

SAFETY INSURANCE GROUP INC  
Form 10-Q  
November 05, 2010  
[Table of Contents](#)

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended September 30, 2010

OR

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

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

Commission File Number: 000-50070

**SAFETY INSURANCE GROUP, INC.**

(Exact name of registrant as specified in its charter)

Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

**Delaware**

(State or other jurisdiction of incorporation or organization)

**13-4181699**

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

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

(Address of principal executive offices including zip code)

**(617) 951-0600**

(Registrant's telephone number, including area code)

**Not Applicable**

(Former name or former address, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

As of November 2, 2010, there were 15,039,472 shares of common stock with a par value of \$0.01 per share outstanding.



Table of Contents

**SAFETY INSURANCE GROUP, INC.**

**Table of Contents**

	<b>Page</b>
<b>PART I.</b>	
	<b>FINANCIAL INFORMATION</b>
<b>Item 1.</b>	
	<b>Financial Statements</b>
	<u>Consolidated Balance Sheets at September 30, 2010 (Unaudited) and December 31, 2009</u>
	3
	<u>Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2010 and 2009 (Unaudited)</u>
	4
	<u>Consolidated Statements of Changes in Shareholders' Equity for the Nine Months Ended September 30, 2010 and 2009 (Unaudited)</u>
	5
	<u>Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended September 30, 2010 and 2009 (Unaudited)</u>
	6
	<u>Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2010 and 2009 (Unaudited)</u>
	7
	<u>Notes to Unaudited Consolidated Financial Statements</u>
	8
<b>Item 2.</b>	
	<b><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>
	<u>Executive Summary and Overview</u>
	24
	<u>Critical Accounting Policies and Estimates</u>
	28
	<u>Results of Operations — Three and Nine Months Ended September 30, 2010 and 2009</u>
	35
	<u>Liquidity and Capital Resources</u>
	42
	<u>Forward-Looking Statements</u>
	44
<b>Item 3.</b>	<b><u>Quantitative and Qualitative Disclosures about Market Risk</u></b>
	45
<b>Item 4.</b>	<b><u>Controls and Procedures</u></b>
	46
<b>PART II.</b>	
	<b><u>OTHER INFORMATION</u></b>
<b>Item 1.</b>	<b><u>Legal Proceedings</u></b>
	46
<b>Item 1A.</b>	<b><u>Risk Factors</u></b>
	46
<b>Item 2.</b>	<b><u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>
	46
<b>Item 3.</b>	<b><u>Defaults upon Senior Securities</u></b>
	46
<b>Item 4.</b>	<b><u>Removed and Reserved</u></b>
	46
<b>Item 5.</b>	<b><u>Other Information</u></b>
	46
<b>Item 6.</b>	<b><u>Exhibits</u></b>
	46
<b>SIGNATURE</b>	47
<b>EXHIBIT INDEX</b>	48

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Consolidated Balance Sheets****(Dollars in thousands, except share data)**

	September 30, 2010 (Unaudited)	December 31, 2009
<b>Assets</b>		
Investment securities available for sale:		
Fixed maturities, at fair value (amortized cost: \$982,910 and \$989,444)	\$ 1,037,739	\$ 1,018,329
Equity securities, at fair value (cost: \$13,524 and \$9,736)	13,958	9,876
Total investment securities	1,051,697	1,028,205
Cash and cash equivalents	90,883	74,470
Accounts receivable, net of allowance for doubtful accounts	158,352	137,238
Accrued investment income	9,223	10,044
Taxes recoverable	2,695	
Receivable from reinsurers related to paid loss and loss adjustment expenses	6,700	6,851
Receivable from reinsurers related to unpaid loss and loss adjustment expenses	56,726	64,874
Ceded unearned premiums	11,892	13,698
Deferred policy acquisition costs	55,579	47,900
Deferred income taxes	4	8,335
Equity and deposits in pools	25,682	23,840
Other assets	10,676	12,382
<b>Total assets</b>	<b>\$ 1,480,109</b>	<b>\$ 1,427,837</b>
<b>Liabilities</b>		
Loss and loss adjustment expense reserves	\$ 413,066	\$ 439,706
Unearned premium reserves	322,761	282,434
Accounts payable and accrued liabilities	43,516	59,869
Taxes payable		3,916
Payable for securities purchased	11,895	
Payable to reinsurers	10,954	4,674
Other liabilities	18,496	16,803
<b>Total liabilities</b>	<b>820,688</b>	<b>807,402</b>
<b>Commitments and contingencies (Note 7)</b>		
<b>Shareholders equity</b>		
Common stock: \$0.01 par value; 30,000,000 shares authorized; 16,754,727 and 16,624,220 shares issued	168	166
Additional paid-in capital	148,800	144,814
Accumulated other comprehensive income, net of taxes	35,921	18,866
Retained earnings	530,058	506,301
Treasury stock, at cost; 1,727,455 and 1,564,548 shares	(55,526)	(49,712)
<b>Total shareholders equity</b>	<b>659,421</b>	<b>620,435</b>
<b>Total liabilities and shareholders equity</b>	<b>\$ 1,480,109</b>	<b>\$ 1,427,837</b>

