized or unique nature which is not served by the standard insurance market and the Company is generally able to use more restrictive policy terms with less price competition for the risks. By writing this business through its excess and surplus lines insurer, the Company is generally free from rate and form filing regulations to which standard insurers must adhere, thereby giving the Company's excess and surplus lines insurer more freedom over the pricing it can charge for risk, as well as the policy terms and conditions offered.

**Program Business.** The Company, through its U.S. brokerage and management services subsidiaries, works with brokers, program administrators and reinsurance intermediaries, the Company targets small and middle-market specialty niche and homogeneous groups of risks, generally where the principal reinsurance requirements are general liability, professional liability or pollution liability. The Company seeks to capitalize on program business opportunities, arising in large part from a reduction in reinsurance availability and a decrease in the number of acceptable insurance companies willing to act as the policy-issuing insurer for a program.

The Company differentiates itself from competitors through the writing of program business by (i) assuming risk on programs where underwriting profits can be realized and (ii) utilizing a due diligence and audit team consisting of experienced professionals to monitor the management administration of each insurance program. The Company's current programs include pest control operators, lawyer's professional liability, commercial multi-line package for small business, surplus lines package for small/medium businesses, taxi and limousine program, commercial automobile physical damage, contractor's commercial risk and bail bonds. Management looks for program business

where the Company can assume a portion of the risk in addition to generating income from fees and commissions.

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**Surety.** The Company's U.S. insurance subsidiary, American Safety Casualty, is licensed to write surety bonds in 47 states and the District of Columbia primarily providing contract performance and payment bonds for environmental and general construction contractors to third parties. American Safety Casualty is listed as an acceptable surety on federal bonds, commonly known as a "Treasury Listed" or "T-listed" surety, enabling it to issue surety bonds for federal projects, as well as state and private projects that utilize such designation as a reference in determining the acceptability of surety companies. American Safety Casualty's underwriting limitation, as determined by the Department of the Treasury as of July 1, 2002, was \$1,525,000 on a per-bond basis; however, this limitation does not constrain the amount of a bond that can be written, provided that the excess exposure is protected with approved reinsurance or other methods prescribed by the Department of the Treasury. During 2002, American Safety Casualty substantially reduced writing contract surety business as a result of adverse loss experience and the lack of affordable reinsurance.

**Underwriting.** ASI Services' underwriting staff handles all insurance underwriting functions for programs on which the Company assumes risk, with specific underwriting authority related to the experience and knowledge level of each underwriter. Risks that are perceived to be more difficult and complex are underwritten by experienced staff and reviewed by management. ASI Services uses management information reports to measure risk selection and pricing in order to control underwriting performance. The principal underwriting factors used by ASI Services for underwriting liability, workers' compensation and surety coverages, are a financially stable business, an established operating history, acceptable loss histories and a demonstrated commitment to loss control practices.

**Claims.** Claims arising under the policies and treaties issued or reinsured by the Company are reviewed and managed by ASI Services' internal claims department. When ASI Services receives notice of a loss, its claims personnel open a claim file and establish a reserve with respect to the loss. For program business, ASI Services retains claims settlement authority, delegating only limited settlement authority to certain third party administrators. ASI Services emphasizes prompt and fair settlement of meritorious claims, maintenance of adequate loss reserves and careful control of claims adjustment and legal expenses.

**Former Lines.** Prior to 2002, the Company wrote commercial lines insurance primarily for habitational and manufacturing risks, workers' compensation and general liability insurance for employee leasing companies (also known as professional employer organizations) and staffing industry companies. The Company continues to manage the runoff of these business lines.

#### Reinsurance Assumed

Reinsurance is a contractual arrangement under which one insurer (the ceding company) transfers to another insurer (the reinsurer) all or a portion of the risk(s) that the ceding company has assumed under the insurance policy or policies it has issued. A ceding company may purchase reinsurance for any number of reasons, including to obtain, through the transfer of a portion of its liabilities, greater underwriting capacity than its own capital resources would support, to stabilize its underwriting results, to protect against catastrophic loss, and to enter into or withdraw from a line of business. Reinsurance can be written on either a quota share or excess of loss basis, under either a treaty or facultative reinsurance agreement.

Substantially all of the reinsurance business that the Company currently assumes is for primary insurance coverages that the Company has developed, underwritten or managed. The Company enters into treaties with its insurance and reinsurance subsidiaries, its risk retention group affiliate and unaffiliated insurers with whom the Company has developed insurance programs. The Company reinsures, generally on an excess of loss basis, the general liability, pollution liability, professional liability and workers' compensation risks for contractors, consultants



and other businesses and property owners who are involved with environmental remediation, contracting and other specialty risks.

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For the year ended December 31, 2001, of the \$26.8 million of gross reinsurance premiums written by the Company, approximately \$10.9 million was assumed from its risk retention group affiliate, with the balance of approximately \$15.9 million assumed from unaffiliated insurers. For the year ended December 31, 2002, of the \$27.7 million of gross reinsurance premiums written by the Company, approximately \$17.9 million was assumed from its risk retention group affiliate, with the balance of approximately \$9.8 million assumed from unaffiliated reinsurers.

The Company's assumed reinsurance business for general liability, pollution liability, and professional liability is written under excess of loss treaties. In the layer of the first \$350,000 of loss per occurrence, the Company retains 75% of the losses arising from claims covered under the policies written and the risk retention group affiliate retains the other 25% of the risk.

#### Selected Operating Information

**Gross Premiums Written and Produced.** As a result of the Company's roles in connection with insurance program development, risk bearing on a primary and reinsurance basis, insurance and reinsurance brokerage, and production and administration, the Company is involved in a number of insurance and reinsurance premium and fee-generating activities. The Company places insurance and reinsurance with its insurance and reinsurance subsidiaries and its risk retention group affiliate, and also acts as an agency and broker for its risk retention group affiliate, unaffiliated insurers and reinsurers for which the Company receives brokerage commissions. For the year ended December 31, 2002, the Company was involved with the placement of approximately \$164.3 million of gross premiums through its various programs and subsidiaries.

The following table sets forth the Company's premiums written, reinsurance assumed and the amounts produced on a brokered basis for the years ended December 31, 2001 and December 31, 2002:

	Year Ended December 31, 2001		Year Ended December 31, 2002		
	<u>Gross</u>	<u>Ceded</u>	<u>Net</u>	<u>Gross</u>	
	(Dollars in thousands)				
The Company	\$ 158,017	\$ 81,582	\$ 76,435	\$ 156,606	\$
American Safety RRG (1)	15,863			20,574	
Other Insurers and Reinsurers (2)	13,256			5,044	
Less: Ceded from American Safety RRG to the Company (3)	<u>(10,864)</u>			<u>(17,889)</u>	
	\$ 176,272			\$ 164,335	
	=====			=====	

1. Represents premiums written by American Safety RRG, the Company's non-subsiary affiliate.
2. Represents premiums produced by the Company, as an agency and broker, for unaffiliated insurers and reinsurers. Also includes the difference between gross and net bail bond premiums.
3. Represents premiums ceded to the Company from American Safety RRG.

**Net Premiums Written.** The following table sets forth the Company's net premiums written (i.e., gross premiums written less premiums ceded to reinsurers.) by principal lines of insurance and reinsurance for the years ended

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December 31, 2001 and December 31, 2002:

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	Year Ended <u>December 31, 2001</u>		Year Ended <u>December 31,</u>	
	(Dollars in thousands)			
General Liability	\$ 45,664	59.7%	\$ 62,242	
Workers' Compensation	21,371	28.0	7,394	
Surety	1,562	2.0	700	
Commercial Lines	3,120	4.1	(286)	
Program Business	<u>4,718</u>	<u>6.2</u>	<u>10,310</u>	
Total	\$ 76,435	100%	\$ 80,360	
	=====	=====	=====	

The following table sets forth the Company's net premiums written by specialty industry for the years ended December 31, 2001 and December 31, 2002:

	Year Ended December 31, 2001		Year Ended December 31, 2002	
	(Dollars in thousands)			
Environmental	\$ 22,624	29.6%	\$ 19,266	24.0%
Excess & Surplus Lines	35,750	46.8	43,555	54.2
Program Business and Other	7,133	9.3	17,825	22.2
Commercial Lines	3,120	4.1	(286)	(0.4)
Employee Leasing	<u>7,808</u>	<u>10.2</u>	<u>-</u>	<u>-</u>
Total	\$ 76,435	100%	\$ 80,360	100%
	=====	=====	=====	=====

**Commissions and Fees.** The Company generates fee and commission income in connection with the Company's program development and management, insurance and reinsurance brokerage services, and production and other insurance related services. Fee and commission income was \$3.9 million for the year ended December 31, 2001, and \$1.3 million for the year ended December 31, 2002. Fee income decreased during 2002 as a result of the conversion of the fee structure from a fixed fee to a reimbursement of costs basis.

**Combined Ratio.** The combined ratio is a standard measure of a property and casualty insurer's performance in managing its losses and expenses. Underwriting results are generally considered profitable when the combined ratio is less than 100%. The difference between combined ratios calculated on a statutory basis and a GAAP basis is the inclusion of deferred acquisition costs on a GAAP basis. The following table compares the statutory combined ratios of the Company with the property and casualty industry over the past three years.

	Combined Ratio (Statutory Basis)		
	Year Ended December 31,		
	<u>2000</u>	<u>2001</u>	<u>2002</u>
The Company(1) (2)	81.0%	88.6%	81.1%
Property and casualty industry(3)	110.3	117.0	105.7

1. Data has been derived from the consolidated financial statements of the Company.
2. Payments by American Safety Casualty and American Safety Indemnity to ASI Services for management

services are included in the combined ratio.

3. The statutory industry data was obtained from A.M. Best.

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Although the combined ratio is the generally accepted measure for comparing results within the property and casualty insurance industry, the combined ratio does not distinguish between property and casualty companies based upon their mix of business. The Company focuses primarily on long-tail liability coverages and writes a limited amount of short-tail liability coverages. Long-tail liability insurance coverages often produce greater underwriting losses than short-tail liability insurance. Long-tail liability coverages also produce more investable cash flow for an insurance company because claims may not be reported for many years. Therefore, the companies writing long-tail insurance coverages may be able to mitigate their higher underwriting losses by deriving investment income. Accordingly, a higher combined ratio (on a statutory basis) for a company writing long-tail liability insurance does not necessarily mean lower profitability. In addition, the Company's reported combined ratio for its insurance operations may not provide an accurate indication of the Company's overall profitability due to the exclusion of fee and commission income and expenses generated in related management and agency subsidiaries.

**Premium and Loss Summary.** The Company is engaged in the development of programs and underwriting of coverages as both a primary casualty insurer and a reinsurer. The following table provides selected historical information based on accounting principles generally accepted in the United States of America ("GAAP") concerning the business written by the Company and the associated underwriting risks. This data should be read in conjunction with the consolidated financial statements and notes thereto and the Selected Financial Data included elsewhere in this Report.

	<u>2000</u>	<u>Year Ended December 31,</u>	
		<u>2001</u>	<u>2002</u>
		(In thousands, except ratio data)	
Reinsurance :			
Gross Premiums Written	\$ 22,646	\$ 26,764	\$ 27,690
Net Premiums Written	20,448	24,971	11,311
Net Premiums Earned	16,630	22,760	7,800
Loss & Loss Adjustment Expense Ratio	73.7%	64.1%	45.0%
Primary:			
Gross Premiums Written	\$ 64,227	\$ 131,253	\$ 128,900
Net Premiums Written	21,005	51,464	69,040
Net Premiums Earned	10,075	40,209	58,140
Loss & Loss Adjustment Expense Ratio	58.0%	72.6%	58.0%
Combined:			
Gross Premiums Written	\$ 86,872	\$ 158,017	\$ 156,600
Net Premiums Written	41,453	76,435	80,360
Net Premiums Earned	26,705	62,969	65,940
Loss & Loss Adjustment Expense Ratio	69.3%	69.9%	58.0%
Expense Ratio	<u>18.2%</u>	<u>22.6%</u>	<u>28.0%</u>
Combined	87.5%	92.5%	86.0%
	=====	=====	=====

Significant fluctuations in demand for and supply of various casualty insurance and reinsurance lines of business have led to substantial price fluctuations over time. The Company's management seeks to expand and contract various lines of business based on the relative favorability of the pricing environment for its insurance products. As a writer of both primary insurance and reinsurance, the Company has additional flexibility to adjust its business mix in response to price differences in these markets and to utilize its knowledge of primary insurance markets to guide its assumption of insurance and reinsurance risks. During the past decade, the Company has operated in a soft market cycle which

was characterized by excess insurance capacity and declining insurance premium rates; however, commencing in fiscal year 2000 the Company has operated in a hardening market cycle which is characterized by increased insurance premium rates for most insurance coverages in the property and casualty market.

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## Reinsurance Ceded

The Company obtains reinsurance for its primary insurance and reinsurance operations from unaffiliated reinsurers to protect and mitigate the exposures of the Company. The Company's reinsurance program for general, pollution and professional liability, and excess and surplus lines risks operates on an excess of loss basis, with the Company's maximum exposure, on a per occurrence basis, limited to \$262,500 for general and pollution liability risks and \$350,000 for excess and surplus lines risks. For workers' compensation business written by the Company, the Company's maximum exposure is \$350,000 per occurrence. Some of the reinsurance treaties maintained by the Company for its protection have certain aggregate limits of liability.

The Company purchases reinsurance for its primary insurance business lines and its reinsurance business. Gross reinsurance premiums ceded in 2001 were \$81.5 million, which constituted 52% of the gross premiums written, and in 2002 were \$76.2 million, which constituted 49% of the gross premiums written. The amount of reinsurance obtained by the Company varies with the line of business insured or reinsured. The Company experienced increased reinsurance costs in 2001 and 2002, and expects such increased reinsurance costs to continue in 2003, as a result of a hardening reinsurance market cycle.

The Company evaluates the credit quality of the U.S. reinsurers and retrocessionaires to which it cedes business. The following table sets forth certain information relating to the Company's unaffiliated reinsurers and retrocessionaires as of December 31, 2002 with recoverables in excess of 5% of the Company's total shareholders equity (in thousands):

Reinsurers	A.M. Best Rating (1)	Total Recoverable for Year Ended December 31, 2002
Berkley Insurance Company	A	34,511
American Constantine	N/A	11,548
Louisiana Pest Control Insurance Company	NR-4	8,309
Zurich Versicherung-Atkiengesellschaft	NR-5	8,085
Alea London	A-	6,770
American Re	A+	4,092
Folksamerica Reinsurance Company	A-	3,924
Hartford Fire Insurance Company	A+	3,637
Alea North American	A-	3,462

### 1. A.M. Best rating currently assigned.

See Item 3. "Legal Proceedings" with respect to the Company's pending material reinsurance recoverables arbitration with Berkley Insurance Company, one of the Company's former reinsurers.

## Loss and Loss Adjustment Expense Reserves

The Company is required to maintain reserves to cover its estimated ultimate liability for losses and loss adjustment expenses with respect to reported and unreported claims incurred. A full actuarial analysis is performed to provide reserve studies, rate studies and opinions. Reserves are estimates at a given time, which are established from actuarial and statistical projections by the Company of the ultimate settlement and administration costs of claims

occurring on or prior to such time, including claims that have not yet been reported to the insurer. The establishment of appropriate loss reserves is an inherently uncertain process, and there can be no assurance that ultimate payments will not materially exceed the Company's reserves.

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With respect to reported claims, reserves are established on a case-by-case basis. The reserve amounts on each reported claim are determined by taking into account the circumstances surrounding each claim and policy provisions relating to the type of loss. Loss reserves are reviewed on a regular basis, and as new data becomes available, appropriate adjustments are made to reserves.

As of December 31, 2002, approximately 16% of the Company's net reserves relate to liability associated with asbestos abatement and other environmental general liability insurance, 17% of such reserves are attributable to the workers' compensation insurance, 45% of such reserves relate to excess and surplus lines, and the balance of 22% of such reserves is allocated among surety and other lines of insurance business.

In establishing reserves for its general liability insurance program, the Company uses paid and reported Bornhuetter-Ferguson methods which are based in part on developing paid and reported losses and an initial expected loss level. Initial expected losses reflect an expected loss ratio (i.e., a ratio of net losses and loss adjustment expenses incurred divided by net premiums earned) estimated from the Company's experience and a loss cost model applied to premium by coverage year. This loss indication and paid/reported losses are assigned respective weights to obtain estimates of ultimate losses which are considered in establishing ultimate loss levels.

In establishing reserves for its workers' compensation insurance program, several methods are employed in determining ultimate losses: a pure premium method; two Bornhuetter-Ferguson methods - paid and reported; and two loss development methods - paid and incurred. The first three methods use industry expected losses adjusted for the Company's experience while the last two methods rely on industry payment and reporting patterns to develop the Company's actual losses. The Company reviews all methods each coverage year in determining ultimate losses.

In establishing reserves for its surety and other coverages, the Company uses an expected loss ratio method due to the lack of historically specific information available to the Company.

All the methods used are generally accepted actuarial methods and, with the exception of the pure premium method, rely in part on loss reporting and payment patterns while considering the long tail nature of the coverages and inherent variability in projecting results from year-to-year. The patterns used are generally based on industry data with supplemental consideration given to Company experience as deemed warranted.

Industry data is also relied upon during the actuarial analysis to provide the basis for reserve analysis on newer lines of insurance business. Provisions for inflation are implicitly considered in the reserving process. For GAAP purposes, the Company's reserves are carried at the total estimate for ultimate expected loss, without any discount to reflect the time value of money. Reserve calculations are reviewed regularly by management and periodically by regulators. A full actuarial analysis is performed annually, assessing the adequacy of statutory reserves (i.e., reserves established to provide for future obligations with respect to all insurance policies as determined in accordance with the rules and procedures proscribed or permitted by state insurance regulatory authorities for recording transactions and preparing financial statements) established by management. The opinion which is filed with the various jurisdictions in which the Company's insurance and reinsurance subsidiaries and its risk retention group affiliate are licensed. Based upon practices and procedures employed by the Company, without regard to independent actuarial opinions, management believes that the Company's reserves are adequate.

As a result of the reinsurance recoveries dispute with Berkley Insurance Company, described above, the Company was required to reduce its statutory capital surplus by 20% of the outstanding paid amounts in dispute (or

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\$2.8 million) to reflect statutory accounting rules regarding the treatment of outstanding reinsurance recoverables. As the Company continues to pay claims under these reinsurance treaties that are not reimbursed by reinsurers, such deductions to the Company's statutory surplus will continue to increase.

The following table provides a reconciliation of beginning and ending liability balances on a GAAP basis for the years indicated:

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	<u>Year Ended December 31,</u>		
	<u>2000</u>	<u>2001</u>	<u>2002</u>
	(In thousands)		
Gross losses and loss adjustment expense reserves at beginning of year	\$ 20,413	\$ 50,509	\$ 121,423
Ceded reserves at beginning of year	<u>6,065</u>	<u>27,189</u>	<u>77,583</u>
Net losses and loss adjustment expense reserves at beginning of year	<u>14,348</u>	<u>23,320</u>	<u>43,840</u>
Add:			
Incurred losses related to:			
Current accident year	17,356	42,469	36,606
Prior accident years	<u>1,150</u>	<u>1,517</u>	<u>1,668</u>
Total incurred losses	<u>18,506</u>	<u>43,986</u>	<u>38,274</u>
Less:			
Claims payments related to:			
Current accident year	4,291	12,952	3,571
Prior accident years	<u>5,243</u>	<u>10,514</u>	<u>14,715</u>
Total claims paid	<u>9,534</u>	<u>23,466</u>	<u>18,286</u>
Net losses and loss adjustment expense reserves at end of year	23,320	43,840	63,828
Ceded reserves at end of year	<u>27,189</u>	<u>77,583</u>	<u>96,801</u>
Gross losses and loss adjustment expense reserves at end of year	\$ 50,509	\$ 121,423	\$ 160,629
	=====	=====	=====

The negative claims development commencing in 2000 and continuing through 2001 in the Company's contract surety business line was the result of a rapid expansion of construction activity in the growing U.S. economy in the 1990's, coupled with the shortage of construction labor, followed by a significant downturn in the economy in early 2000-2001, which resulted in a substantial number of contractor defaults. In addition, premium increased on the Company's assumed workers' compensation business (which has been terminated) during 2002 for prior years which resulted in negative development.

The following table shows the gross, ceded and net development of the reserves for unpaid losses and loss adjustment expenses from 1991 through 2002 for the Company's primary insurance and reinsurance subsidiaries on a GAAP basis. The top line of the table shows the liabilities at the balance sheet date for each of the indicated years and reflects the estimated amounts for losses and loss adjustment expenses for claims arising in that year and all prior years that are unpaid at the balance sheet date, including losses incurred but not yet reported to the Company. In the gross and ceded sections of the table, the second line shows the re-estimated amount of previously recorded liability based on experience as of the end of each succeeding year. The lower portion of the table in the net section shows the cumulative amounts subsequently paid as of successive years with respect to the liability. The estimates change as more information becomes known about the frequency and severity of claims for individual years. A redundancy (deficiency) exists when the re-estimated liability at each December 31 is less (greater) than the prior liability

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estimate. The cumulative redundancy or deficiency depicted in the table, for any particular calendar year, represents the aggregate change in the initial estimates over all subsequent calendar years.

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	Year Ended December 31,								
	1992	1993	1994	1995	1996	1997	1998	1999	2000
	(In thousands)								
Gross reserves	4,135	4,798	6,048	8,294	8,914	11,572	14,701	20,413	25,000
Re-estimated at 12/31/02	<u>1,751</u>	<u>1,681</u>	<u>3,005</u>	<u>6,329</u>	<u>8,898</u>	<u>12,451</u>	<u>15,423</u>	<u>27,051</u>	<u>31,700</u>
Cumulative redundancy (deficiency)	<u>2,384</u>	<u>3,117</u>	<u>3,043</u>	<u>1,965</u>	<u>16</u>	<u>(879)</u>	<u>(722)</u>	<u>(6,638)</u>	<u>(6,700)</u>
Ceded reserves	-	-	-	6	45	779	1,841	6,065	6,065
Re-estimated at 12/31/02	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>252</u>	<u>893</u>	<u>2,369</u>	<u>10,599</u>	<u>16,664</u>
Cumulative redundancy (deficiency)	<u>-</u>	<u>-</u>	<u>-</u>	<u>6</u>	<u>(207)</u>	<u>(114)</u>	<u>(528)</u>	<u>(4,534)</u>	<u>(10,600)</u>
Reserves for unpaid losses and loss adjustment expense	<u>4,135</u>	<u>4,798</u>	<u>6,048</u>	<u>8,288</u>	<u>8,869</u>	<u>10,793</u>	<u>12,860</u>	<u>14,348</u>	<u>23,935</u>
Reserves re-estimated at December 31:									
-----									
1 year later	4,266	4,653	5,854	7,482	9,850	11,587	12,307	15,498	20,413
2 years later	4,100	4,584	5,381	7,518	9,926	12,253	12,967	15,541	20,413
3 years later	4,148	3,920	4,823	7,398	9,606	12,550	12,677	16,452	
4 years later	3,644	3,063	4,373	7,027	9,767	11,556	13,054	-	
5 years later	2,987	2,740	3,941	7,251	8,677	11,558	-	-	
6 years later	2,765	2,535	4,062	6,261	8,646	-	-	-	
7 years later	2,504	2,641	3,324	6,329	-	-	-	-	
8 years later	2,630	2,002	3,005	-	-	-	-	-	
9 years later	2,070	1,681	-	-	-	-	-	-	
10 years later	1,751	-	-	-	-	-	-	-	
Cumulative redundancy (deficiency)	<u>2,384</u>	<u>3,117</u>	<u>3,043</u>	<u>1,959</u>	<u>223</u>	<u>(765)</u>	<u>(194)</u>	<u>(2,104)</u>	<u>(3,000)</u>
Cumulative amount of liability paid through December 31:									
1 year later	524	152	501	931	1,827	3,007	3,701	5,243	6,065
2 years later	651	382	997	2,056	3,506	5,707	6,565	9,616	6,065
3 years later	872	621	1,552	2,906	4,918	7,443	9,058	11,060	
4 years later	1,095	776	1,899	3,656	6,034	8,991	9,086	-	
5 years later	1,235	1,064	2,162	4,619	6,638	8,479	-	-	
6 years later	1,511	1,252	2,428	4,906	6,362	-	-	-	
7 years later	1,516	1,500	2,617	4,793	-	-	-	-	
8 years later	1,733	1,500	2,259	-	-	-	-	-	
9 years later	1,733	1,180	-	-	-	-	-	-	
10 years later	1,413	-	-	-	-	-	-	-	
Net reserve December 31									
Ceded Reserves	-	-	-	6	45	779	1,841	<u>6,065</u>	<u>6,065</u>
Gross Reserve	4,135	4,798	6,048	8,294	8,914	11,572	14,701	20,413	25,000

## Investments

The Company employs an independent, nationally recognized investment management company to provide investment advisory services, subject to the investment policies and guidelines established by the Company's Board of Directors. The Company has consistently invested primarily in investment grade fixed income securities, with the objective of providing reasonable returns while limiting liquidity risk and credit risk. The Company's investment strategy has been to increase its investments in high quality bonds, as opposed to equity securities, in order to avoid market fluctuations. The investment portfolio consists primarily of government and governmental agency securities and high quality marketable corporate securities which are rated at investment grade level.

At December 31, 2001, the Company's total assets of \$297.3 million consisted of the following: cash, investments and notes receivable 47%; premiums receivable and agent's balances 9%; reinsurance recoverables 36%; and other assets 8%. At December 31, 2002, the Company's total assets of \$365.4 million consisted of the following: cash, investments and notes receivable 50%; premiums receivable and agent's balances 5%; reinsurance recoverables 38%; and other assets 7%.

The Company's cash and investments at December 31, 2002 totaled approximately \$171.4 million, and were classified as follows:

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Type of Investment	Book Value
	(In thousands)
Cash and short-term investments	\$ 48,242
United States government securities	36,361
Mortgage-backed securities	10,945
Corporate bonds	34,623
Foreign investments	169
Real estate	41,051
Total	\$ 171,391 =====

The statement and fair values of the bond portfolio, classified by rating, as of December 31, 2002

<u>S&amp;P's/Moody's Rating(1)</u>	<u>Fair Value</u>	<u>Amount Reflected on Balance Sheet</u>
		(In thousands)
AAA/Aaa (including United States Treasuries of \$37,812)	\$ 51,362	\$ 51,362
AA/Aa	3,095	3,095
A/A	17,913	17,913
BBB/Baa	<u>13,481</u>	<u>13,481</u>
Total	\$ 85,851 =====	\$ 85,851 =====

(1) Ratings are assigned by Standard & Poor's ("S&P") or, if no S&P rating is available, by Moody's Investors Service Inc. ("Moody's").

The National Association of Insurance Commissioners (NAIC) has a bond rating system by which it assigns securities to classes called NAIC designations that are used by insurers when preparing their annual financial statements. The NAIC assigns designations to publicly traded as well as privately placed securities. The designations



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assigned by the NAIC range from class 1 to class 6, with a rating in class 1 being the highest quality. As of December 31, 2002, all of the Company's bond portfolio, measured on a statutory carrying value basis, was invested in securities rated in class 1 or class 2 by the NAIC, which are considered investment grade.

The weighted average maturity of the Company's bond portfolio at December 31, 2002 was 7.20 years. The composition of the Company's bond portfolio, classified by maturity, as of December 31, 2002 was as follows:

<u>Maturity (1)</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
	(In thousands)	
Due in one year or less	\$ 9,279	\$ 9,389
Due from one to five years	14,316	15,097
Due from five to ten years	39,147	41,117
Due after ten years	8,411	8,947
Mortgage-backed securities	<u>10,945</u>	<u>11,301</u>
Total	\$ <u>82,098</u>	\$ <u>85,851</u>

1. Based on stated maturity dates with no prepayment assumptions.

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The Company's investment grade fixed maturity securities included mortgage backed bonds of \$11.3 million, which are subject to risks associated with the variable prepayments of the underlying mortgage loans.

At December 31, 2002, the Company had two secured notes receivable from an unrelated party which are carried on the balance sheet at \$6.6 million (which includes an impairment charge of \$2.5 million). The impairment charge was the result of obtaining an updated appraisal for the collateral supporting the loans, which reflected a decrease in the market value of the property due to current economic conditions. The Company ceased accruing interest on these loans after the original maturity dates. These notes are currently in default. The Company has filed suit on one of the secured notes against the borrower and the guarantors and the Company is discussing resolution of the second secured note with the borrower.

American Safety Risk Retention Group, Inc.

**Organization History.** Following the enactment of the Risk Retention Act, the Company, in order to establish a U.S. insurance company to market and underwrite specialty environmental coverages, provided financial and technical assistance in connection with the organization of American Safety RRG in 1988. American Safety RRG is not owned by the Company but is managed by ASI Services, the Company's principal U.S. program development, underwriting and administrative services subsidiary, originally on a fee-for-service basis. American Safety RRG is authorized to write liability insurance in all 50 states as a result of the Risk Retention Act, and is licensed by the Vermont Department of Banking, Insurance, Securities and Health Care Administration (the Vermont Department) under the Vermont Captive Act as a stock captive insurance company. Presently, five of the directors of American Safety RRG are also directors of the Company. The directors of American Safety RRG are elected annually by the insureds/shareholders of American Safety RRG.

The Company transferred its book of primary insurance business to American Safety RRG in 1988 and American Safety RRG replaced American Safety as the policy issuing carrier insuring general, pollution and professional liability risks for contractors, consultants and other businesses and property owners who are involved with environmental remediation. American Safety then became the quota share reinsurer of the risks transferred and subsequently underwritten by American Safety RRG. All reinsurers of American Safety RRG are required to be approved as reinsurers by the Vermont Department, and American Safety has been an authorized reinsurer of

American Safety RRG since 1988. The Company, through its insurance subsidiaries, participates in the business of American Safety RRG through a pooling agreement whereby the Company keeps 75% of the premium and retained risk from business written by American Safety RRG.

Regulation. The Risk Retention Act facilitates the establishment of risk retention groups to insure certain liability risks of its members. The statute applies only to liability insurance and does not permit coverage of personal risk liability or workers' compensation.

The Risk Retention Act and the Vermont Captive Act require that each insured of American Safety RRG be a shareholder. Each insured is required to purchase one share of the American Safety RRG's common stock upon the acceptance of the applicant as an insured. There is no trading market for the shares of common stock of American Safety RRG and each share is restricted as to transfer. If and when a holder of American Safety RRG common stock ceases to be an insured, whether voluntarily or involuntarily, such person's share of common stock is automatically canceled and such person is no longer a shareholder of American Safety RRG. The ownership interests of members in a risk retention group are considered to be exempt securities for purposes of the registration provisions of the Securities Act and the Securities and Exchange Act and are likewise not considered securities for purposes of any state securities law.

Congress intended under the Risk Retention Act that the primary responsibility for regulating the financial condition of a risk retention group would rest on the state in which the group is licensed or chartered. American Safety RRG is subject to regulation as a captive insurer under the insurance laws of Vermont and, to a lesser extent, under the laws of each state in which it is doing business. The Risk Retention Act requires a risk retention group to provide a notice on each insurance policy which it issues to the effect that (i) the policy is issued by a risk retention group; (ii) the risk retention group may not be subject to all of the insurance laws and regulations of the state in which the policy is being issued; and (iii) no state insurance insolvency guaranty fund is available to the policies issued by the risk retention group.

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Management. Since 1990, ASI Services has managed the nationwide operations of American Safety RRG from its offices in Atlanta, Georgia pursuant to a program management agreement. American Safety RRG has also entered into local management services agreements since 1988 with captive management companies of national insurance brokerage or insurance companies with offices located in Burlington, Vermont to provide local administrative services.

ASI Services acts as the program manager for American Safety RRG pursuant to the program management agreement and is authorized to solicit and accept applications for insurance and to issue insurance policies on behalf of American Safety RRG subject to guidelines and procedures established by the board of directors of American Safety RRG. For 2002, the program management agreement between American Safety RRG and ASI Services provided for reimbursement of cost based upon premiums written (as opposed to the previous fee-for-service arrangement). The Company derived approximately 6.9% (\$6.9 million) of its revenues in 2001 and 9.2% (\$11.4 million) of its revenues in 2002 from American Safety Risk Retention Group, Inc.

	Year Ended <u>December 31, 2001</u>	Year End <u>December 31,</u>
	(In thousands)	
Assumed earned premiums from American Safety RRG	\$ 10,964	\$ 13,308
Ceded earned premiums to American Safety RRG	7,005	3,095
Net premiums earned	3,959	10,213
Management fees	1,496	1,183
Brokerage commission income	1,490	-

In the table above, assumed earned premiums represent the assumption of liability risks by the Company from American Safety RRG, and ceded earned premiums represent the transfer of a portion of liability risks from the Company to American Safety RRG under the pooling agreement. Management fees include administrative services, underwriting services, claims administration services, financial, accounting, billing and collection services and consulting services. Fee income decreased during 2002 as a result of the conversion of the fee structure from a fixed fee to a reimbursement of costs basis.

#### Insurance Regulation

The Company's primary insurance and reinsurance operations are subject to regulation under applicable insurance statutes of the jurisdictions or states in which each subsidiary is domiciled and writes insurance. Insurance regulations are intended to provide safeguards for the policyholders rather than to protect shareholders of insurance companies or their holding companies.

The nature and extent of state regulation varies from jurisdiction to jurisdiction, but typically involves prior approval of the acquisition of control of an insurance company or of any company controlling an insurance company, regulation of certain transactions entered into by an insurance company with an affiliate, approval of premium rates for lines of insurance, standards of solvency and minimum amounts of capital and surplus which must be maintained, limitations on types and amounts of investments, restrictions on the size of risks which may be insured by a single company, deposits of securities for the benefit of policyholders, and reports with respect to financial condition and other matters. In addition, state regulatory examiners perform periodic examinations of insurance companies.

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Although the federal government does not directly regulate the business of insurance in the United States, federal initiatives often affect the insurance business in a variety of ways. The insurance regulatory structure has also been subject to scrutiny in recent years by the National Association of Insurance Commissioners ( NAIC ), federal and state legislative bodies and state regulatory authorities. Various new regulatory standards have been adopted and proposed in recent years. The development of standards to ensure the maintenance of appropriate levels of statutory surplus (i.e., the amount remaining after all liabilities, including loss reserves, are subtracted from all admitted assets and determined in accordance with statutory accounting procedures) for insurers has been a matter of particular concern to insurance regulatory authorities.

#### Bermuda Regulation

American Safety, as a licensed Bermuda insurance company, and its Bermuda reinsurance subsidiary, American Safety Re, are subject to regulation under The Insurance Act 1978, as amended, and related regulations (the Bermuda Act ), which provides that no person shall conduct insurance business (including reinsurance) in or from Bermuda unless registered as an insurer under the Bermuda Act by the Supervisor of Insurance (the Supervisor ).

The Bermuda Act requires, among other things, Bermuda insurance companies to meet and maintain certain standards of solvency, to file periodic reports in accordance with the Bermuda Statutory Accounting Rules, to produce annual audited financial statements and to maintain a minimum level of statutory capital and surplus. In general, the regulation of insurers in Bermuda relies heavily upon the auditors, directors and managers of the Bermuda insurer, each of which must certify that the insurer meets the solvency capital requirements of the Bermuda Act. Furthermore, the Supervisor is granted powers to supervise, investigate and intervene in the affairs of insurance companies.

Neither American Safety nor American Safety Re is registered or licensed as an insurance company in any state or jurisdiction in the United States.

#### U.S. Regulation

American Safety, as a specialty insurance holding company, does not itself do business in the United States. The Company, through its U.S. subsidiaries, does business in the United States. The Company's two U.S. insurance subsidiary's operations are subject to state regulation where each is domiciled and where each writes insurance.

American Safety Casualty, a U.S. insurance subsidiary domiciled in Delaware, was acquired by the Company in 1993. American Safety Casualty is currently licensed as a property and casualty insurer in 48 states and the District of Columbia. The insurer is subject to regulation and examination by the Delaware Insurance Department and the other states in which it is an admitted insurer. The Delaware Insurance Department examines American Safety Casualty on a triennial basis. The insurance laws of Delaware place restrictions on a change of control of American Safety as result of its ownership of American Safety Casualty. Under Delaware law no person may obtain 10% or more of the voting securities of American Safety without the prior approval of the Delaware Insurance Department.

American Safety Casualty, as a licensed insurer, is subject to state regulation of rates and policy forms in the various states in which direct premiums are written for its general liability and other lines of business. Under such regulations, a licensed insurer may be required to file and obtain prior approval of its policy form and the rates that are charged to insureds. American Safety Casualty is also required to participate in state insolvency funds, or shared markets, which are designed to protect insureds of insurance carriers which become unable to pay claims due to an insurer's insolvency. Assessments made against insurers participating in such funds are based on direct premiums written (i.e., those premiums written, whether or not earned, during a time period) by participating insurers, as a percentage of total direct written premiums of all participating insurers.

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American Safety Indemnity, a U.S. insurance subsidiary domiciled in Oklahoma was acquired by the Company in 2000. American Safety Indemnity is currently licensed or approved as an excess and surplus lines insurer in 39 states and the District of Columbia. The insurer is subject to regulation examination by the Oklahoma Insurance Department and the other states in which it is approved as an excess and surplus lines insurer. The Oklahoma Insurance Department examines American Safety Indemnity on a triennial basis. The insurance laws of Oklahoma place restrictions on a change of control of American Safety as a percentage of its ownership of American Safety Indemnity. Under Oklahoma law no person may obtain 10% or more of the voting securities of American Safety without the prior approval of the Oklahoma Insurance Department.

The premium rates of American Safety Indemnity, as an excess and surplus lines insurer, are not filed and approved by the various state insurance departments, but certain restrictions regarding the types of insurance written by excess and surplus lines insurers must be met. Generally, excess and surplus lines insurers may only write coverage that is not available in the admitted market and strict guidelines regarding the coverages are set forth in various state statutes. Surplus lines brokers are the licensed individuals or entities placing coverage with excess and surplus lines insurers, and in most states, the broker is responsible for the payment of surplus lines taxes which are payable to the state in which the surplus lines risk is located. Surplus lines insurers are exempt from participation in state insolvency funds which are designed to protect insureds if admitted insurers become insolvent and are unable to pay claims. While American Safety Indemnity is exempt from the majority of state regulatory requirements, it must be approved to write the type of insurance in the states where its surplus business lines insurance is written. The Oklahoma Insurance Department retains primary regulatory authority over American Safety Indemnity, as a licensed and admitted insurance company in Oklahoma.

## Competition

The casualty insurance and reinsurance business is highly competitive with respect to a number of factors, including overall financial strength of the insurer or reinsurer, ratings by rating agencies, premium rates, policy terms and conditions, services offered, reputation and commission rates. The Company faces competition from a number of insurers who have greater financial and marketing resources and greater name recognition than the Company.

Although the Company's business strategy is to develop insurance programs for the environmental remediation industry, the contracting industry, as well as other specialty industries and risks by targeting niche markets where its expertise is required and where competition is limited, the Company nevertheless encounters competition from other insurance companies engaged in insuring risks in broader business lines which encompass the Company's niche markets and specialty programs, and such competition is expected to increase as the Company expands its operations.

#### Harbour Village Development

The Company announced in March 2000 its plans to complete development of the Harbour Village Golf & Yacht Club ( Harbour Village ) in Ponce Inlet, Florida with residential condominium units, marina containing boat slips, par 3 golf course and a beach club. The Harbour Village property (comprising 173 acres) was acquired by the Company through foreclosure in April 1999, and has been under development by the Company's subsidiary, Ponce Lighthouse Properties, Inc. and the Company's general contracting subsidiary, Rivermar Contracting Company.

Management has planned that the Harbour Village project would be developed in three phases with projected completion in 2005. See Item 3. Legal Proceedings with respect to the settlement of recent material zoning litigation relating to the Harbour Village project. See Exhibit 99 for further information regarding Harbour Village.

#### Employees

At December 31, 2002, the Company employed 130 persons, none of whom was represented by a labor union. ASI Services employs all but one of the Company's employees and manages the Company's U.S. business operations. The Company employs a senior financial officer in Bermuda.

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#### Certain Risk Factors

The Company's insurance operations are subject to the following risk factors in addition to the information (including disclosures relating to forward-looking statements) set forth elsewhere in this Report:

##### Industry Cyclicity; Potential Fluctuations in Financial Results

The financial results of casualty insurance companies historically have been subject to significant fluctuations and may vary significantly in the future. Operating results may fluctuate due to a variety of factors, including competitive conditions in the industry, levels of new and renewal insurance business, unpredictable developments in loss trends, adequacy and changes in liabilities established by insurance and reinsurance to reflect the estimated costs of claims payments (known as loss reserves) according to their insurance or reinsurance contracts, collectibility of reinsurance receivables, market acceptance of new coverages or enhancements, legal interpretations of policy provisions, changes in operating expenses, fluctuations in interest rates and other changes in investment markets which affect market prices of investments and income from such investments, and changes in levels of general business activity and economic conditions. The Company has experienced increased competitive pricing pressures in almost all of its insurance business lines in recent years. Recently, however, the insurance industry has progressed from a soft market (wherein insurers could not charge higher premiums) to a hard market (wherein insurers can charge higher premiums). These markets are cyclical and may change at any time.

In addition, insureds are eligible for renewal of their policies on different anniversary dates, subject to underwriting and loss control criteria applied by the Company. If a large number of insureds were to decline to renew their policies or if their policies were not renewed in a given calendar quarter, the Company's results of operations could be materially adversely affected in the renewal quarter and subsequent quarters.

### Significant Industry Concentration; Specialty Industry Risks

Due to the Company's focus on insuring specialty risks, such as the environmental remediation industry and the contracting industry, its operations could be more exposed than its more diversified competitors to the effects of changes in economic conditions, regulations and legal precedents affecting such specialty industries. These changes may include, but are not limited to, economic downturns that may adversely impact the building and real estate development industry, and the degree of enactment and enforcement of federal and state environmental regulations that encourage or require environmental remediation efforts.

### Dependence and Availability of Reinsurance

The availability, amount and cost of reinsurance are subject to prevailing market conditions that are beyond the control of the Company and that affect the Company's business, financial condition and operating results. The Company's business depends significantly upon the Company's ability to limit its risk exposure by ceding (i.e., transferring to others) significant amounts of the potential liability arising from risks insured or reinsured by the Company. As a result of these factors, it is unclear if such reinsurance will continue to be available or available at an affordable cost. If the Company were unable to maintain or replace its reinsurance treaties upon their expiration, either its exposures would increase or, if it were unwilling to bear such increase in exposures, the Company would be required to reduce the level of its underwriting commitments. Furthermore, the Company is subject to credit risk with respect to its reinsurers, as the ceding of risk to its reinsurers does not relieve the Company of its primary liability to its insureds. Although the Company places its reinsurance with reinsurers it believes to be financially stable, a significant reinsurer's inability or unwillingness to make payment under the terms of a reinsurance treaty could have a material adverse effect on the Company's business, financial condition and operating results. See Item 3. Legal Proceedings with respect to pending material reinsurance recoverables arbitration with Berkley Insurance Company, one of the Company's former reinsurers.

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### Possible Inadequacy of Loss Reserves

The establishment of appropriate loss reserves is an inherently uncertain process, particularly in the environmental remediation industry, contracting industry, other specialty and excess and surplus lines risks, where claims that have occurred may not be reported to an insurer until future periods of time. Due to the uncertainties inherent in the Company's business lines, the possibility exists that ultimate losses could exceed the Company's loss reserves. Insurers are required to maintain reserves to cover their estimated ultimate liability for losses and loss adjustment expenses with respect to reported and unreported claims incurred. Reserves are estimates at a given time involving actuarial and statistical projections of what the Company expects to be the cost of the ultimate settlement and administration of claims. These estimates are based on facts and circumstances then known, predictions of future events, estimates of future trends, claims frequency and severity, potential judicial expansion of liability precedents, legislative activity and other factors, such as inflation. The Company engages an internationally recognized actuarial consulting firm to provide reserve studies and rate studies. To the extent that loss reserves prove to be inadequate in the future, the Company would have to increase its reserves and incur charges to earnings in the periods such reserves are increased, which would cause fluctuations in operating results and could have a material adverse effect on the Company's business, financial condition and operating results.

### Reliance on Independent Insurance Agencies and Brokers

The failure or inability of independent insurance agencies and brokers to market the Company's insurance programs successfully could have a material adverse effect on the Company's business, financial condition and operating results. The Company markets its insurance programs primarily through approximately 205 independent insurance agencies and brokerage firms. Agencies and brokers are not obligated to promote the Company's insurance

programs and may sell competitors' insurance programs. As a result, the Company's business depends in part on the marketing efforts of these agencies and brokers and on the Company's ability to offer insurance programs and services that meet the requirements of the clients and customers of these agencies and brokers.

#### Risks Associated with Growth Strategy

The Company's growth strategy includes potential strategic acquisitions, as well as continued internal growth, particularly of its specialty business lines, and development of new insurance lines. If the Company is unable to implement its growth strategy effectively, the Company's business, financial condition and operating results could be materially adversely affected. Although the Company is not engaged in negotiations with respect to any acquisition, any future acquisition would be accompanied by risks commonly encountered in acquisitions of companies. Such risks include, among other things, the difficulty in assimilating the operations and personnel of an acquired company; potential disruption of the Company's ongoing business; inability to successfully integrate acquired systems and insurance programs into the Company's operations; maintenance of uniform standards, controls and procedures; and possible impairment of relationships with employees and insureds of an acquired business as a result of changes in management. Due to the risks and other unforeseen factors, the Company may not be able to successfully implement its strategy for continued internal growth and may not be successful in overcoming the risks or any other problems customarily encountered in connection with an acquisition, or achieving internal growth or development of new insurance lines.