The accompanying notes are an integral part of these financial statements



Table of Contents

## Safety Insurance Group, Inc. and Subsidiaries

## Consolidated Statements of Operations

(Unaudited)

(Dollars in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net earned premiums	\$ 139,190	\$ 133,059	\$ 408,490	\$ 399,715
Net investment income	10,108	11,093	31,757	32,221
Net realized gains (losses) on investments	363	(20)	295	(337)
Finance and other service income	4,770	4,197	13,642	12,578
Total revenue	154,431	148,329	454,184	444,177
Losses and loss adjustment expenses	88,455	82,280	264,905	261,555
Underwriting, operating and related expenses	44,229	42,061	128,354	122,681
Interest expense	22	23	66	66
Total expenses	132,706	124,364	393,325	384,302
Income before income taxes	21,725	23,965	60,859	59,875
Income tax expense	6,258	6,941	17,529	15,992
<b>Net income</b>	<b>\$ 15,467</b>	<b>\$ 17,024</b>	<b>\$ 43,330</b>	<b>\$ 43,883</b>
<b>Earnings per weighted average common share:</b>				
Basic	\$ 1.03	\$ 1.11	\$ 2.87	\$ 2.80
Diluted	\$ 1.03	\$ 1.11	\$ 2.87	\$ 2.79
<b>Cash dividends paid per common share</b>	<b>\$ 0.50</b>	<b>\$ 0.40</b>	<b>\$ 1.30</b>	<b>\$ 1.20</b>
<b>Number of shares used in computing earnings per share:</b>				
Basic	15,018,988	15,296,221	15,072,238	15,694,500
Diluted	15,036,656	15,314,552	15,089,317	15,713,733

The accompanying notes are an integral part of these financial statements

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Consolidated Statements of Changes in Shareholders' Equity****(Unaudited)****(Dollars in thousands)**

	<b>Common Stock</b>	<b>Additional Paid-in Capital</b>	<b>Accumulated Other Comprehensive (Loss) Income, Net of Taxes</b>	<b>Retained Earnings</b>	<b>Treasury Stock</b>	<b>Total Shareholders Equity</b>
Balance at December 31, 2008	\$ 165	\$ 140,261	\$ (6,528)	\$ 476,989	\$ (7,516)	\$ 603,371
Net income, January 1 to September 30, 2009				43,883		43,883
Other comprehensive income, net of deferred federal income taxes			30,725			30,725
Exercise of options and unearned compensation on restricted stock, net of deferred federal income taxes	1	3,266				3,267
Dividends paid				(18,816)		(18,816)
Acquisition of treasury stock					(42,196)	(42,196)
Balance at September 30, 2009	\$ 166	\$ 143,527	\$ 24,197	\$ 502,056	\$ (49,712)	\$ 620,234

	<b>Common Stock</b>	<b>Additional Paid-in Capital</b>	<b>Accumulated Other Comprehensive Income, Net of Taxes</b>	<b>Retained Earnings</b>	<b>Treasury Stock</b>	<b>Total Shareholders Equity</b>
Balance at December 31, 2009	\$ 166	\$ 144,814	\$ 18,866	\$ 506,301	\$ (49,712)	\$ 620,435
Net income, January 1 to September 30, 2010				43,330		43,330
Other comprehensive income, net of deferred federal income taxes			17,055			17,055
Exercise of options and unearned compensation on restricted stock, net of deferred federal income taxes	2	3,986				3,988
Dividends paid				(19,573)		(19,573)
Acquisition of treasury stock					(5,814)	(5,814)
Balance at September 30, 2010	\$ 168	\$ 148,800	\$ 35,921	\$ 530,058	\$ (55,526)	\$ 659,421

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





Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Consolidated Statements of Comprehensive Income****(Unaudited)****(Dollars in thousands)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
<b>Net income</b>	\$ 15,467	\$ 17,024	\$ 43,330	\$ 43,883
<b>Other comprehensive income, net of tax:</b>				
Unrealized holding gains during the period, net of tax expense of \$3,520, \$8,744, \$9,287, and \$16,426	6,539	16,239	17,247	30,506
Reclassification adjustment for (gains) losses included in net income, net of tax (expense) benefit of (\$126), \$7, (\$103), and \$118	(237)	13	(192)	219
Unrealized gains on securities available for sale	6,302	16,252	17,055	30,725
<b>Comprehensive income</b>	\$ 21,769	\$ 33,276	\$ 60,385	\$ 74,608

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

Table of Contents

## Safety Insurance Group, Inc. and Subsidiaries

## Consolidated Statements of Cash Flows

(Unaudited)

(Dollars in thousands)

	Nine Months Ended September 30,	
	2010	2009
<b>Cash flows from operating activities:</b>		
Net income	\$ 43,330	\$ 43,883
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization, net	9,227	9,130
(Benefit) provision for deferred income taxes	(852)	662
Net realized (gains) losses on investments	(295)	337
Gains on sales of fixed assets	(9)	
Changes in assets and liabilities:		
Accounts receivable	(21,114)	(9,561)
Accrued investment income	821	(70)
Receivable from reinsurers	8,299	10,108
Ceded unearned premiums	1,806	6,932
Deferred policy acquisition costs	(7,679)	(4,068)
Other assets	(3,824)	(1,069)
Loss and loss adjustment expense reserves	(26,640)	(20,753)
Unearned premium reserves	40,327	12,528
Accounts payable and accrued liabilities	(16,353)	(12,210)
Payable to reinsurers	6,280	6,106
Other liabilities	(2,223)	(1,082)
Net cash provided by operating activities	31,101	40,873
<b>Cash flows from investing activities:</b>		
Fixed maturities purchased	(215,205)	(140,971)
Equity securities purchased	(5,874)	(4,708)
Proceeds from sales, paydowns and calls of fixed maturities	189,361	82,829
Proceeds from maturities of fixed maturities	40,524	10,022
Proceed from sales of equity securities	2,079	3,164
Proceed from maturities of short-term securities		82,996
Fixed assets purchased	(803)	(217)
Fixed assets sold	9	
Net cash provided by investing activities	10,091	33,115
<b>Cash flows from financing activities:</b>		
Proceeds and excess tax benefits from exercise of stock options	608	271
Dividends paid to shareholders	(19,573)	(18,816)
Acquisition of treasury stock	(5,814)	(42,196)
Net cash used for financing activities	(24,779)	(60,741)
<b>Net increase in cash and cash equivalents</b>	<b>16,413</b>	<b>13,247</b>
Cash and cash equivalents at beginning of year	74,470	60,451
<b>Cash and cash equivalents at end of period</b>	<b>\$ 90,883</b>	<b>\$ 73,698</b>

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

Table of Contents

**Safety Insurance Group, Inc. and Subsidiaries**

**Notes to Unaudited Consolidated Financial Statements**

**(Dollars in thousands except per share and share data)**

**1. Basis of Presentation**

The consolidated financial statements have been prepared on the basis of 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 and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates.

The consolidated financial statements include Safety Insurance Group, Inc. and its subsidiaries (the Company ). The subsidiaries consist of Safety Insurance Company, Safety Indemnity Insurance Company, Safety Property and Casualty Insurance Company, Whiteshirts Asset Management Corporation ( WAMC ), and Whiteshirts Management Corporation, which is WAMC s holding company. All intercompany transactions have been eliminated. Prior period amounts have been reclassified to conform to the current period presentation.