#### Importance of Industry Ratings

Increased public and regulatory scrutiny of the financial stability of insurance companies have resulted in greater emphasis by policyholders upon insurance company ratings, with a resultant potential competitive advantage for insurance companies with higher ratings. In September 2002, A.M. Best, an independent nationally recognized insurance industry rating service and publisher, reaffirmed a rating of "A (Excellent)", with a "stable" outlook, on a group basis to American Safety, as well as its U.S. insurance subsidiary, American Safety Casualty, its U.S. property and casualty excess and surplus line insurance subsidiary, American Safety Indemnity, and its non-subsiary risk retention group affiliate, American Safety RRG. Because A.M. Best continually monitors insurance companies with regard to their ratings, the Company's ratings could change at any time, and any downgrade of such ratings could adversely affect the Company's business, financial condition and results of operations. A.M. Best's ratings represent an independent opinion of an insurer's ability to meet its obligations to policyholders which opinion is of concern primarily to policyholders, insurance agents and brokers and should not be considered an investment recommendation.

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#### Regulation

**Insurance Regulation.** The Company's primary insurance and reinsurance subsidiaries, as well as its non-subsiary risk retention group affiliate, are subject to regulation under applicable insurance statutes of the jurisdictions in which they are domiciled or licensed and write insurance. Such regulation may limit the ability or the speed of the Company to respond to market opportunities and may require the Company to incur significant annual regulatory compliance expenditures. Insurance regulation is intended to provide safeguards for policyholders rather than to protect shareholders of insurance companies or insurance holding companies. Insurance regulation relates to authorized lines of business, capital and surplus requirements, types and amounts of investments, underwriting limitations, trade practices, policy forms, claims practices, mandated participation in shared markets, reserve adequacy, insurer solvency, transactions with related parties, changes in control, payment of dividends and a variety of other financial and nonfinancial components of an insurance company's business. Any changes in insurance laws and regulations could materially adversely affect the Company's business, financial conditions and operating results. The Company is unable to predict what additional laws and regulations, if any, affecting its business may be promulgated in the future or how they might be interpreted.

## Environmental Regulation.

Environmental remediation activities and other environmental risks are highly regulated by both federal and state governments. Environmental regulation continually is evolving and changes in the regulatory patterns at federal and state levels may have a significant effect upon potential claims against the Company. Such changes may also affect the demand for the types of insurance offered by and through the Company and the availability or cost of reinsurance. The Company is unable to predict what additional laws and regulations, if any, affecting environmental remediation activities and other environmental risks may be promulgated in the future or how they might be interpreted.

## Potential Risk of United States Taxation of Bermuda Operations

Bermuda's tax laws are more favorable to American Safety, a Bermuda company, and its Bermuda reinsurance subsidiary, American Safety Re, than the United States' tax laws because these Bermuda companies are not obligated to pay any taxes in Bermuda based upon income or capital gains. If the Company's Bermuda-based operations were determined to be subject to United States taxation, the Company's results of operations could be materially adversely affected. The United States Internal Revenue Code of 1986, as amended, does not contain a definitive identification of activities that constitute being engaged in a United States trade or business, and the possibility exists that the Internal Revenue Service will take the position that the Company's Bermuda-based operations are engaged in a United States trade or business and therefore are subject to United States income taxation. The Company, exclusive of its U.S. subsidiaries, does not consider itself to be engaged in a trade or business in the United States and accordingly does not expect to be subject to United States income taxation. The Company's U.S. subsidiaries are subject to United States taxation.

## Item 2. Properties

The Company's Bermuda offices are located at 44 Church Street, Hamilton, Bermuda, and the telephone number is (441) 296-8560. The principal offices of the Company's U.S. subsidiaries are located at 1845 The Exchange, Suite 200, Atlanta, Georgia 30339, and the telephone number is (770) 916-1908.

## Item 3. Legal Proceedings

The Company, through its subsidiaries, is routinely a party to pending or threatened litigation in the normal course of or related to its business. Based upon information presently available, in view of legal and other defenses available to the Company's subsidiaries, management does not believe that any pending or threatened litigation or disputes will have any material adverse effect on the Company's financial condition except for the following matters.

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Principal Management, Inc. et al. In January 2000, the Company acquired (i) the stock of L&W Holdings, Inc. and its wholly-owned subsidiary, RCA Syndicate #1, Ltd., an Illinois licensed insurer operating on the INEX (formerly the Illinois Insurance Exchange), (ii) the stock of Principal Management, Inc., an insurance program development and management company headquartered in Okemos, Michigan, and in a related transaction, the Company also acquired (iii) the stock of Pegasus Insurance, a Cayman Islands licensed insurer. The transactions were structured as stock acquisitions, with the purchase price payable by the Company consisting of \$3,500,000 plus 200,000 American Safety common shares and earnout provisions for up to an additional 254,000 American Safety common shares over a five-year period. Of the purchase price, \$1,000,000 of cash and 109,086 shares of stock are held by the Company in escrow to secure the obligations of the sellers.

When RCA Syndicate #1, Ltd. filed its 1999 Annual Statement with the Illinois Department of Insurance in March 2000, the Company first became aware that there had been a material adverse change in the business affairs and financial condition of the acquired companies from that represented by the sellers. The Company launched an



investigation which disclosed that the insurance claims experience of the acquired companies had been misrepresented and that incurred losses from insurance claims were significantly in excess of the amounts reported in their claims records and their financial statements. As a result, the Company then made written demand upon the selling shareholders of the acquired companies for rescission of the acquisitions, including a return of the purchase price paid for the companies. The Company filed a lawsuit in April 2000 in the United States District Court for the Northern District of Georgia for damages and, alternatively, to rescind the acquisitions based upon the sellers' breach of the representations and warranties made concerning the business affairs and financial condition of the acquired companies. The sellers' misrepresentations as to the business affairs and financial condition of the acquired companies, and the under-reserving for claims, relate only to the operations of the acquired companies. The sellers/defendants filed several motions for summary judgment opposing the Company's rescission claims. In September 2002, the Court entered an order granting the defendants' motions for summary judgment. However, the Court did not rule that the representations and warranties of the defendants in the definitive agreements were correct. The Court also granted the Company's motions for summary judgment on various counterclaims. The Company filed a motion for reconsideration with respect to the Court's order which the Court denied in November 2002. The case will now proceed to trial or the Court may allow additional summary judgment motions to be filed in order to dispose of the case. Thereafter, the Company will have the right to appeal all adverse prior rulings in the case.

Berkley Insurance Company. During the fourth quarter of 2001, one of the Company's former reinsurers, Berkley Insurance Company, disputed its obligations under several reinsurance treaties entered into during the soft reinsurance market that existed in 1998 and 1999. As a result of adverse loss experience to the reinsurer from certain lines of business, Berkley has stopped reimbursing the Company for amounts due under such treaties and requested that the Company retroactively consider taking a greater portion of the losses than is required under the treaties or, alternatively, to rescind and reform portions of certain treaties. The Company instituted arbitration proceedings against the reinsurer and the arbitration hearing is scheduled for late May 2003. Berkley is a subsidiary of W.R. Berkley Corp. (NYSE:BER). As of December 31, 2002, unreimbursed paid claims under the treaties totaled \$14.9 million and additional ceded case reserves and reserves for incurred but not reported losses totaled approximately \$19.6 million. The Company is discussing resolution of this matter with Berkley, although the Company believes the reinsurer's request has no merit and was made in bad faith. The Company recognized a \$1.1 million expense in 2002 for reinsurance recoverables relating to the Berkley dispute. The Company does not believe this dispute will have a material adverse effect on the overall financial condition or liquidity of the Company as management believes the Company has sufficient current cash flows and invested assets to meet its insurance obligations. However, due to the fact that the final decision rests in the hands of an arbitration panel, it is uncertain whether the panel's decision will be on terms favorable to the Company.

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Harbour Village Zoning. On March 2, 2002, the Town of Ponce Inlet filed a petition for declaratory relief in the Circuit Court of Volusia County, Florida seeking clarification that the Company could not construct a building higher than 35 feet on its beachfront parcels in the last phase of the Harbour Village project, although the Town had permitted 30 other buildings in the Town over 35 feet in height, including 10 at the Harbour Village project. The Company's position was that the Town's 1984 ordinance and subsequent development agreements permitted it to construct a beachfront building of up to 70 feet in height in the Harbour Village project. On March 17, 2003, the Court found that a 1983 Town charter amendment limited all buildings in the Town of Ponce Inlet to 35 feet and accordingly ruled that all ordinances and development agreements of the Town adopted since the 1983 charter amendment were beyond the scope of the Town's authority (i.e., *ultra vires*).

The Company immediately filed a motion for rehearing and upon rehearing on April 11, 2003, the Court vacated its original ruling and issued a new ruling which limited construction of a building no higher than 35 feet on the beachfront parcels. In connection with the rehearing, the Company and the Town of Ponce Inlet agreed to settle pending disputes as to the Company's development plan for the last phase of Harbour Village project and to release all claims against each other. Under the settlement, the Company would (i) continue construction of the 7 story buildings

in the Links phase (containing 376 units), (ii) build not more than a 3 story building with condominium units or a beach club on the beachfront parcels, (iii) reduce the Fisherman's Harbour building to a 2 or 3 story commercial center rather than a mixed use 7 story building (planned for 70 units), and (iv) make other accommodations including the payment of \$500,000 to the Town.

These changes in the Company's development plans would reduce the size of the Harbour Village project from 809 to 676 condominium units. As a result, the Company has reallocated the common and land costs of the Harbour Village project over such reduced number of condominium units, which resulted in an increase to the net loss for the fourth quarter of 2002 of \$229,000 from the development of the Harbour Village project.

#### **Item 4. Submission of Matters to a Vote of Security Holders**

No matter was submitted to a vote of the Company's security holders during the fourth quarter of the fiscal year ended December 31, 2002.

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### **Management of the Company**

The following table provides information regarding the management of the Company. Biographical information for each of such persons is set forth immediately following the table.

<b>Name</b>	<b>Age</b>	<b>Position</b>
Stephen R. Crim .....	39	President, Chief Executive Officer
Joseph D. Scollo, Jr.....	39	Executive Vice President
Fred J. Pinckney .....	55	General Counsel and Secretary
Steven B. Mathis .....	35	Chief Financial Officer
J. Jeffrey Hood .....	39	Senior Vice President-Technical Services
Gary J. Campbell .....	36	Vice President-Finance

*Stephen R. Crim* became President and Chief Executive Officer of the Company on January 1, 2003 and he became President of the Company's insurance and reinsurance operations effective January 1, 2002. Previously, Mr. Crim had been responsible for all underwriting functions since joining the Company in 1990. Previously, Mr. Crim was employed in the underwriting department of Aetna Casualty and Surety and The Hartford Insurance Co. between 1986 and 1990. Mr. Crim has 17 years experience in the insurance industry. Mr. Crim received a bachelors degree in mathematics from the Indiana University in 1986.

*Joseph D. Scollo, Jr.* became Executive Vice President of the Company on January 1, 2003 and was Senior Vice President of Operations since November 1998. Previously, Mr. Scollo served as senior vice president-operations of United Coastal Insurance Company, New Britain, Connecticut since 1989. Mr. Scollo has 15 years experience in the insurance industry. Mr. Scollo received a bachelor of science degree in business from Western New England College in 1985 and is a certified public accountant.

*Fred J. Pinckney* became General Counsel and Secretary of the Company in October 1997. Previously, Mr. Pinckney was an attorney for 25 years in Atlanta, Georgia, where his practice centered on securities and corporate matters. He was involved as special legal counsel in the formation of American Safety in 1986 and acted as outside

legal counsel to the Company prior to joining the Company. Mr. Pinckney received a juris doctor degree from the University of Michigan Law School in 1973 and a bachelor of arts degree in political science from the University of Pittsburgh in 1969.

*Steven B. Mathis* became Chief Financial Officer of the Company in August 1998. Previously he was the Company's controller since 1992 and he is currently responsible for all accounting and treasury functions of the Company. Mr. Mathis has 14 years accounting experience in the insurance industry having held accounting positions with American Insurance Managers, Inc. and American Security Group. Mr. Mathis received a bachelor of business administration degree in accounting from the University of Georgia in 1989.

*J. Jeffrey Hood* is Senior Vice President-Technical Services of ASI Services and is responsible for loss control, claims, regulatory and information technology and regulatory matters. Prior to joining the Company in 1990, Mr. Hood served as a consultant for a national technical engineering firm for four years. Mr. Hood received a bachelor of science degree in petroleum engineering from Mississippi State University in 1985. Mr. Hood has 16 years of experience relating to risk management in the environmental remediation industry.

*Gary J. Campbell* became Vice President-Finance of the Company in July 2001. Previously, Mr. Campbell was a Senior Account Executive for Mutual Risk Management Ltd. for four years in Bermuda. From 1991 to 1997, Mr. Campbell was an audit senior in the Chartered Accounting firm of Withy Addison in Mississauga, Canada. Previously, he worked for two years in audit with Ernst & Young in Mississauga, Canada. Mr. Campbell obtained his Chartered Accounting designation in 1996 and passed the CPA United States Reciprocity Exam in 2002. Mr. Campbell received a bachelor's degree in business from the University of Western Ontario in Canada in 1989.

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## PART II

### Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters

The Company's common shares commenced trading on the National Association of Security Dealers, Inc.'s National Market on February 13, 1998 as a result of the Company's completion of its initial public offering. On February 5, 1999, the Company's common shares were listed and traded on the New York Stock Exchange, Inc. under the symbol "ASI" and the Company's prior listing on the National Association of Security Dealers, Inc.'s National Market ceased. As of March 26, 2003, there were approximately 2,200 holders of the Company's common shares.

The following table sets forth the high and low prices per share of the Company's common shares for the periods indicated.

<u>Fiscal Year Ended December 31, 2001</u>	<u>High</u>	<u>Low</u>
First Quarter	\$ 9.10	\$ 5.75
Second Quarter	10.25	7.95
Third Quarter	10.35	8.80
Fourth Quarter	9.65	8.80
<u>Fiscal Year Ended December 31, 2002</u>	<u>High</u>	<u>Low</u>
First Quarter	\$ 9.32	\$ 8.27
Second Quarter	8.98	7.73
Third Quarter	8.80	7.76
Fourth Quarter	7.75	5.80

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The Company issued four quarterly cash dividend of \$0.12 per common share to shareholders of record during fiscal year 2002. Future cash dividends will be periodically reviewed by the Board of Directors. As an insurance holding company, the Company's ability to pay cash dividends to its shareholders will depend, to a significant degree, on the ability of the Company's subsidiaries to generate earnings from which to pay cash dividends to American Safety. The jurisdictions in which American Safety and its insurance and reinsurance subsidiaries are domiciled place limitations on the amount of dividends or other distributions payable by insurance companies in order to protect the solvency of insurers. The Company's current plans are for its insurance and reinsurance subsidiaries to principally retain their capital for growth.

### Item 6. Selected Financial Data

The following table sets forth selected consolidated financial data with respect to the Company for the periods indicated. The balance sheet and income statement data have been derived from the audited financial statements of the Company. This information should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Company's consolidated financial statements and notes thereto included elsewhere in this Report.

	<u>Year Ended December 31,</u>			
	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>
	(In thousands, except per share and ratio data)			
Income Statement Data:				
Revenues:				
Direct and assumed premiums earned	\$ 13,114	\$18,140	\$54,078	\$146,765
Ceded premiums earned	<u>(3,994)</u>	<u>(6,015)</u>	<u>(27,373)</u>	<u>(83,796)</u>
Net premiums earned	9,120	12,125	26,705	62,969
Net investment income	2,847	2,878	2,605	3,650
Interest on notes receivable	2,409	2,614	1,531	767
Brokerage commission income	1,183	1,389	3,291	2,411
Management fees from affiliate	1,344	1,386	1,425	1,496
Net realized gains (losses)	443	174	(518)	652
Real estate income	-	-	-	27,561
Other income	<u>24</u>	<u>921</u>	<u>939</u>	<u>1,026</u>
Total revenues	<u>17,370</u>	<u>21,487</u>	<u>35,979</u>	<u>100,532</u>
Expenses:				
Losses and loss adjustment expenses incurred	5,177	6,896	18,506	43,986
Acquisition expenses	1,192	894	3,693	10,431
Real estate expenses	-	-	-	25,126
Other expenses	5,246	7,694	12,758	15,074
Expenses due to rescission	<u>-</u>	<u>-</u>	<u>3,542</u>	<u>600</u>
Total expenses	<u>11,615</u>	<u>15,484</u>	<u>38,499</u>	<u>95,217</u>
Earnings (loss) before income taxes	5,755	6,003	2,520	5,315
Income Taxes	<u>(199)</u>	<u>83</u>	<u>(1,157)</u>	<u>1,161</u>
Net earnings (loss)	\$ 5,954	\$5,920	\$ (1,363)	\$ 4,154
Net diluted earnings (loss) per share	=====	=====	=====	=====
Common shares and common share equivalents used in computing net diluted earnings per share	\$ 1.04	\$ 0.98	\$ (0.25)	\$ 0.84
	5,738	6,032	5,497	4,935
GAAP Ratios:				
Loss and loss adjustment expense ratio	56.8%	56.9%	69.3%	69.9%

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Expense Ratio	23.9	16.7	18.2	22.6
Combined ratio	80.7%	73.6%	87.5%	92.5%
Net premiums written to equity	0.2x	0.3x	0.7x	1.3x
Statutory Ratios:				
Loss and loss adjustment expense ratio	56.8%	56.9%	69.3%	69.9%
Expense Ratio	22.6	14.0	11.7	18.7
Combined ratio	79.4%	70.9%	81.0%	88.6%
Balance Sheet Data (at end of period)				
Total investments	\$ 51,048	\$ 59,648	\$ 91,247	\$ 83,57
Total assets	86,147	104,107	207,298	297,26
Unpaid losses and loss adjustment expenses	14,700	20,413	50,509	121,42
Total liabilities	26,878	42,978	149,495	237,28
Total shareholders' equity	59,269	61,039	57,803	59,98

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## Item 7. Management's Discussion and Analysis of Results of Operations and Financial Condition

The information in the following discussion is presented on the basis of accounting principles generally accepted in the United States of America ( GAAP ) and should be read in conjunction with the Company s consolidated financial statements and notes thereto included elsewhere in this Report. All amounts and percentages are rounded:

### Results of Operations

The following table sets forth the Company's consolidated revenues:

	Year Ended December 31,			2000
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>200</u>
	(In thousands)			
Net Premiums earned:				
Reinsurance:				
Workers' Compensation	\$ 11,151	\$ 12,657	\$ 1,617	
General Liability	5,479	9,707	5,988	
Program Business	<u>-</u>	<u>396</u>	<u>204</u>	
Total reinsurance	<u>16,630</u>	<u>22,760</u>	<u>7,809</u>	
Primary Insurance:				
Commercial Lines	2,638	4,197	772	
Workers' Compensation	249	6,376	7,365	
Surety	4,539	5,916	1,158	
General Liability	845	18,423	42,740	
Program Business	<u>1,804</u>	<u>5,297</u>	<u>6,105</u>	

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Total primary insurance	<u>10,075</u>	<u>40,209</u>	<u>58,140</u>
Total net premiums earned	<u>26,705</u>	<u>62,969</u>	<u>65,949</u>
Net Investment Income	2,605	3,650	4,016
Interest on notes receivable	1,531	767	-
Commission and fee income:			
Brokerage commission income	3,292	2,411	143
Management fees from affiliates	<u>1,425</u>	<u>1,496</u>	<u>1,183</u>
Total commission and fee income	<u>4,717</u>	<u>3,907</u>	<u>1,326</u>
Net realized gains (losses)	(518)	652	710
Real estate income	-	27,561	51,780
Other income	<u>939</u>	<u>1,026</u>	<u>186</u>
Total Revenues	\$ <u>35,979</u>	\$ <u>100,532</u>	\$ <u>123,967</u>

The following table sets forth the components of the Company's statutory combined ratio

	<u>2000</u>	<u>2001</u>
Insurance Operations		
Loss & Loss Adjustment Expense Ratio	69.3%	69.9%
Expense Ratio	<u>11.7</u>	<u>18.7</u>
Combined Ratio	81.0%	88.6%
	=====	=====

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**Year Ended December 31, 2002 to Year ended December 31, 2001**

*Net Premiums Earned.* Net premiums earned are that portion of net premiums written which applies to the expired portion of the policy period. Net premiums earned increased 4.7% from \$63 million in 2001 to \$65.9 million in 2002. The principal factors accounting for the increase were an increase in general liability primary premiums of \$24.3 million and an increase in program business premiums of \$808,000. These increases were partially offset by a decrease in net premiums earned for workers compensation, general liability reinsurance, commercial lines and surety of 56.5% from \$38.9 million in 2001 to \$16.9 million in 2002. These results were in line with the Company's strategy to focus on its more profitable lines of insurance business.

*Net Investment Income.* Net investment income increased 10% from \$3.7 million in 2001 to \$4.0 million in 2002 due to higher levels of invested assets generated from positive cash flows from operations. The average annual pre-tax yield on investments was 5% in 2001 and 4.3% in 2002. The average annual after-tax yield on investments was 3.7% in 2001 and 3.2% in 2002.

*Interest from Notes Receivable.* Interest from notes receivable decreased 100% from \$767,000 in 2001 to \$0 in 2002 due to the impairment of two loans. During 2001, the Company ceased accruing interest for accounting purposes on two impaired loans with one borrower in accordance with its accounting policies. Average notes receivable have decreased to \$7.4 million from \$8.5 million. The average annual pretax yield on notes receivable was 9% and 0% in 2001 and 2002, respectively.

*Brokerage Commission Income and Management Fees.* Income from insurance brokerage operations and management fees decreased 66.1% from \$3.9 million in 2001 to \$1.3 million in 2002. This decrease is the result of a change in the manner fees are realized from the Company's risk retention group affiliate. Previously, the risk retention group affiliate paid a fixed management fee plus a commission based on a percentage of the premiums produced.

Effective January 1, 2002, the risk retention group pays fees based on its portion of costs allocated against its portion of premiums written. This change was implemented to coincide with the creation of an internal pooling agreement between the Company (including its subsidiaries) and the risk retention group. The result of this change will initially lower the commission income and management fees paid to the Company by the risk retention group affiliate, but the net premiums earned retained by the Company will increase which the Company will earn as revenue over the life of the underlying policies as opposed to earning the commissions and fees at the time such policies are written.

*Net Realized Gains.* Net realized gains from the sale of investments increased from a gain of \$652,000 in 2001 to a gain of \$710,000 in 2002. These gains were primarily realized from the sale of bonds in the Company's investment portfolio.