The financial information as of September 30, 2010 and for the three and nine months ended September 30, 2010 and 2009 is unaudited; however, in the opinion of the Company, the information includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the financial condition and results of operations for the periods. These unaudited consolidated financial statements may not be indicative of financial results for the full year and should be read in conjunction with the audited financial statements included in the Company s annual report on Form 10-K filed with the U.S. Securities and Exchange Commission ( SEC ) on March 15, 2010.

The Company is a leading provider of personal lines property and casualty insurance focused primarily on the Massachusetts market. The Company s principal product line is private passenger automobile insurance, which accounted for 69.2% of its direct written premiums in 2009. The Company operates through its insurance company subsidiaries, Safety Insurance Company, Safety Indemnity Insurance Company, and Safety Property and Casualty Insurance Company (together referred to as the Insurance Subsidiaries ).

The Insurance Subsidiaries began writing private passenger automobile and homeowners insurance in New Hampshire on October 15, 2008. For the nine months ended September 30, 2010 and the year ended December 31, 2009, the Company wrote \$1,962 and \$978, respectively, in direct written premiums in New Hampshire.

**2. Recent Accounting Pronouncements**

## Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

In June 2009, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Codification (ASC) 105, *Generally Accepted Accounting Principles*. ASC 105 is now the single source of authoritative nongovernmental GAAP. ASC 105 reorganizes the thousands of GAAP pronouncements into roughly 90 accounting topics and displays them using a consistent structure. Also included is relevant SEC guidance organized using the same topical structure in separate sections. ASC 105 was effective for financial statements issued for reporting periods that ended after September 15, 2009. As of September 30, 2009, all of the Company's disclosures in its consolidated financial statements were referenced in accordance with ASC 105. The implementation of ASC 105 did not have an impact on the Company's consolidated results of operations or financial position as it did not change authoritative guidance.

ASC 320, *Investments - Debt and Equity Securities* requires entities to separate an other-than-temporary impairment of a debt security into two components when there are credit related losses associated with the impaired debt security for which management asserts that it does not have the intent to sell the security, and it is more likely than not that it will not be required to sell the security before recovery of its cost basis. The amount of the other-than-temporary impairment related to a credit loss is recognized in earnings, and the amount of the other-than-temporary impairment related to other factors is recorded in other comprehensive loss. The Company adopted ASC 320 effective April 1, 2009. The adoption of ASC 320 did not have an impact on the Company's consolidated results of operations or financial position. For further information, see Note 5, *Investments*.

ASC 825, *Financial Instruments* requires disclosures about fair value of financial instruments in interim and annual financial statements and is effective for periods ending after June 15, 2009. The Company adopted ASC 825 effective for its interim reporting period ending June 30, 2009, and its adoption did not have an impact on the Company's consolidated financial condition or results of operations. For further information, see Note 5, *Investments*.

Table of Contents

**Safety Insurance Group, Inc. and Subsidiaries**

**Notes to Unaudited Consolidated Financial Statements**

**(Dollars in thousands except per share and share data)**

ASC 820, *Fair Value Measurements and Disclosures* expands certain disclosure requirements and is effective for periods ending after June 15, 2009. The Company adopted ASC 820 effective for its interim period ending June 30, 2009, and its adoption did not have an impact on the Company's consolidated financial condition or results of operations.

ASC 855, *Subsequent Events* establishes principles and requirements for subsequent events. ASC 855 is effective for interim and annual financial periods ending after June 15, 2009, and was applied prospectively. In February 2010, the FASB issued updated guidance which amended the subsequent events disclosure requirements to eliminate the requirement for SEC filers to disclose the date through which it has evaluated subsequent events, clarify the period through which conduit bond obligors must evaluate subsequent events and refine the scope of the disclosure requirements for reissued financial statements. The updated guidance was effective upon issuance. The adoption of the guidance had no impact on the Company's consolidated financial condition or results of operations.

In January 2010, the FASB issued ASC Update No. 2010-06 (Topic 820), *Improving Disclosures about Fair Value Measurements* which amends and clarifies existing guidance related to fair value measurements and disclosures. This guidance requires new disclosures for (1) transfers in and out of Level 1 and Level 2 and reasons for such transfers; and (2) the separate presentation of purchases, sales, issuances and settlement in the Level 3 reconciliation. It also clarifies guidance around disaggregation and disclosures of inputs and valuation techniques for Level 2 and Level 3 fair value measurements. The Company adopted this guidance effective for quarter ended March 31, 2010, except for the new disclosures in the Level 3 reconciliation. The Level 3 disclosures are effective for periods ending after December 15, 2010. The adoption of the guidance did not have and is not expected to have an impact on the Company's consolidated financial condition or results of operations when fully adopted.

**3. Earnings per Weighted Average Common Share**

Basic earnings per weighted average common share (EPS) is calculated by dividing net income by the weighted average number of basic common shares outstanding during the period including unvested restricted shares which are considered participating securities. Diluted earnings per share amounts are based on the weighted average number of common shares including unvested restricted shares and the net effect of potentially dilutive common shares outstanding. At September 30, 2010 and 2009, the Company's potentially dilutive instruments were common shares under options of 191,780 and 225,003, respectively.

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Notes to Unaudited Consolidated Financial Statements****(Dollars in thousands except per share and share data)**

The following table sets forth the computation of basic and diluted EPS for the periods indicated.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net income as reported	\$ 15,467	\$ 17,024	\$ 43,330	\$ 43,883
Less dividends:				
Distributed to common shareholders	7,371	6,026	19,211	18,509
Distributed to participating security holders	139	111	362	307
Total undistributed earnings	\$ 7,957	\$ 10,887	\$ 23,757	\$ 25,067
Undistributed earnings to common shareholders	\$ 7,810	\$ 10,694	\$ 23,320	\$ 24,643
Undistributed earnings to participating security holders	\$ 147	\$ 193	\$ 437	\$ 424
Net income available to common shareholders for basic and diluted earnings per share	\$ 15,467	\$ 17,024	\$ 43,330	\$ 43,883
Weighted average number of common shares outstanding	14,741,487	15,017,392	14,795,227	15,428,696
Common equivalent shares- restricted stock	277,501	278,829	277,011	265,804
Weighted average common and common equivalent shares outstanding used to calculate basic earnings per share	15,018,988	15,296,221	15,072,238	15,694,500
Common equivalent shares- stock options	17,668	18,331	17,079	19,233
Weighted average common and common equivalent shares outstanding used to calculate diluted earnings per share	15,036,656	15,314,552	15,089,317	15,713,733
Basic earnings per share	\$ 1.03	\$ 1.11	\$ 2.87	\$ 2.80
Diluted earnings per share	\$ 1.03	\$ 1.11	\$ 2.87	\$ 2.79

Diluted EPS excludes stock options with exercise prices and exercise tax benefits greater than the average market price of the Company's common stock during the period because their inclusion would be anti-dilutive. There were 119,725 anti-dilutive stock options for both the three and nine months ended September 30, 2010. There were 167,925 anti-dilutive stock options for both the three and nine months ended September 30, 2009.

**4. Stock-Based Compensation****Management Omnibus Incentive Plan**



## Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

Long-term incentive compensation is provided under the Company's 2002 Management Omnibus Incentive Plan (the Incentive Plan) which provides for a variety of stock-based compensation awards, including nonqualified stock options, incentive stock options, stock appreciation rights and restricted stock (RS) awards.

The maximum number of shares of common stock with respect to which awards may be granted is 2,500,000. Shares of stock covered by an award under the Incentive Plan that are forfeited will again be available for issuance in connection with future grants of awards under the plan. At September 30, 2010, there were 813,484 shares available for future grant. The Board of Directors and the Compensation Committee intend to issue more awards under the Incentive Plan in the future.

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Notes to Unaudited Consolidated Financial Statements****(Dollars in thousands except per share and share data)**

A summary of stock based awards granted under the Incentive Plan during the nine months ended September 30, 2010 is as follows:

Type of Equity Awarded	Effective Date	Number of Awards Granted	Fair Value per Share (1)	Vesting Terms
RS	March 9, 2010	77,360	\$ 38.78	3 years, 30%-30%-40%
RS	March 9, 2010	4,000	\$ 38.78	No vesting period (2)
RS	March 23, 2010	25,590	\$ 38.09	5 years, 20% annually

(1) The fair value per share of the restricted stock grant is equal to the closing price of the Company's common stock on the grant date.

(2) The shares cannot be sold, assigned, pledged, or otherwise transferred, encumbered or disposed of until the recipient is no longer a member of the Board of Directors.