*Real Estate Income.* Real estate sales at the Harbour Village project increased 87.9% from \$27.6 million in 2001 to \$51.8 million in 2002. The sales in 2002 were realized from the closing of 160 condominium units and 62 boat slips and the sales in 2001 were realized from the closing of 102 condominium units and 59 boat slips. See Exhibit 99 for further information regarding Harbour Village.

*Other Income.* Other income decreased 81.9% from \$1 million in 2001 to \$186,000 in 2002 as a result of reduced fees earned by our financial services subsidiary. During 2001, the Company discontinued this financial services business.

*Losses and Loss Adjustment Expenses.* Loss and loss adjustment expenses decreased 13% from \$44 million in 2001 to \$38.3 million in 2002 as a result of decreased net premiums earned in commercial lines, surety and workers compensation lines of insurance business and a refocusing of the Company's strategy to concentrate on more profitable lines of business, which caused the loss ratio to decrease from 70% in 2001 to 58% in 2002.

*Acquisition Expenses.* Policy acquisition expenses increased from \$10.4 million in 2001 to \$12.5 million in 2002 as a result of increased net earned premiums in the general liability line of business and a change in the reinsurance arrangement between the Company and its risk retention group affiliate.

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*Payroll and Other Expenses.* Payroll and other expenses increased 30.1% from \$15.1 million in 2001 to \$19.6 million in 2002 due to higher payroll and legal expenses, a \$2.5 million impairment charge to notes receivable, and a \$1.1 million expense of reinsurance recoverables. The \$2.5 million charge for impairment to notes receivable is the result of the Company obtaining an updated appraisal, which shows a decrease in the market value of the property due to current economic conditions, for the collateral supporting the loans. The \$1.1 million expense in 2002 of reinsurance recoverables relates to the Berkley arbitration dispute, and is in recognition of a settlement offer that the Company made to Berkley. See Item 3. Legal Proceedings with respect to the Company's pending material arbitration dispute with Berkley.

*Real Estate Expenses.* Real estate expenses associated with Harbour Village increased from \$25.1 million in 2001 to \$48.5 million in 2002. Of the \$48.5 million of costs recognized during 2002, \$44.1 million of the costs were previously capitalized variable costs related to the sale of condominium units and boat slips, and the remaining \$4.4 million were fixed costs of the project, which includes the \$0.5 million for the Town of Ponce Inlet as part of the settlement of material zoning litigation described in Item 3 of this Report. Of the \$25.1 million of costs recognized during 2001, \$23.5 million of the costs were previously capitalized variable costs related to the sale of condominium units and boat slips, and the remaining \$1.6 million were fixed costs of the project. See Exhibit 99 for further information regarding Harbour Village.

*Expense due to Rescission.* Expense due to rescission litigation was \$1.6 million in 2002 as compared to \$600,000 in 2001. Of the \$1.6 million of expense recognized, \$565,000 was for legal fees, and \$1 million was related

to amounts held in escrow for the acquisition as a result of the Court's granting of defendants' summary judgment motions in part of the lawsuit.

*Income Taxes.* Federal and state income tax expense was \$919,000 in 2002 as compared to \$1.2 million in 2001. The effective tax rate increased to 27% for 2002 from 22% in 2001. This increase is a result of higher levels of taxable income in the Company's insurance and real estate subsidiaries.

*Total Earnings.* Net earnings after tax decreased 40.2% to \$2.5 million in 2002 from \$4.2 million in 2001. The decrease in net earnings is primarily due to the impairment of notes receivable, reinsurance recoverable write-offs relating to the Berkley dispute, and increased rescission expense.

#### **Year Ended December 31, 2001 to Year ended December 31, 2000**

*Net Premiums Earned.* Net premiums earned increased 135.8% from \$26.7 million in 2000 to \$63.0 million in 2001. The principal factors accounting for the increase were an increase of general liability reinsurance premiums of \$4.2 million, an increase in workers' compensation primary premiums of \$6.1 million, an increase in general liability primary premiums of \$17.6 million, an increase in commercial lines premiums of \$2.6 million, and an increase in program business premiums of \$3.9 million.

*Net Investment Income.* Net investment income increased 40.1% from \$2.6 million in 2000 to \$3.7 million in 2001 as a result of increased levels of invested assets generated from increased cash flows from operations. The average annual pre-tax yield on investments was 4.8% in 2000 and 5% in 2001. The average annual after-tax yield on investments was 4.0% in 2000 and 3.7% in 2001.

*Interest from Notes Receivable.* Interest from notes receivable decreased 49.9% from \$1.5 million in 2000 to \$800,000 in 2001 principally from repayment of various loans. Average notes receivable have decreased from \$10.9 million in 2000 to \$8.5 million in 2001. The average annual pretax yield on notes receivable was 14.1% and 9.0% in 2000 and 2001, respectively. The Company ceased accruing interest on two impaired loans with one borrower in accordance with its accounting policies.

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*Brokerage Commission Income.* Income from insurance brokerage operations decreased 26.7% from \$3.3 million in 2000 to \$2.4 million in 2001 due to reduced levels of insurance premiums being produced through the Company's risk retention group affiliate, and increased levels of insurance premiums being produced by the Company's excess and surplus lines carrier insurance company (which are not recognized as brokerage commission income).

*Management Fees.* Management fees received from the Company's risk retention group affiliate increased 5% from \$1.43 million in 2000 to \$1.5 million in 2001 and is consistent with the prior year.

*Net Realized Gains.* Net realized gains (losses) from the sale of investments increased from a loss of \$518,000 in 2000 to a gain of \$652,000 in 2001. These gains were primarily realized from the sale of bonds in the Company's investment portfolio.

*Real Estate Income.* Real estate sales at the Harbour Village project were \$27.6 million in 2001. These sales were realized from the closing of 102 condominium units and 59 boat slips in 2001. See Exhibit 99 included in this Report for further information regarding Harbour Village.

*Losses and Loss Adjustment Expenses.* Loss and loss adjustment expenses increased 137.7% from \$18.5 million in 2000 to \$44.0 million in 2001 due to an increase in net premiums earned and increases in surety and commercial lines reserves.



*Acquisition Expenses.* Acquisition expenses increased from \$3.7 million to \$10.4 million as a result of increased net earned premiums. Premium tax expense also increased to \$3.7 million from \$948,000 due to higher volumes of direct premiums earned.

*Payroll and Other Expenses.* Payroll and other expenses increased 23.4% from \$12.2 million in 2000 to \$15.1 million in 2001 due to increases in payroll and litigation costs, expense of certain workers' compensation receivables, and costs associated with the Company's discontinued financial service subsidiary.

*Real Estate Expenses.* Real estate expenses associated with Harbour Village increased from \$542,000 in 2000 to \$25.1 million in 2001. Of the costs recognized in 2001, \$20.7 million were previously capitalized variable costs related to the sale of the condominium units and boat slips, and the remaining \$721,000 of expenses were fixed costs of the project, including advertising and other administrative costs. See Exhibit 99 included in this Report for further information regarding Harbour Village.

*Expense due to Rescission.* Expense due to rescission litigation was \$600,000 for 2001, as compared to \$3.5 million in 2000, which is associated with the rescission of the previously acquired Michigan agency and two related insurance companies.

*Income Taxes.* Federal and state income taxes increased from a benefit of \$1.2 million in 2000 to an expense of \$1.2 million in 2001 as a result of increased levels of income in the Company's U.S. insurance and real estate subsidiaries.

*Total Earnings.* Net earnings after tax increased 404.8% to a profit of \$4.2 million for 2001 from a loss of \$1.4 million for 2000. This increase in net earnings is due to increases in insurance and real estate income. Another reason for the increase is a reduction in rescission expenses in 2001 as compared to 2000.

## **Liquidity and Capital Resources**

The Company historically has met its cash requirements and financed its growth principally through cash flows generated from operations. During the past decade, the Company has operated in a soft market cycle which was characterized by excess insurance capacity and declining insurance premium rates; however, commencing in fiscal year 2000 the Company has operated in a hardening market with increased insurance premium rates for workers compensation and excess and surplus lines. The Company's primary sources of cash flow are proceeds from the sale or maturity of invested assets, premiums written, investment income, income from real estate development sales, commission income, management fees and reinsurance recoverables from reinsurers. The Company's short-term cash requirements are primarily for claims payments, reinsurance premiums, commissions, salaries, employee benefits, real estate development expenses, other operating expenses, and the purchase of investment securities, which have historically been satisfied from operating cash flows. Due to the uncertainty regarding settlement of unpaid claims, the long-term liquidity requirements of the Company may vary, and the Company has attempted to structure its investment portfolio to take into account the historical payout patterns. The Company also purchases reinsurance to mitigate the effect of large claims and to help stabilize demands on its liquidity. Notwithstanding the Company's dispute with one of its former reinsurers, Berkley Insurance Company, as described in Item 3. of this Report, management believes that the Company's current cash flows are sufficient for the short-term needs of its insurance business and the Company's invested assets are sufficient for the long-term needs of its insurance business.

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As discussed in Item 3. Legal Proceedings, the Company has a pending material dispute with Berkley Insurance Company, one of the Company's former reinsurers, with respect to unreimbursed paid claims under treaties totaling \$14.9 million and additional ceded case reserves and reserves for incurred but not reported losses totaling approximately \$19.6 million as of December 31, 2002. The Company recognized a \$1.1 million expense in 2002 for

reinsurance recoverables relating to the Berkley dispute as a result of a settlement offer made by the Company. The Company does not believe this dispute will have a material adverse effect on the overall financial condition or liquidity of the Company as management believes the Company has sufficient current cash flows and invested assets to meet its insurance obligations. However, due to the fact that the final decision rests in the hands of an arbitration panel, it is uncertain whether the panel's decision will be on terms favorable to the Company.

On a consolidated basis, net cash provided from operations was \$28.1 million for the twelve months ended December 31, 2001 and \$34.3 million as of December 31, 2002. The positive cash flows for said periods were primarily attributable to net premiums written, net earnings and sales of real estate. Because workers' compensation and general liability claims may be paid over an extended period of time, the Company has established loss reserves for such lines of business. The assets supporting the Company's reserves continue to earn investment income until claims payments are made.

Total assets increased from \$297.3 million at December 31, 2001 to \$365.4 million at December 31, 2002 primarily due to increases in invested assets, cash and reinsurance recoverables. Cash, invested assets and notes receivable increased from \$130.6 million at December 31, 2001 to \$174.3 million at December 31, 2002, as a result of increases in fixed maturities and cash. At December 31, 2002, the Company has repurchased 1,612,189 shares of its common stock at a total cost of \$9.7 million since January 1999.

American Safety is an insurance holding company whose principal assets are its investment portfolio and its investment in the capital stock of its subsidiaries. American Safety's ability to pay dividends to its shareholders will depend, to a significant degree, on the ability of the Company's subsidiaries to generate earnings from which to pay dividends to American Safety. The jurisdictions in which American Safety and its insurance and reinsurance subsidiaries are domiciled place limitations on the amount of dividends or other distributions payable by insurance companies in order to protect the solvency of insurers.

Management has planned that the Harbour Village project would be developed in three Phases with projected completion in 2005. Through December 31, 2002, the Company had outstanding borrowings of \$17.0 million from an initial \$37 million development and construction loan facility. The estimated completion cost for the remainder of the Harbour Village project was approximately \$67.5 million at December 31, 2002. See Item 3. Legal Proceedings with respect to the settlement of material zoning litigation involving the Harbour Village project. See Exhibit 99 for further information regarding Harbour Village.

### **Critical Accounting Policies**

The accounting policies described below are those the Company considers critical in preparing its financial statements. These policies include significant estimates made by management using information available at the time the estimates are made. However, as described below, these estimates could change materially if different information or assumptions were used. The descriptions below are summarized and have been simplified for clarity. A more detailed description of the significant accounting policies used by the Company in preparing its financial statements is included in Note (1) of Notes to the Consolidated Financial Statements.

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*Reinsurance.* One of the Company's former reinsurers, Berkley Insurance Company, has disputed its obligations under several reinsurance treaties entered into during the "soft reinsurance market" that existed in 1998 and 1999. As of December 31, 2002, unreimbursed paid claims totaled \$14.9 million and additional ceded case and incurred but not reported reserves totaled approximately \$19.6 million. A reserve of \$1.1 million for this dispute has been established because of the conditions set forth in Statement of Financial Accounting Standards ("SFAS") No. 5, Accounting for Contingencies. If any of these factors change in the future, the Company may have to establish additional reserves at that time, which could be material. See Item 3. "Legal Proceedings" for a discussion of the Company's pending

material reinsurance recoverables dispute with Berkley Insurance Company, one of the Company's former reinsurers.

*Unpaid Losses Loss Adjustment Expenses.* The Company is required to estimate its liability for loss and loss adjustment expenses. The estimated liability for unpaid losses and loss adjustment expenses recorded on the Company's balance sheet at the end of any given period should be adequate to cover all future payments required to be made on account of insured events that occurred on or before the balance sheet date. However, because the future cannot be predicted with certainty, the actual future payments are usually different from the previously recorded estimates, and sometimes the differences may be material. These differences are included in the Company's results of operations in the future periods in which they become known.

*Deferred Income Taxes.* The Company is required to establish a valuation allowance for the portion of any deferred tax asset, which amounted to \$7.4 million at December 31, 2002, that management believes will not be realized. The Company believes that it is more likely than not that the Company will realize the full benefit of its deferred tax assets in future periods. Accordingly, no valuation allowance has been established.

*Construction Accounting.* The Company recognizes revenue on Harbour Village, its real estate development project, when title to each condominium unit and boat slip transfers to the purchaser. When title transfers, the Company uses a percentage of completion method based on actual costs to total estimated costs (including allocated common costs) to recognize revenue. The estimated future common costs of amenities at December 31, 2002 were \$2.0 million, of which \$836,000 related to condominium units that were closed in 2002. The percentage of completion method is based upon future estimated costs, and actual costs may vary greatly from these estimated costs requiring an adjustment to be recorded in future periods.

### ***Income Taxes***

American Safety is incorporated under the laws of Bermuda and, under current Bermuda law, is not obligated to pay any taxes in Bermuda based upon income or capital gains. American Safety has received an undertaking from the Minister of Finance in Bermuda pursuant to the provisions of The Exempted Undertakings Tax Protection Act 1966, which exempts American Safety and its shareholders, other than shareholders ordinarily resident in Bermuda, from any Bermuda taxes computed on profits, income or any capital asset, gain or appreciation, or any tax in the nature of estate, duty or inheritance until March 28, 2016. The Company, exclusive of its United States subsidiaries, does not consider itself to be engaged in a trade or business in the United States and accordingly does not expect to be subject to direct United States income taxation. The Company's U.S. subsidiaries are subject to taxation in the United States.

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### ***Impact of Inflation***

Property and casualty insurance premiums are established before the amounts of losses and loss adjustment expenses are known and therefore before the extent by which inflation may affect such expenses is known. Consequently, the Company attempts, in establishing its premiums, to anticipate the potential impact of inflation. However, for competitive and regulatory reasons, the Company may be limited in raising its premiums consistent with anticipated inflation, in which event the Company, rather than its insureds, would absorb inflation costs. Inflation also affects the rate of investment return on the Company's investment portfolio with a corresponding effect on the Company's investment income.

### ***Combined Ratio***

The combined ratio of an insurance company measures only the underwriting results of insurance operations and not the profitability of the overall company. The Company's reported combined ratio for its insurance operations may not provide an accurate indication of the Company's overall profitability from insurance and reinsurance programs due

to the exclusion of fee and commission income and expenses generated in related management and agency subsidiaries. Depending on the Company's mix of business going forward, the combined ratio may fluctuate from time to time and may not reflect the overall profitability of the Company's insurance and reinsurance programs.

### ***Reserves***

Certain of the Company's insurance policies and reinsurance assumed, including general and pollution liability policies covering environmental remediation, excess and surplus, and workers' compensation risks, may be subject to claims brought years after an incident has occurred or the policy period has ended. The Company is required to maintain reserves to cover its estimated liability for losses and loss adjustment expenses with respect to reported and unreported claims incurred. The Company engages an independent internationally recognized actuarial consulting firm to provide reserve studies, rate studies, and opinions. Reserves are estimates at a given time, which are established from actuarial and statistical projections by the Company of the ultimate settlement and administration costs of claims occurring on or prior to such time, including claims that have not yet been reported to the insurer. The establishment of appropriate loss reserves is an inherently uncertain process, and there can be no assurance that the ultimate payments will not materially exceed the Company's reserves.

### ***Forward Looking Statements***

This Report contains forward-looking statements within the meaning of United States securities laws which are intended to be covered by the safe harbors created thereby. Such statements include the Company's estimations of future insurance claims and losses, and the Company's expectations with respect to the outcome of the Principal Management acquisition rescission litigation, the arbitration of the Berkley reinsurance recoverables dispute, and the future profitability and value of the Harbour Village real estate project, as reflected in the Company's consolidated financial statements and Exhibit 99 to this Report. In addition, all statements, other than statements of historical facts, included or incorporated by reference in this Report that address activities, events or developments that the Company expects or anticipates will or may occur in the future constitute forward-looking statements.

Forward-looking statements involve risks and uncertainties which may cause actual results to differ materially, and are subject to change based on various insurance industry factors, including, without limitation, competitive conditions in the insurance industry, levels of new and renewal insurance business, unpredictable developments in loss trends, adequacy and changes in loss reserves, timing or collectibility of reinsurance receivables, market acceptance of new coverages and enhancements, changes in reinsurance costs and availability, potential adverse decisions in litigation and arbitration proceedings, and changes in levels of general business activity and economic conditions. With respect to the development of the Harbour Village project, such forward-looking statements involve risks and uncertainties which may cause actual results to differ materially, and are subject to change based on various real estate development industry factors, including competitive housing conditions in the local market area, risks inherent in real estate development and new construction, increases in construction costs, construction delays, weather, zoning, litigation, changes in interest rates and the availability of mortgage financing for prospective purchasers of condominium units and boat slips, and changes in local and national levels of general business activity and economic conditions. An adverse outcome of the Principal Management acquisition rescission litigation or the arbitration of the Berkley reinsurance recoverables dispute would have a material adverse effect on the financial condition of the Company. See discussion in Item 3. of this Report as to these material matters.

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Although the Company believes that the assumptions underlying the forward-looking statements contained herein are reasonable, any of the assumptions could over time prove to be inaccurate and therefore, there can be no assurance that the forward-looking statements included in this Report will themselves prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by the Company or any other person that the objectives and

plans of the Company will be achieved. The Company expressly disclaims any obligation to update any forward-looking statements except as required by law.

### Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Market risk is the risk of economic losses due to adverse changes in the estimated fair value of a financial instrument as the result of changes in equity prices, interest rates, foreign exchange rates and commodity prices. The Company's Consolidated Balance Sheets includes assets whose estimated fair values are subject to market risk. The primary market risk to the Company is interest rate risk associated with investments in fixed maturities. The Company has no direct commodity or foreign exchange risk as of December 31, 2002. The estimated fair value of the Company's investment portfolio at December 31, 2002 was \$145.5 million, 71% of which was invested in fixed maturities and short-term investments, and 29% of which was invested in real estate.

#### *Interest Rate Risk*

The Company's fixed maturity investments and borrowings are subject to interest rate risk. Increases and decreases in interest rates typically result in decreases and increases in the fair value of these financial instruments.

Approximately three quarters of the Company's investable assets come from premiums paid by policyholders. These funds are invested predominantly in high quality corporate, government and municipal bonds with relatively short durations. The fixed maturity portfolio is exposed to interest rate fluctuations; as interest rates rise, their fair values decline and as interest rates fall, the fair value of the fixed maturity portfolio rises. The changes in the fair market value of the fixed maturity portfolio are presented as a component of shareholders' equity in accumulated other comprehensive income, net of taxes.

The Company works to manage the impact of interest rate fluctuations on its fixed maturity portfolio. The effective duration of the fixed maturity portfolio is managed with consideration given to the estimated duration of the Company's liabilities. The Company has investment policies which limit the maximum duration and maturity of the fixed maturity portfolio.

The table below summarizes the Company's interest rate risk and shows the effect of a hypothetical change in interest rates as of December 31, 2002. The selected hypothetical changes do not indicate what would be the potential best or worst case scenarios (dollars in thousands):

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<u>Fixed Maturity Investments</u>	Estimated Fair Value at December 31, 2002	Estimated Change in Interest Rate (bp=basis points)	Estimated Fair Value after Hypothetical Change in Interest Rate	Pe	Sh
Total Fixed Maturity	\$104,417	200bp decrease	\$113,181		
Investments (including		100bp decrease	108,757		
short-term investments)		100bp increase	99,909		
		200bp increase	95,485		

#### *Credit Risk*

The Company invests primarily in the debt securities markets, which exposes us to credit risk. Credit risk is a consequence of extending credit and/or carrying investment positions. We require that all securities be rated investment grade at the time of purchase. We use specific criteria to judge the credit quality and liquidity of our investments and use a variety of credit rating services to monitor these criteria. See discussion under "Investments" in Item 1 of this Report.

### **Item 8. Financial Statements and Supplementary Data**

The Company's consolidated financial statements required under this Item 8 are included as part of Item 14 of this Report.

### **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

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## **PART III**

### **Item 10. Directors and Executive Officers of the Registrant**

The information required by this Item 10 regarding directors and executive officers of the Company will be set forth in the Company's 2003 Proxy Statement which will be filed with the Securities and Exchange Commission pursuant to applicable regulations, and is hereby incorporated by this reference. Additional information required by this Item 10 with respect to executive officers is set forth in Item 4 of this Report.

### **Item 11. Executive Compensation**

The information required by this Item 11 regarding executive compensation will be set forth in the Company's 2003 Proxy Statement which will be filed with the Securities and Exchange Commission pursuant to applicable regulations, and is hereby incorporated by this reference.

### **Item 12. Security Ownership of Certain Beneficial Owners and Management**

The information required by this Item 12 regarding security ownership of certain beneficial owners and management of the Company will be set forth in the Company's 2003 Proxy Statement which will be filed with the Securities and Exchange Commission pursuant to applicable regulations, and is hereby incorporated by this reference.

### **Item 13. Certain Relationships and Related Transactions**

The information required by this Item 13 regarding certain relationships and related transactions of the Company will be set forth in the Company's 2003 Proxy Statement which will be filed with the Securities and Exchange Commission pursuant to applicable regulations, and is hereby incorporated by this reference.

### **Item 14. Controls and Procedures**

#### **Evaluation of Disclosure Controls and Procedures**

The Company's Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-14(c)) as of a date within ninety days before the filing of this Report, have concluded that, as of such date, our disclosure controls and procedures were adequate

and effective to ensure that material information relating to the Company (including consolidated subsidiaries) would be made known to them.

#### Changes in Internal Controls

There were no significant changes in our internal controls or in other factors that could significantly affect the Company's disclosure controls and procedures subsequent to the date of their evaluation, nor were there any significant deficiencies or material weaknesses in the Company's internal controls. As a result, no corrective actions were required or undertaken.

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### PART IV

#### Item 15. Exhibits, Financial Statements Schedules, and Reports on Form 8-K

##### (a) Financial Statements Schedules, and Exhibits

##### 1. Financial Statements

The following is a list of financial statements, together with reports thereon, filed as part of this Report:

- Independent Auditors' Report
- Consolidated Balance Sheets at December 31, 2001 and 2002
- ; Consolidated Statements of Operations for the Years Ended December 31, 2000, 2001 and 2002
- Consolidated Statements of Shareholders' Equity for the Years Ended December 31, 2000, 2001 and 2002
- Consolidated Statements of Cash Flow for the Years Ended December 31, 2000, 2001 and 2002
- Consolidated Statements of Comprehensive Earnings for the Years Ended December 31, 2000, 2001 and 2002
- Notes to Consolidated Financial Statements
- Selected Quarterly Financial Data

##### 2. Financial Statement Schedules

The following is a list of financial statement schedules filed as part of this Report:

<u>Schedule Number</u>	<u>Page</u>
- Schedule II - Condensed Financial Statements (Parent only)	—
- Schedule III - Supplemental Information	—
- Schedule IV - Reinsurance	—

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Other schedules have been omitted as they are not applicable to the Company, or the required information has been included in the financial statements and related notes.

3. Exhibits

The following is a list of exhibits required to be filed as part of this Report:

<u>Exhibit Number</u>	<u>Title</u>
<u>Number</u>	<u>Exhibit Title</u>
3.1*	Memorandum of Association of American Safety Insurance Group, Ltd.
3.2*	Form of Bye-Laws of American Safety Insurance Group, Ltd.
4.1*	Common Share Certificate
10.2*	Incentive Stock Option Plan
10.2 (a)****	First Amendment to Incentive Stock Option Plan
10.3*	Directors Stock Award Plan
10.4**	Lease Agreement between 1845 Tenants-In-Common (formerly known as Wind Exchange, L.L.C.) and American Safety Insurance Services, Inc. (formerly Environmental Management Services, Inc.) for office space in Atlanta,
10.5*	Program Management Agreement between Synergy Insurance Services, Inc. as American Safety Insurance Services, Inc.) and American Safety Risk Group, Inc.
10.5 (a)****	Amended and Restated Program Management Agreement between American Safety Insurance Services, Inc. and American Safety Risk Retention Group, Inc.
10.6****+	Employment Agreement between the American Safety Insurance Services, Inc. and Stephen R. Crim
10.7****+	Employment Agreement between Rivermar Contracting Company and Frederick Treadway
12.	Ratio of Earnings to Fixed Charges
21***	Subsidiaries of the Company
99	Harbour Village Development Status

\*Incorporated by reference to the Exhibits to Registrant's Amendment No. 1 to Registration Statement filed January 27, 1998 on Form S-1 (Registration No. 333-42749)

\*\*Incorporated by reference to the Exhibits to Registrant's Registration Statement filed December 19, 1997 on Form S-1 (Registration No. 333-42749)

\*\*\*Incorporated by reference to the Exhibits to Registrant's Annual Report filed April 1, 2002 on Form 10-K for the fiscal year ended December 31, 2001 (File No. 1-14795)

\*\*\*\*Incorporated by reference to the Exhibits to Registrant's Registration Statement filed September 25, 2002 on Form S-1 (Registration No. 333-10065)

+Management contract or compensatory plan or arrangement.

(b) Reports on Form 8-K:



The Company filed a Form 8-K dated October 23, 2002 regarding the Principal Management acquisition rescission litigation.

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## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized on April 15, 2003.

AMERICAN SAFETY INSURANCE GROUP, LTD.

By: /s/ Stephen R. Crim  
Stephen R. Crim  
President

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed by the following persons in the capacities indicated on April 15, 2003.

Signature	Title
<u>/s/ Stephen R. Crim</u> Stephen R. Crim	President and Director (Principal Executive Officer)
<u>/s/ Steven B. Mathis</u> Steven B. Mathis	Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)
<u>/s/ Frederick C. Treadway</u> Frederick C. Treadway	Chairman of the Board of Directors
<u>/s/ Cody W. Birdwell</u> Cody W. Birdwell	Director
<u>/s/ David V. Brueggen</u> David V. Brueggen	Director
<u>/s/ William O. Mauldin</u> William O. Mauldin, Jr.	Director
<u>/s/ Thomas W. Mueller</u> Thomas W. Mueller	Director
<u>/s/ Jerome D. Weaver</u> Jerome D. Weaver	Director

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Certification Pursuant to §-302 of the Sarbanes-Oxley Act of 2002

I, Stephen R. Crim, certify that:

1. I have reviewed this Annual Report on Form 10-K of American Safety Insurance Group

2. Based on my knowledge, this Annual Report does not contain any untrue statements or omissions of a material fact necessary to make the statements made, in light of the circumstances known at the time they were made, not misleading with respect to the period covered by this Annual Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Annual Report, fairly present in all material respects the financial condition, results of operations, and cash flows of the Registrant as of, and for, the periods presented in this Annual Report;
4. The Registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the Registrant and its consolidated subsidiaries, and we are responsible for:
  - a) designing such disclosure controls and procedures to ensure that the information required to be disclosed by the Registrant, including its consolidated subsidiaries, is made known to us in a timely manner, particularly during the period in which this Annual Report is being prepared;
  - b) evaluating the effectiveness of the Registrant's disclosure controls and procedures as of the end of the period prior to the filing date of this Annual Report (the "Evaluation Date"); and
  - c) presenting in this Annual Report our conclusions about the effectiveness of the Registrant's disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The Registrant's other certifying officers and I have disclosed, based on our knowledge and belief, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or other equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls that could reasonably be expected to affect the Registrant's ability to record, process, summarize and report financial data, and to disclose the Registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees of the Registrant and that results in the Registrant's internal controls; and
6. The Registrant's other certifying officers and I have indicated in this Annual Report whether or not there were any changes in internal controls or in other factors that could significantly affect our evaluation, as of the date of our most recent evaluation, including any corrective actions with respect to any material weaknesses.

Date: April 15, 2003

/s/ Stephen R. Crim  
Stephen R. Crim  
Chief Executive Officer and President

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Certification Pursuant to § 302 of the Sarbanes-Oxley Act of 2002

I, Steven B. Mathis, certify that:

SIGNATURES

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1. I have reviewed this Annual Report on Form 10-K of American Safety Insurance G
2. Based on my knowledge, this Annual Report does not contain any untrue stateme  
a material fact necessary to make the statements made, in light of the circu  
were made, not misleading with respect to the period covered by this Annual Re
3. Based on my knowledge, the financial statements, and other financial infor  
fairly present in all material respects the financial condition, results  
Registrant as of, and for, the periods presented in this Annual Report;
4. The Registrant's other certifying officers and I are responsible for est  
controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) f
  - a) designed such disclosure controls and procedures to ensure that m  
Registrant, including its consolidated subsidiaries, is made known to  
particularly during the period in which this Annual Report is being prepar
  - b) evaluated the effectiveness of the Registrant's disclosure controls and  
prior to the filing date of this Annual Report (the "Evaluation Date"); an
  - c) presented in this Annual Report our conclusions about the effectiven  
procedures based on our evaluation as of the Evaluation Date;
5. The Registrant's other certifying officers and I have disclosed, based o  
Registrant's auditors and the audit committee of Registrant's board of d  
equivalent function):
  - a) all significant deficiencies in the design or operation of internal contro  
Registrant's ability to record, process, summarize and report financial da  
Registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other empl  
the Registrant's internal controls; and
6. The Registrant's other certifying officers and I have indicated in this A  
significant changes in internal controls or in other factors that could sig  
subsequent to the date of our most recent evaluation, including any correcti  
deficiencies and material weaknesses.

Date: April 15, 2003

/s/ Steven B. Mathis  
Steven B. Mathis  
Chief Financial Officer

**AMERICAN SAFETY INSURANCE GROUP, LTD. AND SUBSIDIARIES**  
**Consolidated Financial Statements**  
**December 31, 2001 and 2002**  
**With Independent Auditors' Report Thereon**

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Independent Auditors' Report

The Board of Directors  
American Safety Insurance Group, Ltd.:

We have audited the consolidated financial statements of American Safety Insurance Group, Ltd. and subsidiaries as listing in the accompanying index. In connection with our audits of the consolidated financial statements, we also have audited the financial statement schedules as listed in the accompanying index. These consolidated financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedules based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of American Safety Insurance Group, Ltd. and subsidiaries as of December 31, 2001 and 2002, and the results of their operations and their cash flow for each of the years in the three-year period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

KPMG LLP

Atlanta, Georgia  
April 11, 2003

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**AMERICAN SAFETY INSURANCE GROUP, LTD. AND SUBSIDIARIES**

**Consolidated Balance Sheets**

**Years ended December 31, 2001, and 2002**

	2001
Assets	
Investments:	
Fixed maturity securities available for sale, at fair value	\$ 61,836,101
	\$

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Investment in real estate	37,662,600	
Short-term investments	21,742,272	
Total investments	121,240,973	1
Cash and cash equivalents	1,302,842	
Restricted cash	9,010,489	
Accrued investment income	2,424,551	
Notes receivable - other	8,081,899	
Premiums receivable	25,783,225	
Ceded unearned premium	20,423,690	
Reinsurance recoverable	87,173,021	1
Funds on deposit	312,717	
Due from affiliate	1,108,520	
Income tax recoverable	1,614,940	
Deferred income taxes	7,415,033	
Deferred policy acquisition costs	4,519,439	
Property, plant equipment	2,046,332	
Prepaid items	1,480,078	
Intangible assets	1,466,629	
Other assets	1,857,239	
Total assets	\$ 297,261,617	\$ 3
Liabilities and Shareholders' Equity		
Liabilities:		
Unpaid losses and loss adjustment expenses	\$ 121,423,039	\$ 1
Unearned premiums	53,205,500	
Reinsurance on paid losses and loss adjustment expenses	2,081,845	
Ceded premiums payable	14,224,460	
Due to affiliate:		
Ceded premiums payable	-	
Reinsurance on paid losses and loss adjustment expenses	-	
Other	-	
Escrow deposits	11,718,824	
Accounts payable and accrued expenses	13,459,422	
Funds held	1,433,648	
Dividend payable	-	
Loan payable	16,403,135	
Collateral held	821,302	
Deferred revenue	2,185,104	
Unearned loan fees	325,000	
Total liabilities	237,281,279	3
Shareholders' equity		
Preferred stock, \$0.01 par value; authorized 5,000,000 shares; no shares issued and outstanding	-	
Common stock, \$0.01 par value; authorized 15,000,000 shares; issued and outstanding at December 31, 2001, 6,287,266 shares, and at December 31, 2002, 6,352,077 shares	62,873	
Additional paid-in capital	35,206,614	
Retained earnings	33,416,851	
Accumulated other comprehensive income, net	834,974	
Treasury stock, 1,589,239 shares at December 31, 2001, and 1,612,189 shares at December 31, 2002,		

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at cost		(9,540,974)	
Total shareholders' equity		59,980,338	
Total liabilities and shareholders' equity	\$	297,261,617	\$ 3

See accompanying notes to consolidated financial statements.

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**AMERICAN SAFETY INSURANCE GROUP, LTD. AND SUBSIDIARIES**

**Consolidated Statements of Earnings**

**Years ended December 31, 2000, 2001, and 2002**

	2000	2001
Revenues:		
Direct premiums earned	\$ 35,602,221	\$ 119,120,688
Assumed premiums earned:		
Affiliate	5,760,586	10,964,521
Nonaffiliates	12,715,642	16,679,635
Total assumed premiums earned	18,476,228	27,644,156
Ceded premiums earned:		
Affiliate	4,468,674	7,005,328
Nonaffiliates	22,904,586	76,790,218
Total ceded premiums earned	27,373,260	83,795,546
Net premiums earned	26,705,189	62,969,298
Net investment income	2,605,218	3,649,985
Interest on notes receivable	1,531,183	766,937
Brokerage commission income	3,291,605	2,410,810
Management fees from affiliate	1,424,986	1,496,068
Net realized gains (losses)	(517,857)	652,230
Real estate income	-	27,561,004
Other income	938,570	1,026,067
Total revenues	35,978,894	100,532,399
Expenses:		
Losses and loss adjustment expenses incurred	18,506,290	43,986,019
Acquisition expenses	3,692,579	10,430,824
Payroll and related expenses	7,561,311	8,238,355
Real estate expenses	542,444	25,125,848
Other expenses	4,654,307	6,835,780
Expenses due to rescission	3,541,848	600,000
Total expenses	38,498,779	95,216,826
Earnings (loss) before income taxes	(2,519,885)	5,315,573
Income taxes (benefit)	(1,156,728)	1,161,304
Net earnings (loss)	\$ (1,363,157)	\$ 4,154,269
Net earnings (loss) per share:		
Basic	\$ (0.25)	\$ 0.87
Diluted	\$ (0.25)	\$ 0.84

Average number of shares outstanding

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Basic	5,496,106	4,797,371
Diluted	5,497,434	4,933,167

See accompanying notes to consolidated financial statements.

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**AMERICAN SAFETY INSURANCE GROUP, LTD. AND SUBSIDIARIES**

**Consolidated Statements of Shareholders' Equity**

**Years ended December 31, 2000, 2001 and 2002**

	2000	2001
Common stock - number of shares:		
Balance at beginning of period	6,077,750	6,281,386
Issuance of common shares	203,636	5,880
Balance at end of period	6,281,386	6,287,266
Common stock:		
Balance at beginning of period	\$ 60,777	\$ 62,814
Issuance of common shares	2,037	59
Balance at end of period	62,814	62,873
Additional paid-in capital		
Balance at beginning of period	33,810,387	35,148,577
Issuance of common shares	1,338,190	58,037
Balance at end of period	35,148,577	35,206,614
Retained earnings:		
Balance at beginning of period	30,625,739	29,262,582
Net earnings (loss)	(1,363,157)	4,154,269
Dividends declared (\$0.48 per share in 2002)	-	-
Balance at end of period	29,262,582	33,416,851
Accumulated other comprehensive income:		
Balance at beginning of period	(1,288,804)	428,085
Unrealized gain (loss) during the period (net of deferred tax benefit (expense) of \$(240,095), \$(152,279), and \$(541,271) respectively)	1,716,889	406,889
Balance at end of period	428,085	834,974
Treasury Stock:		
Balance at beginning of period	(2,169,339)	(7,098,913)
Purchased 967,200 shares in 2000, 322,039 shares in 2001, and 22,950 shares in 2002	(4,929,574)	(2,442,061)
Balance at end of period	(7,098,913)	(9,540,974)
Total shareholders' equity	\$ 57,803,145	\$ 59,980,338

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## AMERICAN SAFETY INSURANCE GROUP, LTD. AND SUBSIDIARIES

## Consolidated Statements of Cash Flow

## Years ended December 31, 2000, 2001 and 2002

	2000	2001
Cash flow from operating activities:		
Net earnings (loss)	\$ (1,363,157)	\$ 4,154,269
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Realized losses (gains) on sale of investments	517,857	(652,230)
Amortization of deferred acquisition costs, net	(2,317,085)	(1,927,653)
Reinsurance recoverable allowance	-	-
Impairment of notes receivable	-	-
Real estate impairment allowance	-	-
Change in:		
Accrued investment income	1,239,988	(880,876)
Premiums receivable	(21,104,838)	7,561,157
Reinsurance recoverable and ceded unearned premiums	(40,401,341)	(55,876,484)
Unearned loan fees	568,750	(243,750)
Due from affiliate	1,103,428	(123,200)
Prepaid items	(1,317,597)	275,113
Funds held	4,503,963	(3,427,824)
Funds deposited	55,407	(14,717)
Collateral held	335,863	(723,537)
Income taxes	(993,235)	(1,486,449)
Unpaid losses and loss adjustment expenses	30,095,391	70,914,412
Unearned premiums	32,793,955	11,252,146
Ceded premiums payable	17,572,588	(10,087,196)
Due to affiliate	(917,829)	(797,576)
Accounts payable and accrued expenses	4,490,959	7,074,993
Deferred revenue	-	2,185,104
Other, net	(497,614)	905,758
Net cash provided by operating activities	24,365,453	28,081,460
Cash flow from investing activities:		
Purchase of fixed maturities	(15,549,384)	(54,172,603)
Purchase of common stocks	(5,908,304)	(2,905,977)
Proceeds from maturity and redemption of fixed maturities	868,191	530,323
Proceeds from sales of fixed maturities	16,358,289	38,168,205
Proceeds from sales of common stock	5,771,377	3,068,210
Purchase of Trafalgar Insurance Company, net of cash of acquired company	(7,050,877)	-
Proceeds from notes receivable - related parties	1,530,000	-
Decrease (increase) in short-term investments	(8,562,586)	(6,429,895)
Repayment (advance) in notes receivable - other	(2,572,754)	796,119
Increase in investment in real estate	(12,796,382)	(13,716,295)
Sales (purchases) of fixed assets, net	298,551	(1,110,589)
Net cash used in investing activities	(27,613,879)	(35,772,502)
	2000	2001



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Cash flow from financing activities:		
Proceeds from sale of common stock	17,227	58,094
Purchase of treasury stock	(4,929,574)	(2,442,061)
Proceeds from loan payable	11,435,221	4,967,914
Proceeds from escrow deposits	6,200,182	5,518,642
Dividends paid	-	-
(Deposits) withdrawals from restricted cash, net	(6,117,682)	(2,892,807)
Net cash provided by financing activities	6,605,374	5,209,782
Net increase (decrease) in cash	3,356,948	(2,481,260)
Cash and cash equivalents at beginning of period	427,154	
Cash and cash equivalents at end of period	\$ 3,784,102	\$ 1,302,842
Non Cash Items:		
Operating activities:		
Recoverable due to rescission in other assets	(1,323,000)	-
Change in prepaid items	(170,000)	-
Investing activities:		
Decrease in notes receivable-other	4,950,000	-
Purchase of real estate	(4,950,000)	-
Financing activities:		
Issuance of common stock	1,323,000	-
Notes receivable related parties	170,000	
Supplemental disclosure of cash flow information:		
Income taxes paid	\$ 114,572	\$ 2,800,000
Interest paid	\$ -	\$ 1,265,874

See accompanying notes to consolidated financial statements.

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### AMERICAN SAFETY INSURANCE GROUP, LTD. AND SUBSIDIARIES

#### Consolidated Statements of Comprehensive Earnings

##### Years ended December 31, 2000, 2001 and 2002

	2000	2001
Net earnings (loss)	\$ (1,363,157)	\$ 4,154,269
Other comprehensive earnings (loss) before income taxes:		
Unrealized gains on securities available for sale	1,414,896	1,315,686
Reclassification adjustment for realized gains (losses) included in net earnings	(542,088)	756,512
Total other comprehensive earnings before taxes	1,956,984	559,174
Income tax expense related to items of comprehensive income	240,095	152,285
Other comprehensive earnings net of income taxes	1,716,889	406,889
Total comprehensive earnings	\$ 353,732	\$ 4,561,158

See accompanying notes to consolidated financial statements.

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## AMERICAN SAFETY INSURANCE GROUP, LTD. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2000, 2001 and 2002

#### (1) Summary of Significant Accounting Policies

##### (a) Basis of Presentation

The accompanying consolidated financial statements of American Safety Insurance Group, Ltd. ( American Safety ) and its subsidiaries (collectively, the Company ) are prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ). The preparation of financial statements in conformity with GAAP requires management to make estimates, based on the best information available, in recording transactions resulting from business operations. The balance sheet amounts that involve a greater extent of accounting estimates and actuarial determinations subject to future changes are the Company s liabilities for unpaid losses and loss adjustment expenses. As additional information becomes available (or actual amounts are determinable), the recorded estimates may be revised and reflected in operating results. While management believes that the liability for unpaid losses and loss adjustment expenses is adequate to cover the ultimate liability, such estimates may be more or less than the amounts actually paid when claims are settled. The Company also uses estimates for its assets of real estate and notes receivable.

##### (b) Description of Common Stock - Voting and Ownership Rights

The authorized share capital of the Company is 20 million shares, consisting of 15 million common shares, par value \$.01 per share ( Common Shares ), and 5 million preferred shares, par value \$.01 per share ( Preferred Shares ). The Common Shares are validly issued, fully paid, and non-assessable. There are no provisions of Bermuda law or the Company s Bye-Laws which impose any limitations on the rights of shareholders to hold or vote Common Shares by reason of such shareholders not being residents of Bermuda. Holders of Common Shares are entitled to receive dividends ratably when and as declared by the Board of Directors out of funds legally available therefor.

Each holder of Common Shares is entitled to one vote per share on all matters submitted to a vote of the Company s shareholders, subject to the 9.5% voting limitation described below. All matters, including the election of directors, voted upon at any duly held shareholders meeting shall be authorized by a majority of the votes cast at the meeting by shareholders represented in person or by proxy, except (i) approval of a merger, consolidation or amalgamation; (ii) the sale, lease, or exchange of all or substantially all of the assets of the Company; and (iii) amendment of certain provisions of the Bye-Laws, which each require the approval of at least 66-2/3% of the outstanding voting shares (in addition to any regulatory or court approvals). The Common Shares have noncumulative voting rights, which means that the holders of a majority of the Common

Shares may elect all of the directors of the Company and, in such event, the holders of the remaining shares will not be able to elect any directors.

The Bye-Laws contain certain provisions that limit the voting rights that may be exercised by certain holders of Common Shares. The Bye-Laws provide that each holder of Common Shares is entitled to one vote per share on all matters submitted to a vote of the Company's shareholders, except that if, and so long as, the Controlled Shares (as defined below) of any person constitute 9.5% or more of the issued and outstanding Common Shares, the voting rights with respect to the Controlled Shares owned by such person shall be limited, in the aggregate, to a voting power of 9.5%, other than the voting rights of Frederick C. Treadway or Treadway Associates, L.P., affiliates of a founding shareholder of the Company. Controlled Shares mean (i) all shares of the Company directly, indirectly, or constructively owned by any person and (ii) all shares of the Company directly, indirectly, or beneficially owned by such person within the meaning of Section 13(d) of the Exchange Act (including any shares owned by a group of persons, as so defined and including any shares that would otherwise be excluded by the provisions of Section 13(d)(6) of the Exchange Act). Under these provisions, if, and so long as, any person directly, indirectly, or constructively owns Controlled Shares having more than 9.5% of the total number of votes exercisable in respect of all shares of voting stock of the Company, the voting rights attributable to such shares will be limited, in the aggregate, to 9.5% of the total number of votes.

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No holder of Common Shares of the Company shall, by reason only of such holder, have any preemptive right to subscribe to any additional issue of shares of any class or series nor to any security convertible into such shares.

(c) Principles of Consolidation

The consolidated financial statements include the accounts of American Safety Insurance Group, Ltd., a Bermuda company, American Safety Reinsurance, Ltd. (American Safety Re ) formed in January 1998 to serve as the successor for the reinsurance business of American Safety, as a 100%-owned licensed Bermuda insurance company, and American Safety Holdings Corp. ( American Safety Holdings ), formed in July 1999 to serve as a 100%-owned insurance and financial services holding company. American Safety Holdings in turn wholly owns American Safety Casualty Insurance Company ( American Safety Casualty ), a property and casualty insurance company, American Safety Insurance Services, Inc. ( ASI Services ), an insurance management and brokerage company, Ponce Lighthouse Properties, Inc. ( Ponce ), the development company of the Harbour Village project, and Rivermar Contracting Company ( Rivermar ), the general contractor of the Harbour Village project. American Safety Casualty wholly owns American Safety Indemnity Company, a property and casualty excess and surplus lines insurance company. ASI Services wholly owns the following subsidiaries: Sureco Bond Services, Inc. ( Sureco ), a bonding agency; Environmental Claims Services, Inc. ( ECSI ), a claims consulting firm; American Safety Financial Corp., a financial services subsidiary; and American Safety Purchasing Group, Inc., which acts as a purchasing group for the placement of business with American Safety Casualty. All significant intercompany balances have been eliminated in consolidation.

(d) Business Environment

The following is a description of certain risks facing the Company and its subsidiaries:

*Legal/Regulatory Risk* is the risk that changes in the legal or regulatory environment in which an insurer operates will create additional expenses not anticipated by the insurer in pricing its products and beyond those recorded in the financial statements. That is, regulatory initiatives designed to reduce insurer profits or otherwise affecting the industry in which the insurer operates, new legal theories or insurance company insolvencies through guaranty fund assessments, may create costs for the insurer beyond those recorded in the financial statements. The Company attempts to mitigate this risk by actively writing insurance business in several states, thereby spreading this risk over a large geographic area.

*Potential Risk of United States Taxation of Bermuda Operations.* Under current Bermuda law, American Safety is not required to pay any taxes in Bermuda on either income or capital gains. American Safety has received an undertaking from the Minister of Finance in Bermuda that will exempt American Safety from taxation until the year 2016 in the event of any such taxes being imposed. Whether a foreign corporation is engaged in a United States trade or business or is carrying on an insurance business in the United States depends upon the level of activities conducted in the United States. If the activities of a foreign company are continuous, regular, and considerable, the foreign company will be deemed to be engaged in a United States trade or business. Due to the fact that American Safety will continue to maintain an office in Bermuda and American Safety and American Safety Re's sole business is reinsuring contracts via treaty reinsurance agreements, which are all signed outside of the United States, American Safety does not consider itself to be engaged in a trade or business in the United States and, accordingly, does not expect to be subject to United States income taxes. This position is consistent with the position taken by various other entities that have similar operational structures as American Safety.

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However, because the Internal Revenue Code of 1986, as amended, the Treasury Regulations and court decisions do not definitively identify activities that constitute being engaged in a United States trade or business, and because of the factual nature of the determination, there can be no assurance that the Internal Revenue Service will not contend that American Safety or its Bermuda insurance subsidiary are engaged in a United States trade or business. In general, if American Safety or its Bermuda insurance subsidiary are considered to be engaged in a United States trade or business, it would be subject to (i) United States Federal income tax on its taxable income that is effectively connected with a United States trade or business at graduated rates and (ii) the 30 percent branch profits tax on its effectively connected earnings and profits deemed repatriated from the United States. Certain subsidiaries of American Safety are, however subject to U.S. Federal and state income tax, as they are domiciled and conduct business in the United States.

*Credit Risk* is the risk that issuers of securities owned by the insurer or secured notes receivable will default or that other parties, including reinsurers that have obligations to the insurer, will not pay or perform. The Company attempts to mitigate this risk by adhering to a conservative investment strategy, by obtaining sufficient collateral for secured note obligations and by maintaining sound reinsurance, credit and collection policies.

*Interest Rate Risk* is the risk that interest rates will change and cause a decrease in the value of an insurer's investments. The Company attempts to mitigate this risk by attempting to match the maturities of its assets with the expected payouts of its liabilities.

(e) Investments

Fixed maturity securities for which the Company has the positive intent and ability to hold to maturity are classified as held to maturity and are reported at amortized cost. Fixed maturity and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as trading and are reported at fair value, with unrealized gains and losses included in earnings. Fixed maturity and equity securities not classified as either held to maturity or trading are classified as available for sale and are reported at fair value, with unrealized gains and losses (net of deferred taxes) charged or credited as a component of accumulated other comprehensive income.

While it is the Company's intent to hold fixed maturity securities until the foreseeable future or until maturity, it may sell such securities in response to, among other things, market conditions, liquidity needs, or interest rate fluctuations. At December 31, 2001 and 2002, the Company considered all of its fixed maturity securities as available for sale.

Investment income is recorded as earned on the accrual basis and includes amortization of premiums and accretion of discounts using the interest method. Realized gains or losses on disposal of investments are determined on a specific identification basis and are included in revenues. Investments in real estate are carried at the lower of cost or fair value plus capitalized development costs.

The Company owns no on-balance sheet or off-balance sheet derivative instruments.

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(f) Notes Receivable

Notes receivable represent indebtedness under various secured lending arrangements with related and unrelated parties. Interest income, loan fees, and deferred loan costs are recognized on an effective yield basis over the life of the loan. The allowance for possible loan losses has been determined based on those losses management considers probable at each reporting date. At December 31, 2001 and 2002, the Company has established an allowance of \$2.5 million.

The Company ceases the accrual of interest on loans when any payment is past due. Additionally, the Company assesses loan impairment by comparing the carrying value of such loan, including accrued but unpaid interest at the valuation date to the fair value of collateral held with respect to such loan. Any shortage of fair value over carrying value is first recognized by reversing interest income recognized for the year of impairment and then recognizing any further loss against the allowance for loan losses.

(g) Recognition of Premium Income

General liability premiums are primarily assumed from American Safety Risk Retention Group, Inc. ( American Safety RRG ), a non-subsiary affiliate. General liability premiums are estimated based upon the annual revenues of the underlying insureds. Additional or return premiums are recognized for differences between provisional premiums billed and estimated ultimate general liability premiums due when the final audit is complete after the policy has expired. General liability, surety, commercial auto, other commercial lines and workers compensation premiums are recorded ratably over the policy period with unearned premium calculated on a pro rata basis over the lives of the underlying coverages.

(h) Brokerage Commission Income

Brokerage commissions on business produced by Sureco and ASI Services are recognized when the related insurance policies are written. Commissions are refundable upon early termination of a policy. A provision is made for expected adjustments relating to policy cancellations in accordance with Statements of Financial Accounting Services ( SFAS ) No. 5, Accounting for Contingencies. For ASI Services produced business which remains in the consolidated group, any commissions recognized are eliminated in consolidation.

(i) Management Fees from Affiliate

The program management agreement between American Safety RRG and ASI Services provided for payment of a monthly fee, based on the American Safety RRG s share of allocatable expenses, which are determined based on the amount of premiums written by American Safety RRG. The level of program management fees is designed to reimburse the Company for the allocable share of expenses incurred in managing the American Safety RRG program. The fees are earned as expenses are incurred.

(j) Deferred Policy Acquisition Costs

The costs of acquiring business, primarily commissions and underwriting expenses, are deferred (to the extent they are recoverable from future premium income) and amortized to earnings in relation to the amount of premiums earned. If necessary, investment income is considered in the determination of the recoverability of deferred policy acquisition costs. Deferred revenue results when reinsurance ceding commissions received exceed the related deferred acquisition costs for direct and assumed business.

An analysis of deferred policy acquisition costs follows:

	<u>Years ended December 31,</u>		
	<u>2000</u>	<u>2001</u>	<u>2002</u>
Balance, beginning of period	\$ 274,701	\$ 2,591,786	\$ 4,519,439
Acquisition costs deferred	7,380,284	13,477,149	13,180,599
Amortized during the period	<u>(5,063,199)</u>	<u>(11,549,496)</u>	<u>(10,016,580)</u>
Balance, end of period	\$ 2,591,786	\$ 4,519,439	\$ 7,683,458
	=====	=====	=====

(k) Unpaid Losses and Loss Adjustment Expenses

The Company provides a liability for unpaid losses and loss adjustment expenses based upon aggregate case estimates for reported claims and estimates for incurred but not reported losses. Because of the length of time required for the ultimate liability for losses and loss adjustment expenses to be determined for certain lines of business underwritten, the Company has limited experience upon which to base an estimate of the ultimate liability. For this business, management has established loss and loss adjustment expense reserves based on an independent actuarial valuation that it believes is reasonable and representative of anticipated ultimate experience. Beginning in 1996, the Company's actuarial consultant refined the estimation process for the determination of ultimate loss and loss adjustment expense to begin to recognize differences between the Company's reporting and settlement patterns and industry patterns as sufficient Company specific data (10 years of Company specific actuarial data) was then available. This method (Bornhuetter-Ferguson) entails developing an initial expected loss ratio based upon gross ultimate losses from prior accident years, estimating the portion of ultimate losses expected to be reported and unreported, and adding the actual reported losses to the expected unreported losses to derive the indicated ultimate losses. However, the net amounts that will ultimately be paid to settle the liability may be more or less than the estimated amounts provided.

(l) Income Taxes

For subsidiaries subject to taxation, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

(m) Reinsurance

Reinsurance contracts do not relieve the Company from its obligation to policyholders. Failure of reinsurers to honor their obligations could result in losses to the Company.

The Company evaluates the financial condition of its reinsurers and monitors concentration of credit risk to minimize its exposure to significant losses from reinsurer insolvencies. Reinsurance recoverables on unpaid losses and prepaid reinsurance represent amounts recoverable from reinsurers for unpaid losses and unearned ceded reinsurance premiums, respectively.

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**(n) Goodwill and Intangibles**

The Company adopted SFAS 142 on January 1, 2002. Under SFAS 142, goodwill and indefinite-lived intangible assets are no longer amortized but are reviewed annually (or more frequently if impairment indicators arise) for impairment. Prior to adoption, the Company amortized goodwill over a 20 year period. Separable intangible assets that are not deemed to have an indefinite life will continue to be amortized over their useful lives (but with no maximum life).

Goodwill and Intangibles (in thousands)	December 31, 2001	December 31, 2000
Goodwill	\$ 1,467	\$ -
Indefinite-lived intangibles	<u>-</u>	<u>1,467</u>
Total goodwill and intangibles	\$ <u>1,467</u>	\$ <u>1,467</u>

In accordance with the disclosure requirements of SFAS 142 the following table shows the effect of the goodwill and intangibles amortization on the reported net income for the year ended December 31, 2000, 2001 and 2002 to show comparability between the periods presented.

	Year Ended December		
	(in thousands, except per share)		
	<u>2000</u>	<u>2001</u>	<u>2002</u>
Reported net earnings (loss)	\$ (1,363)	\$ 4,154	\$ 2,154
Add back: Goodwill and intangibles amortization	<u>70</u>	<u>87</u>	<u>-</u>
Adjusted net earnings (loss)	\$ <u>(1,293)</u>	\$ <u>4,241</u>	\$ <u>2,154</u>
Reported earnings (loss) per share - basic	\$ (0.25)	\$ 0.87	\$ 0.87
Add back: Goodwill and intangibles amortization	\$ <u>0.01</u>	\$ <u>0.02</u>	\$ <u>-</u>
Adjusted net earnings (loss) per share - basic	\$ <u>(0.24)</u>	\$ <u>0.89</u>	\$ <u>0.87</u>
Adjusted net earnings (loss) per share - diluted	\$ <u>(0.24)</u>	\$ <u>0.86</u>	\$ <u>0.86</u>

**(o) Net Earnings Per Share**



Basic earnings (loss) per share and diluted earnings (loss) per share are computed by dividing net earnings (loss) by the weighted average number of shares outstanding for the period (basic EPS) plus dilutive shares subject to stock options (diluted EPS).

Earnings (loss) per share are as follows:

	<u>2000</u>	<u>2001</u>	
Weighted average shares outstanding	5,496,106	4,797,371	
Shares attributable to stock options	<u>1,328</u>	<u>135,796</u>	
Weighted average common and common equivalents	5,497,434	4,933,167	
Earnings (loss) per share:			
Basic	\$ (0.25)	\$ 0.87	\$
Diluted	\$ (0.25)	\$ 0.84	\$

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(p) Employee Stock Options

At December 31, 2002, we had an employee stock option plan, which is described more fully in Note 14. We apply the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations in accounting for our plan. No compensation expense is reflected in net earnings as all options granted under our stock option plan have an exercise price equal to the market value of the underlying common stock on the date of grant. The options in the plan vest evenly over a three year period. The following table illustrates the effect on net earnings and earnings per share, assuming we had applied the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation.

	<u>2000</u>	<u>2001</u>	Year Ending Decem
	(In thousands, except per share amounts)		
Net earning (loss):			
As reported	\$ (1,363)	\$ 4,154	\$
Effect of stock options	886	2,210	
Pro forma net earnings (loss)	\$ (2,249)	\$ 1,944	\$
Net earnings (loss) per share:			
Basic - as reported	\$ (0.25)	\$ 0.87	\$
Basic - pro forma	(0.41)	0.41	
Diluted - as reported	\$ (0.25)	\$ 0.84	\$
Diluted - pro forma	(0.41)	0.39	

(q) Accounting Pronouncements

During the last two years, the FASB has issued a number of accounting pronouncements with various effective dates. SFAS No. 141, Business Combinations; SFAS No. 142, Goodwill and Other Intangible Assets; SFAS No. 143, Accounting for Asset Retirement Obligations; SFAS No. 144, Accounting for the impairment or Disposal of Long-Live Assets; SFAS No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections; SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities; and SFAS No. 147, Acquisitions of Certain Financial Institutions - an Amendment of FASB Statements No. 72 and 144 and FASB Interpretation No. 9. These pronouncements do not have a material effect on our financial statements.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure. This standard, which amends the transition and disclosure issues associated with SFAS No. 123, became effective for years ending after December 15, 2002. We have no plans to adopt the fair value provisions of SFAS No. 123. The requirements of this standard are not expected to impact our financial position or results of operations.

In November 2002, the FASB issued Interpretation No. 45, Guarantors Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. The disclosure provisions of this interpretation are effective for fiscal years ending after December 15, 2002. The initial recognition and measurement provisions of this interpretation apply to guarantees issued or modified after December 31, 2002 on a prospective basis. This interpretation is not expected to have a material impact on our financial position or results of operations.

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities. This interpretation addresses consolidation and disclosure issues associated with variable interest entities. We are currently evaluating our investments in variable interest entities. The requirements of the interpretation, however, are not expected to have a material impact on our financial position or results of operations.

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(r) Revenue Recognition of Real Estate

The Company recognizes revenue from the sale of real estate when the title to each individual unit or boat slip passes to the purchaser. When the title passes, the Company uses a percentage of completion method, based on the ratio of actual costs to total estimated costs (including allocated common costs that may not yet have been expended) to recognize revenue. The revenue recognized relates only to units and boat slips that have closed that meet the criteria in paragraph 37 for SFAS 66, Accounting for Sales of Real Estate. The actual and estimated costs refer to costs that are allocated to each individual unit or boat slip. The difference between total sales price and the revenue recognized is set up as deferred revenue and is recognized as the additional costs of each unit are incurred. An impairment of \$431,000 was recorded in 2002 as an adjustment to the carried investment in real estate. Please see Note 3 herein for more information regarding the Company's real estate operations.

(s) Capitalizing Costs on Real Estate

The Company capitalizes the following costs with respect to real estate: (a) project costs, which include acquisition, design and planning costs, and construction costs, all of which are directly associated with the project; (b) taxes and insurance incurred during the planning, design and construction periods; (c) costs of amenities (since these items will transfer to an owner's association at no charge when the project is complete); (d) interest costs on qualifying assets until the assets are ready for their intended use; and (e) indirect costs of construction management and supervision.

(t) Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, money market instruments and other debt instruments with a maturity of 90 days or less when purchased.

(u) Reclassifications

Certain items in the prior periods' financial statements have been reclassified to conform with the 2002 presentation.

(2) Investments

Net investment income is summarized as follows:

		<u>Years ended December 31,</u>		
	<u>2000</u>	<u>2001</u>	<u>2002</u>	
Fixed maturities	\$ 2,183,392	\$ 3,282,285	\$ 3,980,246	
Equity securities	48,760	16,803	-	
Short-term investments and cash	<u>460,777</u>	<u>526,903</u>	<u>278,138</u>	
	692,929	3,825,991	4,258,384	
Less investment expenses	<u>87,711</u>	<u>176,006</u>		<u>242,2</u>
Net investment income	\$ 2,605,218	\$ 3,649,985	\$ 4,016,177	
	=====	=====	=====	

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Realized and unrealized gains and losses were as follows:

	<u>2000</u>	<u>Years ended December 31,</u>		
		<u>2001</u>		
Realized gains:				
Fixed maturities	\$ 37,757	\$ 974,604	\$	1
Equity securities	-	-		
Real estate	<u>24,231</u>	<u>-</u>		
Total gains	<u>61,988</u>	<u>974,604</u>		<u>1</u>
Realized losses:				
Fixed maturities	(573,884)	(218,092)		(1
Equity securities	(5,961)	-		

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Real estate		-	(104,282)	
Total losses		<u>(579,845)</u>	<u>(322,374)</u>	(1
Net realized gains (losses)	\$	(517,857)	\$ 652,230	\$
		=====	=====	==
Changes in unrealized gains (losses):				
Fixed maturities	\$	1,951,504	\$ 559,172	\$ 2
Equity securities		<u>5,480</u>	<u>-</u>	
Net unrealized gains (losses)	\$	1,956,984	\$ 559,172	\$ 2
		=====	=====	=

At December 31, 2001 and 2002, the Company did not hold fixed-maturity securities, which individually exceeded 10% of shareholders equity, except U.S. government, and government agency securities.

The amortized cost and estimated fair values of investments at December 31, 2001 and 2002 are as follows:

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estim fair
December 31, 2001:				
Securities available for sale:				
Fixed maturities:				
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	\$ 28,618,104	\$ 1,091,312	\$ 101,892	\$ 29,607,52
Corporate securities	24,157,207	380,283	146,968	24,390,52
Mortgage-backed securities	<u>7,914,282</u>	<u>3,956</u>	<u>80,183</u>	<u>7,838,05</u>
Total fixed maturities	\$ 60,689,593	\$ 1,475,551	\$ 329,043	\$ 61,836,10
	=====	=====	=====	=====
December 31, 2002:				
Securities available for sale:				
Fixed maturities:				
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	\$ 36,361,353	\$ 1,451,538	\$ 569	\$ 37,812,32
Corporate securities	34,791,767	2,006,419	60,538	36,737,64
Mortgage-backed securities	<u>10,945,048</u>	<u>359,776</u>	<u>4,136</u>	<u>11,300,68</u>
Total fixed maturities	\$ 82,098,168	\$ 3,817,733	\$ 65,243	\$ 85,850,65
	=====	=====	=====	=====

(a) Unrealized gains include \$1,666, which relates to funds held.

The amortized cost and estimated fair values of fixed maturities at December 31, 2002, by contractual maturity are shown below. Expected maturities may differ from contractual maturities as

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certain borrowers may have the right to call or prepay obligations with or without call or prepayment penalty.

		<u>Amortized cost</u>		<u>Estimated fair value</u>
Due in one year or less	\$	9,278,654	\$	9,389,075
Due after one year through five years		14,315,871		15,096,536
Due after five years through ten years		39,147,113		41,117,441
Due after ten years		8,411,482		8,946,918
Mortgage-backed securities		<u>10,945,048</u>		<u>11,300,688</u>
Total	\$	82,098,168 =====	\$	85,850,658 =====

Bonds with an amortized cost of \$14,199,157 and \$13,442,000 were on deposit with insurance regulatory authorities at December 31, 2001 and 2002 in accordance with statutory requirements.

(3) Investment in Real Estate

The Company's investment in real estate is known as Harbour Village Golf and Yacht Club ( Harbour Village ) comprised of 173 acres of property in Ponce Inlet, Florida that was acquired in foreclosure during April 1999. At the date of foreclosure the Company evaluated the carrying value of its investment in real estate by comparing the fair value of the foreclosed collateral to the book value of the underlying loan and accrued interest. As the book value of the loan and accrued interest was less than the fair value of the collateral, no loss was recognized on foreclosure and the book balance of the loan and accrued interest became the basis of the real estate. See Note 9, Loans Payable, and Note 17, Subsequent Events, for additional information.

As of December 31, 2001 and 2002, the investment in real estate for the Harbour Village project is categorized as follows (in thousands):

		<u>2001</u>		<u>2002</u>
Land	\$	4,360	\$	2,437
Capitalized overhead, interest and taxes		3,925		3,021
Work in process		<u>28,328</u>		<u>35,593</u>
Total	\$	36,613 =====	\$	41,051 =====

At December 31, 2001 and 2002, the Company was holding \$9.0 million and \$7.5 million, respectively, of escrowed cash deposits from the purchasers of units at Harbour Village. This money will stay in escrow until the units are closed and title has transferred to the purchaser. At that point, the Company will be entitled to take those funds out of escrow.

(4) Notes Receivable

As of December 31, 2002, notes receivable consists of two notes which are secured by real and

personal property and various corporate and personal guarantees. These notes are currently in default.

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These two notes became past due during 2001 and were deemed impaired at that time. Prior to impairment, the Company recognized interest income of \$437,483 in 2000 and \$663,093 in 2001.

The recorded investment in notes receivable, which meet the definition of impaired loans at December 31, 2001 and 2002 was \$8,081,899 and \$6,649,716, respectively. The weighted average recorded investment in impaired notes receivable as of December 31, 2001 and 2002 was \$2,494,294 and \$7,723,853, respectively. No interest income has been recognized on impaired notes receivable during the twelve months ended December 31, 2000, 2001 and 2002. During the fourth quarter of 2002, an impairment of \$2,468,172 was recorded as a result of receiving an updated appraisal for the collateral supporting the loan, which reflected a decrease in the market value of the property due to current economic conditions.

#### (5) Financial Instruments

The carrying amounts for short-term investments, cash, premiums receivable, commissions receivable, accrued investment income, ceded premiums payable, funds held, collateral held and accounts payable and accrued expenses approximate their fair values due to the short-term nature of these instruments.

Estimated fair values for fixed maturities were provided by outside consultants using market quotations, prices provided by market makers or estimates of fair values obtained from yield data relating to investment securities with similar characteristics.

The two notes receivable at December 31, 2001 and 2002, have fair values which approximate carrying values based on the value of the underlying collateral.

#### (6) Reinsurance

##### *General Liability*

The Company has excess of loss reinsurance treaties with QBE Reinsurance Corporation, Partner Reinsurance Company US, Hartford Fire Insurance Company, Continental Casualty Company, Alea London, Ltd., Terra Nova Insurance Company and Lloyds of London (the Reinsurers ) for the Company's general liability lines of business. These treaties provide \$10.65 million excess \$350,000 to the Company.

##### *Workers' Compensation*

The Company assumes workers' compensation business from Legion Insurance Company ( Legion ). This business is produced by ASI Services, which bills and collects the premiums on behalf of Legion and remits net of its agent's commissions. Legion then deducts its expenses for the program as well as 10% of the premium to deposit in its loss fund. The balance of the premium is ceded to

American Safety Casualty. Legion uses the 10% loss fund to pay claims, and when this fund is extinguished, Legion cedes the losses to American Safety Casualty. American Safety Casualty has a 50% quota share arrangement between itself and American Reinsurance, Ltd. Pursuant to the arrangement with Legion Insurance Company, the Company's exposure is limited to \$250,000 per occurrence and a 70% aggregate stop-loss ratio percentage.

During 2000, American Safety Casualty began direct writing the workers' compensation business that had been previously written by Legion. The reinsurance structure described above is also utilized by American Safety Casualty except the 10% loss fund is not applicable to business directly written by American Safety Casualty. Effective January 2001, Legion terminated new and renewal writings under the program.

The Company has excess of loss treaties with QBE Reinsurance Company U.S., Partners Reinsurance Company U.S., Hartford Fire Insurance Company, Lloyd's of London, American Healthcare Indemnity Company, and Insurance Corporation of Hanover for the Company's workers compensation line of business. These treaties provide \$19.65 million excess \$350,000 to the Company.

#### *Excess and Surplus*

The Company has an excess of loss reinsurance treaty with Folksamerica Reinsurance Company, QBE Reinsurance Corporation, Continental Casualty Company and Partner Reinsurance Company to reinsure the Company's excess and surplus risks. The treaty provides \$650,000 excess \$350,000 of coverage to the Company.

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#### *Surety*

The Company has an excess of loss reinsurance treaty with Berkley Insurance Company for the Company's surety line of business. The treaties provide per bond and per principal reinsurance of \$750,000 excess \$250,000. American Safety Casualty also has a 50% quota share arrangement with American Safety Reinsurance, Ltd. Effective January 1, 2002, the Company has no reinsurance for its surety line of business and has substantially reduced writing contract surety business.

#### *Program Business*

The Company's program business division buys various forms of reinsurance on both a quota share basis as well as an excess of loss basis. These treaties cover the majority of risks written by the Company in this division. Where appropriate, collateral is obtained from the reinsurers to secure their obligations.

The approximate effect of reinsurance on the financial statement accounts listed below is as follows:

<u>2000</u>	<u>Years ended December 31,</u>	<u>2002</u>
	<u>2001</u>	
	(In thousands)	

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Written premiums:						
Direct	\$	64,227	\$	131,253	\$	128,907
Assumed		22,646		26,764		27,699
Ceded		<u>(45,420)</u>		<u>(81,582)</u>		<u>(76,246)</u>
Net	\$	41,453	\$	76,435	\$	80,360
		=====		=====		=====
Earned premiums:						
Direct	\$	35,602	\$	119,121	\$	118,438
Assumed		18,476		27,644		21,568
Ceded		<u>(27,373)</u>		<u>(83,796)</u>		<u>(74,057)</u>
Net	\$	26,705	\$	62,969	\$	65,949
		=====		=====		=====
Losses and loss adjustment expenses incurred:						
Direct	\$	29,291	\$	111,700	\$	91,287
Assumed		13,739		18,115		12,638
Ceded		<u>(24,524)</u>		<u>(85,829)</u>		<u>(65,651)</u>
Net	\$	18,506	\$	43,986	\$	38,274
		=====		=====		=====
Unpaid loss and loss adjustment expenses:						
Direct	\$	28,431	\$	97,756	\$	131,736
Assumed		22,078		23,667		28,893
Ceded		<u>(27,189)</u>		<u>(77,583)</u>		<u>(96,801)</u>
Net	\$	23,320	\$	43,840	\$	63,828
		=====		=====		=====

During the fourth quarter of 2001, one of the Company's former reinsurers, Berkley Insurance Company, disputed its obligations under several reinsurance treaties entered into during the soft reinsurance market that existed in 1998 and 1999. As a result of adverse loss experience to the reinsurer from certain lines of business, Berkley has stopped reimbursing the Company for amounts due under such treaties and has requested that the Company retroactively consider taking a greater portion of the losses than is required under the treaties or, alternatively, to rescind and reform portions of certain treaties. The Company instituted arbitration proceedings against the reinsurer and the arbitration hearing is scheduled for late May 2003. Berkley is a subsidiary of W.R. Berkley Corp. (NYSE:BER). As of December 31, 2002, unreimbursed paid claims under the treaties totaled \$14.9 million and additional ceded case reserves and reserves for incurred but not reported losses totaled approximately \$19.6 million. A reserve of \$1.1 million has been established at December 31, 2002 in recognition of a settlement offer made by the Company to Berkley. If any of these factors change in the future, the Company will establish additional reserves at that time, which could be material. The Company does not believe this dispute will have a material adverse effect on the overall financial condition or liquidity of the Company as management believes the Company has sufficient current cash flows and invested assets to meet its insurance obligations. However, due to the fact that the final decision rests in the hands of an arbitration panel, it is uncertain whether the panel's decision will be on terms favorable to the Company.

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(7) Income Taxes

Total income tax expense (benefit) for the years ended December 31, 2000, 2001 and 2002 were allocated as follows:



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	<u>2000</u>	<u>2001</u>	
Tax expense (benefit) attributable to:			
Income (loss) from continuing operations	\$ (1,156,728)	\$ 1,161,304	\$
Unrealized gain (losses) on securities available for sale	\$ <u>240,095</u>	\$ <u>152,279</u>	\$
Total	\$ <u>(916,633)</u>	\$ <u>1,313,583</u>	\$
	=====	=====	
	<u>Current</u>	<u>Deferred</u>	
December 31, 2000	\$ (106,588)	\$ (1,050,140)	\$
December 31, 2001	1,345,427	(184,123)	
December 31, 2002	450,939	467,851	

and 2002, respectively. Income tax expense from continuing operations for the years ended December 31, 2000, 2001 and 2002 differed from the amount computed by applying the U.S. Federal income tax rate of 34% to earnings before Federal income taxes as a result of the following:

	<u>2000</u>	<u>2001</u>	
Expected income tax expense (benefit)	(856,761)	\$ 1,807,295	\$
Foreign earned income not subject to direct taxation	(169,124)	(614,882)	
Tax-exempt interest	(151,738)	(15,654)	
State taxes and other	<u>20,895</u>	<u>(15,455)</u>	
	\$ <u>(1,156,728)</u>	\$ <u>1,161,304</u>	\$
	=====	=====	

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Deferred income taxes are based upon temporary differences between the financial statement and tax bases of assets and liabilities. The following deferred taxes are recorded:

	<u>2001</u>	
Deferred tax assets:		
Loss reserve discounting	\$ 2,336,868	
Unearned premium reserves	2,128,862	
Difference between tax and GAAP basis of Harbour Village project	<u>5,118,563</u>	
Gross deferred tax assets	<u>9,584,293</u>	
Deferred tax liabilities:		
Deferred acquisition costs	1,855,958	
Unrealized gain on securities	311,530	
Other	<u>1,772</u>	
Gross deferred tax liabilities	<u>2,169,260</u>	
Net deferred tax asset	\$ 7,415,033	
	=====	

A valuation allowance has not been established as the Company believes it is more likely than not that the deferred tax asset will be realized.

(8) Insurance Accounting

The consolidated financial statements have been prepared in conformity with GAAP which vary in certain respects, for the Company, American Safety Casualty and American Safety Indemnity, from statutory accounting practices prescribed or permitted by regulatory authorities. Statutory accounting practices include state laws, regulations, and general administrative rules, as well as a variety of publications of the National Association of Insurance Commissioners (the NAIC). In its March 1998 meeting, the NAIC membership adopted the Codification of Statutory Accounting Principles Project (the Codification) as the NAIC-supported basis of accounting. The Codification was approved with a provision allowing for commissioner discretion in determining appropriate statutory accounting for insurers. Accordingly, such discretion will continue to allow prescribed or permitted accounting practices that may differ from state to state.

The implementation date of Codification for the Company was January 1, 2001. The Company evaluated the impact of adopting Codification on statutory capital and surplus at January 1, 2001 and determined that statutory capital and surplus increased by \$803,935 due to the recognition of a deferred tax asset for statutory reporting.

The Bermuda Insurance Act of 1978 and related regulations (the Act) requires the Company to meet a minimum solvency margin. Statutory capital and surplus as of December 31, 2000, 2001 and 2002 were \$57,709,998, \$60,066,839 and \$62,522,785, respectively, and the amounts required to be maintained by the Company were \$3,179,716, \$3,610,139 and \$6,832,605, respectively. In addition, a minimum liquidity ratio must be maintained whereby relevant assets, as defined by the Act, must exceed 75% of relevant liabilities. Once these requirements have been met, there is no restriction on the retained earnings available for distribution.

As reported in American Safety Casualty's 2002 annual statement, the statutory capital and surplus of American Safety Casualty approximated \$29,525,318. The maximum amount of dividends which can be paid, without prior written approval of the Commissioner of Insurance of the State of Delaware, is limited to the greater of 10% of surplus as regards policyholders or net income, excluding realized capital gains, of the preceding year. Dividends are also limited to the amount of unassigned surplus. Accordingly, American Safety Casualty can pay dividends in 2003 of approximately \$47,000.

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The National Association of Insurance Commissioners (the NAIC) has established risk-based capital (RBC) requirements to help state regulators monitor the financial strength and stability of property and casualty insurers by identifying those companies that may be inadequately capitalized. Under the NAIC's requirements, each insurer must maintain its total capital above a calculated threshold or take corrective measures to achieve the threshold. The threshold of adequate capital is based on a formula that takes into account the amount of risk each company faces on its products and investments. The RBC formula takes into consideration four major areas of risk: (i) asset risk which primarily focuses on the quality of investments; (ii) insurance risk which encompasses coverage-related issues and anticipated frequency and severity of losses when pricing and designing insurance coverages; (iii) interest rate risk which involves asset/liability matching issues; and (iv) other business risks.

American Safety Casualty and American Safety Indemnity have calculated their RBC level and have determined that their capital and surplus is in excess of threshold requirements.

(9) Loans Payable

Acquisition and Development Loan

In July 2000, the Company, through its subsidiary, Ponce Lighthouse Properties, Inc., initially closed a \$37,900,000 acquisition, development and construction loan facility with a commercial bank for the Harbour Village project. The current facility has been increased to \$57.0 million. As of December 31, 2001, and December 31, 2002, the Company had outstanding borrowings of \$15,290,265 and \$16,971,148, respectively. Interest only is due monthly until July 31, 2004, at which time all outstanding principal and interest is due. Partial repayments are required as residential condominium units and boat slips are sold. The loan bears interest at a variable rate equal to 30 day LIBOR plus 2.25%, adjusted monthly. The loan is secured by a first mortgage on the real estate and a first priority security interest in all contracts for the sale of condominium units and boat slips, as well as all personal property used in the project. Both the Company and American Safety Holdings Corp., a subsidiary, have provided partial loan guarantees. The Company was in compliance with all debt covenants at December 31, 2001 and 2002, and there were no defaults of events of default during 2001 and 2002.

Finance of Insurance Premiums

The Company through its subsidiary, Ponce Lighthouse Properties, Inc., financed various insurance premiums in connection with the Harbour Village project. The premium financing loan is unsecured and bears interest at various rates. The outstanding balance at December 31, 2001 and December 31, 2002 was \$43,433 and \$172,599, respectively. The outstanding principal of \$172,599 is due in 2003.

Other Borrowings

The Company, through its subsidiary, American Safety Holdings Corp., has a loan facility of \$5.0 million. This loan bears interest of LIBOR plus 2.5%, adjusted monthly. At December 31, 2002, the outstanding borrowings under this loan were \$5.0 million. This loan is due in 2003.

Maturities of Loans Payable

Loans payable mature as follows: \$5,189,683 in 2003, \$16,989,742 in 2004, and \$2,848 in 2005.

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Interest Cost

The Company capitalizes interest as a component of cost during the development and construction period. In 2001 and 2002, the Company incurred \$1,232,860 and \$459,839, respectively in interest cost, all of which was capitalized.

(10) Related Party and Affiliate Transactions

The Company previously entered into reinsurance agreements with two companies, Intersure Reinsurance Company ( Intersure Re ) and Omega Reinsurance Company ( Omega Re ), each of which was owned and controlled, respectively, by a then senior officer of the Company, in order to provide limits of coverage on terms not readily available in the commercial reinsurance market. Reinsurance premiums ceded and earned aggregated \$308,875, \$587,071 and \$816,924 for the years ended December 31, 2000, 2001 and 2002, respectively. These treaties have been replaced by unaffiliated reinsurers and are in run-off. Intersure Re has exercised a previously granted option to purchase common shares of American Safety at an option price approximating fair value at the date of the grants. See Note (14).

ASI Services, American Safety's underwriting and administrative services subsidiary, leases office space from an entity which is owned by certain directors and shareholders of the Company. The lease commenced on March 1, 2001 and expires on February 28, 2006. The Company pays base annual rent of \$450,193 plus an annual increase based on the consumer price index of at least 4%.

For the years ended December 31, 2000, 2001 and 2002, ASI Services and ECSI received fees and commission income from American Safety RRG for risk management, claims administration and other management services.

The following tables reconcile the income statement effects to the Company from American Safety RRG:

	Years Ended December	
	2000	2001
		(In thousands)
Assumed premiums from American Safety RRG	\$ 5,761	\$ 10,964
Ceded premiums to American Safety RRG	4,469	7,005
Net premiums earned	1,292	3,959
Management fee	1,424	1,496
Brokerage commission income	2,515	1,490
Total revenues	\$ 5,231	\$ 6,945
Loss and loss adjustment expense incurred	\$ 535	\$ 2,392

The following table shows the balance sheet effects to the Company from American Safety RRG:

Assets	December 31,	
	2000	2001
Due from affiliate	\$ 985,320	\$ 1,108,520

## Liabilities

Unpaid loss and Loss adjustment expenses	5,902,643	8,821,395
Unearned premiums	1,508,781	4,238,931
Ceded premiums payable	567,786	-
Reinsurance payable on paid loss and Loss adjustment expenses	229,790	-
Due to affiliate	-	-

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**(11) Segment Information***Factors used to identify the Company's reportable segments:*

The Company's United States and Bermuda operating segments were identified by management as separate operating segments based upon the regulatory environments of each of these countries. Significant differences exist under United States and Bermuda law concerning the regulation of insurance entities, including differences in: types of permissible investments, minimum capital requirements, solvency monitoring, pricing, corporate taxation, etc.

*Products and services from each reportable segment:*

The Company is a specialty insurance holding company which, through its United States and Bermuda operating segments, develops, underwrites, manages and markets primary casualty insurance and reinsurance programs in the alternative insurance market for environmental risks, contracting and other specialty risks. The Company has demonstrated expertise in developing specialty insurance coverages and custom designed risk management programs not generally available in the standard insurance market.

The Company is the owner/developer of the Harbour Village project in Ponce Inlet, Florida, as discussed in Note 3, and this item is reflected in the segment United States-Real Estate.

The United States operating segment's specialty insurance programs include insurance and reinsurance for general, pollution and professional liability, workers' compensation, surety, as well as custom designed risk management programs for contractors, consultants and other business and property owners who are involved with environmental remediation, general construction and other specialty risks. These products have been aggregated into the Insurance segment, which is further broken down into United States-Insurance and Bermuda.

Through its United States brokerage and management services subsidiaries, the Company also provides specialized insurance program development, underwriting, risk and reinsurance placement, program management, brokerage, loss control, claims administration, information technology and marketing services. The Company also insures and places risks through two United States insurance subsidiaries, as well as its non-subsidiary risk retention group affiliate and other unaffiliated insurance companies.

Through its Bermuda operating segment, the Company places and reinsures a portion of the risks underwritten directly by its United States segment, its risk retention group affiliate and other insurers.

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*Information about segment profit or loss and assets*

	<u>2000</u>	<u>December</u> <u>2001</u>
		(In thous
United States - Insurance		
Net premiums earned - All other	\$ 24,314	\$ 6
Net premiums earned - Intersegment	(8,501)	(1
Net investment income and interest on notes receivable	1,955	
Real estate income	-	
Other income	3,804	
Total revenues	21,572	5
Interest expense	-	
Depreciation and amortization expense	240	
Equity in net earnings of subsidiaries	-	
Income taxes	(973)	
Segment earnings (loss)	(1,503)	
Significant noncash items other than depreciation and amortization	-	
Property, plant and equipment	702	
Total investments	56,032	7
Total assets	155,821	23
Total policy and contract liabilities	87,149	17
Total liabilities	127,480	20
United States - Real Estate		
Net premiums earned - All other	-	
Net premiums earned - Intersegment	-	
Net investment income and interest on notes receivable	-	
Real estate income	-	2
Other income	1	
Total revenues	1	2
Interest expense	-	
Depreciation and amortization expense	44	
Equity in net earnings of subsidiaries	-	
Income taxes (benefit)	(184)	
Segment earnings (loss)	(357)	
Significant noncash items other than depreciation and amortization	-	
Property, plant and equipment	234	
Total investments	24,836	3
Total assets	28,975	4
Total policy and contract liabilities	-	
Total liabilities	19,658	3
Bermuda		
Net premiums earned - All other	2,392	
Net premiums earned - Intersegment	8,501	1
Net investment income and interest on notes receivable	2,181	
Real estate income	-	
Other income	491	
Total revenues	13,565	1
Interest expense	-	
Depreciation and amortization expense	16	
Equity in net earnings (loss) of subsidiaries	(1,861)	
Income taxes	-	
Segment earnings	497	
Significant noncash items other than depreciation		

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and amortization	-	
Property, plant and equipment	-	
Total investments	58,200	6
Total assets	85,486	9
Total policy and contract liabilities	16,501	1
Total liabilities	17,520	2
Intersegment Eliminations		
Net premiums earned - All other	-	
Net premiums earned - Intersegment	-	
Net investment income and interest on notes receivable	-	
Real estate income	-	
Other income	841	
Total revenues	841	
Interest expense	-	
Depreciation and amortization expense	-	
Equity in net earnings (loss) of subsidiaries	1,861	(
Income taxes	-	
Segment earnings	-	
Significant noncash items other than depreciation and amortization	-	
Property, plant and equipment	-	
Total investments	(47,821)	(5
Total assets	(62,984)	(7
Total policy and contract liabilities	(11,188)	(1
Total liabilities	(15,163)	(2
Total		
Net premiums earned - All other	26,706	6
Net premiums earned - Intersegment	-	
Net investment income and interest on notes receivable	4,136	
Real estate income	-	2
Other income	5,137	
Total revenues	35,979	10
Interest expense	-	
Depreciation and amortization expense	300	
Equity in net earnings of subsidiaries	-	
Income taxes (benefit)	(1,157)	
Segment earnings (loss)	(1,363)	
Significant noncash items other than depreciation and amortization	-	
Property, plant and equipment	936	
Total investments	91,247	12
Total assets	207,298	29
Total policy and contract liabilities	92,462	17
Total liabilities	149,495	23

### (12) Commitments and Contingencies

At December 31, 2001 and 2002, the Company had aggregate outstanding irrevocable letters of credit which had not been drawn amounting to \$1,000,000 in favor of the Vermont Department of Banking, Insurance, Securities and Health Care Administration. Investments in the amount of \$1,000,000 have been pledged as collateral to the issuing bank.

### (13) Liability for Unpaid Loss and Loss Adjustment Expenses

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Activity in the liability for unpaid claims and claim adjustment expenses is summarized as follows:

	<u>2000</u>	<u>Years End</u>
		(In
Unpaid loss and loss adjustment expenses, January 1	\$ 20,413	
Reinsurance recoverable on unpaid losses and loss adjustment expenses at end of period	<u>6,065</u>	
Net unpaid loss and loss adjustment expense, January 1	<u>14,348</u>	
Incurred related to:		
Current year	17,356	
Prior years	<u>1,150</u>	
Total incurred	<u>18,506</u>	
Paid related to:		
Current year	4,291	
Prior years	<u>5,243</u>	
Total paid	<u>9,534</u>	
Net unpaid losses and loss adjustment expenses at end of period	23,320	
Reinsurance recoverable on unpaid losses and loss adjustment expenses at end of period	<u>27,189</u>	
Unpaid loss and loss adjustment end expenses at of period	\$ 50,509	

The negative claims development commencing in 2000 and continuing through 2001 in the Company's contract surety business line was the result of a rapid expansion of construction activity in the growing U.S. economy in the 1990's, coupled with the shortage of construction labor, followed by a significant downturn in the economy in early 2000-2001, which resulted in a substantial number of contractor defaults. In addition, premium increased on the Company's assumed workers compensation business (which has been terminated) during 2002 for prior years which resulted in negative development. Management continually attempts to improve its loss estimation process by refining its ability to analyze loss development patterns, claims payments and other information, but many reasons remain for potential adverse development of estimated ultimate liabilities. For example, the uncertainties inherent in the loss estimation process have become increasingly subject to changes in legal trends. In recent years, this trend has expanded the liability of insureds, established new liabilities and reinterpreted contracts to provide unanticipated coverage long after the related policies were written. Such changes from past experience significantly affect the ability of insurers to estimate the liabilities for unpaid losses and related expenses.

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Management recognizes the higher variability associated with certain exposures and books of business and considers this factor when establishing liabilities for losses. Management currently believes the Company's gross and net liabilities are adequate.



The net liabilities for losses and loss adjustment expenses maintained by the Company's insurance subsidiaries are equal under both statutory and generally accepted accounting principles.

#### (14) Stock Options

The Company's stock option plan grants incentive stock options to employees. The options have a term of 10 years. The exercise price is equal to the fair market value at the date of grant. The majority of our options generally vest over three years. At December 31, 2002, 596,483 shares were available for future grants.

We use the intrinsic value method to value stock options in accordance with APB No. 25. Under this method, we do not recognize compensation cost for stock options provided the option price equals fair market value at the date of grant. Our stock option plan sets the exercise price equal to the fair market value at the date of grant.

The following table shows the stock option activity for the Company during 2000, 2001 and 2002.

		<u>Option shares</u>		<u>Weighted average exercise price</u>
Outstanding at December 31, 1999	\$	542,431	\$	9.78
2000 activity:				
Granted		99,650		6.00
Canceled		<u>(17,891)</u>		<u>—</u>
Outstanding at December 31, 2000	\$	624,190	\$	9.20
		=====		=====
		=====		=====
2001 activity:				
Granted		328,724		6.00
Canceled		<u>(15,341)</u>		<u>—</u>
Outstanding at December 31, 2001	\$	937,573	\$	8.13
		=====		=====
		=====		=====
2002 activity:				
Granted		106,000		8.85
Exercised		(61,757)		—
Canceled		<u>(23,466)</u>		<u>—</u>
Outstanding at December 31, 2002	\$	958,350	\$	8.34
		=====		=====

Of the 624,190 outstanding options at December 31, 2000, 361,140 were exercisable.  
Of the 937,573 outstanding options at December 31, 2001, 834,718 were exercisable.  
Of the 958,350 outstanding options at December 31, 2002, 827,433 were exercisable.

The remainder of the options vests evenly over a three year period.

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The following table summarizes information about stock options outstanding at December 31, 2002:

Range of exercise price	Options Outstanding		Weighted average remaining contractual life	Weighted average exercise price	Grant Year	Options
	Number outstanding					
\$ 7.08	65,500		4.75	\$ 7.08	1997	6
11.00	315,000		5.13	11.00	1998	31
9.50	88,100		6.13	9.50	1999	8
6.00	88,250		7.22	6.00	2000	5
6.00	300,000		8.04	6.00	2001	30
8.85	<u>101,500</u>		9.14	8.85	2002	
\$ 6.00-11.00	958,350		6.73	\$ 8.34		82

The fair value of each option granted during 2000, 2001 and 2002 was estimated on the date of grant using the Black-Scholes multiple option approach with the following assumptions: dividend yield of 0.0%; 0.0% and 6.0% expected volatility of 51.08%, 44.33% and 42.75% in 2000, 2001 and 2002, respectively; risk-free interest rate of 5.4%, 5.4% and 3.5% in 2000, 2001 and 2002, respectively; and expected life from the vesting dates ranging from 0.50 years to 10.00 years.

The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future amounts. The Company expects to grant additional awards in future years. The Company granted options in 2000, 2001 and 2002 at an amount deemed to be fair market value at the date of grant. See Note 1(p) for more information.

(15) Acquisitions

On March 24, 2000, the Company purchased Trafalgar Insurance Company, a Oklahoma licensed insurance company, which has authority to operate as an excess and surplus lines insurance company in 34 states and the District of Columbia. Trafalgar Insurance Company's stock was acquired from Houston Casualty Company for a purchase price of \$16.3 million cash, and Trafalgar had, at closing, cash of \$9.3 million and investments of \$5.7 million creating \$1.3 million of goodwill. The net cash outlay for this acquisition was \$7.0 million. Prior to closing, Trafalgar entered into a bulk assumption reinsurance agreement with Houston Casualty, under which Houston Casualty assumed all of Trafalgar's prior and existing insurance business. Trafalgar has been renamed American Safety Indemnity Company.

In January 2000, the Company acquired (i) the stock of L&W Holdings, Inc. and its wholly-owned subsidiary, RCA Syndicate #1, Ltd., an Illinois licensed insurer operating on the INEX (formerly the Illinois Insurance Exchange), (ii) the stock of Principal Management, Inc., an insurance program development and management company headquartered in Okemos, Michigan, and in a related transaction, the Company also acquired (iii) the stock of Pegasus Insurance, a Cayman Islands licensed insurer. The transactions were structured as stock acquisitions, with the purchase price payable by the Company consisting of \$3,500,000 plus 200,000 American Safety common shares and earnout provisions for up to an additional 254,000 American Safety common shares over a five-year period. Of the purchase price, \$1,000,000 of cash and 109,086 shares of stock are held by the Company in escrow to secure the obligations of the sellers. The Company filed a lawsuit in April

2000 in the United States District Court for the Northern District of Georgia for damages and, alternatively, to rescind the acquisitions based upon the sellers' breach of the representations and warranties made concerning the business affairs and financial condition of the acquired companies. The sellers' misrepresentations as to the business affairs and financial condition of the acquired companies, and the under-reserving for claims, relate only to the operations of the acquired companies. The sellers/defendants filed several motions for summary judgment opposing the Company's rescission claims. In September 2002, the Court entered an order granting the defendants motions for summary judgment. However, the Court did not rule that the representations and warranties of the defendants in the definitive agreements were correct. The Court also granted the Company's motions for summary judgment on various counterclaims. The Company filed a motion for reconsideration with respect to the Court's order which the Court denied in November 2002. The case will now proceed to trial or the Court may allow additional summary judgment motions to be filed in order to dispose of the case. Thereafter, the Company will have the right to appeal all adverse prior rulings in the case.

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(16) Litigation

The Company is a defendant in various litigation matters considered to be in the normal course of or related to its business. While the outcome of these matters cannot be estimated with certainty, management believes (after consultation with legal counsel) that the resolution of such litigation will not have a material adverse effect on the Company's financial statements except for the following matters.

*Principal Management, Inc. et al.* In January 2000, the Company acquired (i) the stock of L&W Holdings, Inc. and its wholly-owned subsidiary, RCA Syndicate #1, Ltd., an Illinois licensed insurer operating on the INEX (formerly the Illinois Insurance Exchange), (ii) the stock of Principal Management, Inc., an insurance program development and management company headquartered in Okemos, Michigan, and in a related transaction, the Company also acquired (iii) the stock of Pegasus Insurance, a Cayman Islands licensed insurer. The transactions were structured as stock acquisitions, with the purchase price payable by the Company consisting of \$3,500,000 plus 200,000 American Safety common shares and earnout provisions for up to an additional 254,000 American Safety common shares over a five-year period. Of the purchase price, \$1,000,000 of cash and 109,086 shares of stock are held by the Company in escrow to secure the obligations of the sellers.

When RCA Syndicate #1, Ltd. filed its 1999 Annual Statement with the Illinois Department of Insurance in March 2000, the Company first became aware that there had been a material adverse change in the business affairs and financial condition of the acquired companies from that represented by the sellers. The Company launched an investigation which disclosed that the insurance claims experience of the acquired companies had been misrepresented and that incurred losses from insurance claims were significantly in excess of the amounts reported in their claims records and their financial statements. As a result, the Company then made written demand upon the selling shareholders of the acquired companies for rescission of the acquisitions, including a return of the purchase price paid for the companies. The Company filed a lawsuit in April 2000 in the United States District Court for the Northern District of Georgia for damages and, alternatively, to rescind the acquisitions based upon the sellers' breach of the representations and warranties made concerning the business affairs and financial condition of the acquired companies. The sellers' misrepresentations as to the business affairs and financial condition of the acquired companies, and the under-reserving for claims, relate only to the operations of the acquired companies. The

sellers/defendants filed several motions for summary judgment opposing the Company's rescission claims. In September 2002, the Court entered an order granting the defendants' motions for summary judgment. However, the Court did not rule that the representations and warranties of the defendants in the definitive agreements were correct. The Court also granted the Company's motions for summary judgment on various counterclaims. The Company filed a motion for reconsideration with respect to the Court's order which the Court denied in November 2002. As a result, the Company recognized a \$1 million expense in 2002. The case will now proceed to trial or the Court may allow additional summary judgment motions to be filed in order to dispose of the case. Thereafter, the Company will have the right to appeal all adverse prior rulings in the case.

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*Berkley Insurance Company.* During the fourth quarter of 2001, one of the Company's former reinsurers, Berkley Insurance Company, disputed its obligations under several reinsurance treaties entered into during the soft reinsurance market that existed in 1998 and 1999. As a result of adverse loss experience to the reinsurer from certain lines of business, Berkley has stopped reimbursing the Company for amounts due under such treaties and requested that the Company retroactively consider taking a greater portion of the losses than is required under the treaties or, alternatively, to rescind and reform portions of certain treaties. The Company instituted arbitration proceedings against the reinsurer and the arbitration hearing is scheduled for late May 2003. Berkley is a subsidiary of W.R. Berkley Corp. (NYSE:BER). As of December 31, 2002, unreimbursed paid claims under the treaties totaled \$14.9 million and additional ceded case reserves and reserves for incurred but not reported losses totaled approximately \$19.6 million. The Company is discussing resolution of this matter with Berkley, although the Company believes the reinsurer's request has no merit and was made in bad faith. The Company recognized a \$1.1 million write-off in 2002 for reinsurance recoverables relating to the Berkley dispute as a result of a settlement offer made by the Company. The Company does not believe this dispute will have a material adverse effect on the overall financial condition or liquidity of the Company as management believes the Company has sufficient current cash flows and invested assets to meet its insurance obligations. However, due to the fact that the final decision rests in the hands of an arbitration panel, it is uncertain whether the panel's decision will be on terms favorable to the Company.

#### 17. Subsequent Event

*Harbour Village Zoning.* On March 2, 2002, the Town of Ponce Inlet filed a petition for declaratory relief in the Circuit Court of Volusia County, Florida seeking clarification that the Company could not construct a building higher than 35 feet on a beachfront parcel of the last phase of the Harbour Village project, although the Town permitted 30 other buildings in the Town over 35 feet in height, including 10 at the Harbour Village project. The Company's position was that the Town's 1984 ordinance and subsequent development agreements permitted it to construct a beachfront building of up to 70 feet in height in the Harbour Village project. On March 17, 2003, the Court found that a 1983 Town charter amendment limited all buildings in the Town of Ponce Inlet to 35 feet with no exceptions and accordingly ruled that all ordinances and development agreements of the Town adopted since the 1983 charter amendment were beyond the scope of the Town's authority (i.e., ultra vires).

The Company immediately filed a motion for rehearing and upon rehearing on April 11, 2003, the Court vacated its original ruling and issued a new ruling which limited construction of a building no higher than 35 feet on the beachfront parcel. In connection with the rehearing, the Company and the

Town of Ponce Inlet agreed to settle pending disputes as to the Company's development plan for the last phase of Harbour Village project and to release all claims against each other. Under this settlement, the Company would (i) continue construction of the 7 story buildings in the Links phase (containing 376 units), (ii) build not more than a 3 story building with condominium units or a beach club on the beachfront parcels, (iii) reduce the Fisherman's Harbour building to a 2 or 3 story commercial center rather than a mixed use 7 story building (planned for 70 units), and (iv) make other accommodations including the payment of \$500,000 to the Town which was expensed in 2002.

These changes in the Company's development plans would reduce the size of the Harbour Village project from 809 to 676 condominium units. As a result, the Company has reallocated the common and land costs of the Harbour Village project over such reduced number of condominium units, which resulted in an increase to the net loss for the fourth quarter of 2002 of \$229,000 from the development of the Harbour Village project.

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**AMERICAN SAFETY INSURANCE GROUP, LTD.**
**SELECTED QUARTERLY FINANCIAL DATA****(unaudited)**

The following table presents the quarterly results of consolidated operations for 2001 and 2002 (dollars in thousands, except per share amounts):

<u>2001</u>	<u>Mar. 31</u>	<u>June 30</u>	<u>Sept. 30</u>
Operating revenues*	\$ 15,322	\$ 17,966	\$ 20,817
Income (loss) before taxes	1,301	1,806	1,246
Net earnings (loss)	1,262	1,585	979
Comprehensive income (loss)	1,744	988	2,208
Net earnings (loss) per share:			
Basic	\$ 0.26	\$ 0.33	\$ 0.20
Diluted	0.25	0.32	0.20
Common stock price ranges:			
High	\$ 9.10	\$ 10.25	\$ 10.35
Low	5.75	7.95	8.80
<u>2002</u>	<u>Mar. 31</u>	<u>June 30</u>	<u>Sept. 30</u>
Operating revenues*	\$ 34,426	\$ 30,516	\$ 29,859
Income (loss) before taxes	3,019	2,735	1,212
Net earnings (loss)	2,046	1,853	1,034
Comprehensive income (loss)	818	3,341	3,906
Net earnings (loss) per share:			
Basic	\$ 0.43	\$ 0.39	\$ 0.22
Diluted	0.43	0.38	0.21

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Common stock price ranges:

High	\$	9.32	\$	8.98	\$	8.80
Low		8.27		7.73		7.76

\*Operating revenues are total revenues less amounts for realized gains and losses.

During the fourth quarter of 2001, the Company incurred decreased earnings because of increases in reserves for its surety and commercial lines books of business. During the fourth quarter of 2002, the Company incurred a net loss as a result of impairment of notes receivable, allowance for reinsurance recoverable, and also from decreased closings in its real estate subsidiaries.

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**AMERICAN SAFETY INSURANCE GROUP, LTD. (PARENT ONLY)**

**SCHEDULE II - CONDENSED BALANCE SHEETS**

**DECEMBER 31, 2001 AND 2002**

	2001
Investment in subsidiary	\$51,376,103
Other investments:	
Fixed maturities	4,297,570
Cash and cash equivalents	14,737
Short term investments	201,742
Secured note receivable	2,500,000
Accrued investment income	456,181
Total investment income	58,846,333
Premiums receivable	1,434,586
Due from affiliate	1,304,302
Ceded loss reserves	577,000
Other assets	1,056,421
Total assets	\$63,218,642
Liability and shareholders' equity	
Unpaid losses and loss adjustments expenses	\$1,964,279
Ceded premiums payable	992,803
Assumed loss and LAE payable	-
Due to related party	-
Dividend payable	-
Accounts payable and accrued expenses	181,222
Total liabilities	3,138,304
Common and preferred stock	162,873
Additional paid in capital	35,206,612
Accumulated other comprehensive earnings, net	834,974
Retained earnings	33,416,853
Treasury stock	(9,540,974)
Total shareholders' equity	60,080,338
Total liabilities and shareholders' equity	\$63,218,642

See accompanying independent auditors report.

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**AMERICAN SAFETY INSURANCE GROUP, LTD. (PARENT ONLY)****SCHEDULE II - CONDENSED INCOME STATEMENT****YEARS ENDED DECEMBER 31, 2000, 2001 AND 2002**

	2000	2001
Revenues:		
Direct and assumed premiums earned	\$ 18,300	\$ (156,789)
Ceded premiums earned	15,038	79,415
Net premiums earned	33,338	(77,374)
Investment income	339,055	227,807
Interest on notes receivable	951,784	103,814
Realized gains (losses) on sales of investments	(131,212)	-
Other income	270,180	211,175
Total Revenues	1,463,145	465,422
Expenses:		
Losses and LAE Incurred	50,234	(1,001,970)
Acquisition expenses	(3,700)	-
Other underwriting expenses	491,492	567,861
Expenses due to rescission	1,567,305	-
Total Expenses	2,105,331	(434,109)
Earnings (loss) before equity in net earnings (loss) of subsidiary	(642,186)	899,531
Equity in net earnings (loss) of subsidiary	(720,971)	3,254,738
Net (loss) earnings	\$ (1,363,157)	\$4,154,269

See accompanying independent auditors report.

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**AMERICAN SAFETY INSURANCE GROUP, LTD. (PARENT ONLY)****SCHEDULE II - STATEMENT OF CASH FLOW****YEARS ENDED DECEMBER 31, 2000, 2001 AND 2002**

	2000	2001
Cash flow from operating activities:		
Net earnings (loss) before equity in earnings of subsidiary	\$ (642,186)	\$ 899,531
Adjustments to reconcile net earnings (loss) to net cash provided (used) by operating activities:		
Change in:		
Accrued investment income	1,967,860	(138,442)
Premiums receivable/payable	(341,365)	895,630
Due from/to affiliate	(2,773,905)	519,850
Unpaid losses and loss adjustment expenses	(592,108)	(2,007,292)

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Liability for deductible fees held	(48,375)	-
Accounts payable and accrued expenses	(19,777)	169,169
Assumed loss and LAE payable	(914,648)	121,352
Other, net	23,209	7,277
Net cash provided (used) by operating activities	(3,341,295)	467,075
Cash flow from investing activities:		
Decrease in investments	10,954,164	1,837,081
Investment in subsidiary	(3,900,000)	-
Decrease in short term investments	-	-
Sale of fixed assets, net	841,701	-
Net cash provided by investing activities	7,895,865	1,837,081
Cash flow from financing activities:		
Proceeds from sale of common stock	17,227	-
Dividends paid	-	-
Purchase of Treasury Stock	(4,929,574)	(2,442,061)
Net cash (used) by financing activities	(4,912,347)	(2,442,061)
Net (decrease) increase in cash	(357,777)	(137,905)
Cash and cash equivalents at beginning of year	510,419	152,642
Cash and cash equivalents at end of year	\$ 152,642	\$ 14,737

See accompanying independent auditors report.

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**AMERICAN SAFETY INSURANCE GROUP, LTD. (PARENT ONLY)**

**SCHEDULE II - CONDENSED COMPREHENSIVE INCOME**

**YEARS ENDED DECEMBER 31, 2000, 2001 AND 2002**

	2000	2001
Net earnings (loss)	\$ (1,363,157)	\$4,154,269
Other comprehensive earnings before income taxes:		
Unrealized gains (losses) on securities available for sale	1,414,896	1,315,686
Reclassification adjustment for realized gains (losses) included in net earnings	(542,088)	756,512
Total other comprehensive earnings before taxes	1,956,984	559,174
Income tax expense related to items of comprehensive income	240,095	152,285
Other comprehensive earnings net of income taxes	1,716,889	406,889
Total comprehensive earnings	\$ 353,732	\$4,561,158

See accompanying independent auditors report.

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**AMERICAN SAFETY INSURANCE GROUP, LTD. (PARENT ONLY)****SCHEDULE III - SUPPLEMENTAL INFORMATION CONCERNING****PROPERTY-CASUALTY INSURANCE OPERATIONS**

(in thousands)

	Column B	Column C Reserves for Unpaid Claims and Claim Adjust- ment Expenses	Column D Discount if any, Deducted in Column C	Column E Unearned Premiums	Column F Earned Premiums	Column G Net Investment Income	Column H Claims and Claim Adjust- ment Expenses Incurred Related to Current Year	Prior Years
-----								
United States								
December 31, 2000	2,974	11,462	-	15,466	15,812	1,955	11,762	598
December 31, 2001	4,196	30,787	-	30,045	47,749	2,882	31,463	1,494
December 31, 2002	4,232	43,188		33,019	40,503	3,070	23,104	651
Bermuda								
December 31, 2000	65	11,858	-	3,850	10,893	650	5,594	552
December 31, 2001	323	13,053	-	2,737	15,220	768	11,006	23
December 31, 2002	3,451	20,640		14,175	25,446	946	13,502	1,017
Combined Total								
December 31, 2000	3,039	23,320	-	19,316	26,705	2,605	17,356	1,150
December 31, 2001	4,519	43,840	-	32,782	62,969	3,650	42,469	1,517
December 31, 2002	7,683	63,828		47,194	65,949	4,016	36,606	1,668

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**AMERICAN SAFETY INSURANCE GROUP, LTD. (PARENT ONLY)****SCHEDULE IV - REINSURANCE****YEARS ENDED DECEMBER 31, 2000, 2001 AND 2002**

	Property-Liability Insurance Premiums Earned	Gross Amount	Ceded to Other Companies	Assumed from Other Companies	A
United States					
December 31, 2000		35,602	26,971	15,783	2
December 31, 2001		119,121	81,391	25,205	6
December 31, 2002		118,438	73,240	20,115	6
Bermuda					
December 31, 2000		-	303	2,694	
December 31, 2001		-	587	2,439	
December 31, 2002		-	817	1,453	
Combined Total					
December 31, 2000		35,602	27,274	18,477	2

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December 31, 2001	119,121	81,978	27,644	6
December 31, 2002	118,438	74,057	21,568	6

See accompanying independent auditors' report.

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**AMERICAN SAFETY INSURANCE GROUP, LTD.**

**EXHIBIT 12**

**RATIO OF EARNINGS TO FIXED CHARGES**

	2000	2001
Earnings		
Pre-tax earnings (loss)	(2,520)	(5,316)
Plus: Interest expense recognized	-	470
Total Earnings	(2,520)	5,786
Fixed charges	244	1,237
Interest accruals for the period	244	1,237
Total fixed charges	244	1,237
Coverage Ratio	\$ (2,764)	4.677445

\*Dollar amounts are in thousands.

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**Exhibit 99**  
**Harbour Village Development Status**  
**(000)s except references to Condo Units**  
**(Unaudited)**

	Marina Condos	Phase 1 Townhouses Oak Hammock	Riverwalk	Phase 2 The Links North	The Links South	Phase 3 Fisherman Harbour
12/31/2002						
Planned Number of Condo Units and Boat Slips	248	18	28	188	188	(Note
Condo Units and Boat Slips under Contract	248	15	27	172	129	
Value of Pre-sale Contracts (Note 1)	62,892	6,693	10,507	43,223	35,222	
Number of Closed Units	248	3	11	-	-	-
Number of Buildings	8	4	6	4	4	1
Number of Buildings Complete by Task						
Building Foundation	8	4	5	4	-	-
Vertical Building Completed	8	4	5	2	-	-
Interior Finish Completed	8	3	4	-	-	-
Certificate of Occupancy						

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Received	8	2	4	-	-	-
Actual 12/31/2002 YTD						
Units Closed	146	3	11	-	-	-
Revenue Recognized	39,754	1,270	3,712	-	-	-
Other Revenue						
Total Revenue						
Gross Profit (Loss) Recognized	5,784	(392)	(176)	-	-	-
Other Expense (Income) Items (Note 2)						
Pre-Tax Profit						
Actual 12/31/2002 QTD						
Units Closed	-	3	10	-	-	-
Revenue Recognized	978	1,270	3,400	-	-	-
Other Revenue						
Total Revenue						
Gross Profit (Loss) Recognized	(717)	(392)	(176)	-	-	-
Other Expense (Income) Items-Note 2						
Pre-Tax Profit (loss)						
Outlook For 1st Quarter of 2003						
Units Closed	-	5	5	-	-	-
Revenue Recognized	157	2,009	1,962	-	-	-
Other Revenue						
Total Revenue						
Gross Profit Recognized	19	-	-	-	-	-
Other Expense (Income) Items						
Pre-Tax Profit (Loss)						

Note 1 - No assurance can be given that purchasers under binding pre-sale contracts with deposits will close each contemplated transaction .

Note 2 - Other includes net brokerage commissions, advertising, promotion, and other general and administrative costs. These items are not allocated to specific buildings.

Note 3 - As a result of the settlement of material zoning litigation brought by the Town of Ponce Inlet, Florida, the Company among other matters, reduce the Fisherman s Harbour building to a 2 story commercial center, rather than a mixed use building with 70 units. See Item 3. "Legal Proceedings".

Item 3. Legal Proceedings for a discussion of the material zoning litigation.

The projected results contained above for unit closings, revenue, gross profit, fixed costs and pre-tax profit are forward looking statements. With respect to the Company s development of the Harbour Village project, such forward looking statements involve risks and uncertainties which may cause actual results to differ materially, and are subject

to change based on various real estate development industry factors, including competitive housing conditions in the local market area, risks inherent in real estate development and new construction, increases in construction costs, construction delays, weather, zoning, litigation, changes in interest rates and the availability of mortgage financing for prospective purchasers of condominium units and boat slips and changes in local and national levels of general business activity and economic conditions.