**Accounting and Reporting for Stock-Based Awards**

ASC 718, *Compensation - Stock Compensation* requires the Company to measure and recognize the cost of employee services received in exchange for an award of equity instruments. The Company adopted ASC 718 effective January 1, 2006. Under the provisions of ASC 718, share-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as an expense over the requisite service period (generally the vesting period of the equity grant).

As permitted by ASC 718, the Company elected the modified prospective transition method. Under the modified prospective transition method, (i) compensation expense for share-based awards granted prior to January 1, 2006 is recognized over the remaining service period using the compensation cost calculated for pro forma disclosure purposes under ASC 718 as adjusted to incorporate forfeiture assumptions under ASC 718, and (ii) compensation expense for all share-based awards granted subsequent to December 31, 2005 is based on the grant date fair value estimated in accordance with the provisions of ASC 718.

**Stock Options**

The fair value of stock options used to compute net income and earnings per share for the three and nine month periods ended September 30, 2010 and 2009 is the estimated fair value at grant date using the Black-Scholes option-pricing model with the following assumptions:

Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Expected dividend yield	<b>1.68%</b>	1.36% - 1.87%	<b>1.36% - 1.68%</b>	1.36% - 2.16%
Expected volatility	<b>0.36</b>	0.31 - 0.36	<b>0.31 - 0.36</b>	0.28 - 0.36
Risk-free interest rate	<b>4.76%</b>	3.82% - 4.76%	<b>4.35% - 4.76%</b>	3.23% - 4.76%
Expected holding period	<b>6.5 years</b>	6.5 - 7 years	<b>6.5 - 7 years</b>	6.5 - 7 years

Expected dividend yield is the Company's dividend yield on the measurement date and is based on the assumption that the current yield will continue in the future. Expected volatility is based on historical volatility of the Company's common stock as well as the volatility of a peer group of property and casualty insurers measured for a period equal to the expected holding period of the option. The risk-free interest rate is based upon the yield on the measurement date of a zero-coupon U.S. Treasury bond with a maturity period equal to the expected holding period of the option. The expected holding period is based upon the simplified method provided in SEC Staff Accounting Bulletin No. 107, *Share-Based Payment*, which utilizes the mid-points between the vesting dates and the expiration date of the option award to calculate the overall expected term. There were no stock options granted during the three and nine month periods ended September 30, 2010 and 2009.

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Notes to Unaudited Consolidated Financial Statements****(Dollars in thousands except per share and share data)**

The following table summarizes stock option activity under the Incentive Plan for the nine months ended September 30, 2010.

	Shares Under Option	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at beginning of year	215,337	\$ 35.40		
Exercised	(23,557)	\$ 22.04		
Outstanding at end of period	191,780	\$ 37.04	4.9 years	\$ 1,054
Exercisable at end of period	167,835	\$ 36.21	4.8 years	\$ 1,054

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based upon the Company's closing stock price of \$42.02 on September 30, 2010, which would have been received by the option holders had all option holders exercised their options as of that date. The range of exercise prices on stock options outstanding under the Incentive Plan was \$12.00 to \$42.85 at September 30, 2010 and 2009. The total intrinsic value of options exercised during the nine months ended September 30, 2010 and 2009 was \$471 and \$217, respectively.

A summary of the status of non-vested options as of September 30, 2010 is presented below.

	Number of Shares	Weighted Average Grant Date Exercise Price
Non-vested at beginning of year	60,490	\$ 41.26
Vested	(36,545)	\$ 40.22
Non-vested at end of period	23,945	\$ 42.85

As of September 30, 2010, there was \$149 of unrecognized compensation expense related to non-vested option awards that is expected to be recognized over a weighted average period of 0.3 years. Cash received from options exercised was \$519 and \$199 for the nine months ended September 30, 2010, and 2009, respectively.

**Restricted Stock**

Restricted stock awarded to employees in the form of unvested shares is recorded at the market value of the Company's common stock on the grant date and amortized ratably as expense over the requisite service period.

Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

The following table summarizes restricted stock activity under the Incentive Plan during the nine months ended September 30, 2010.

	Shares Under Restriction	Weighted Average Fair Value
Outstanding at beginning of the year	298,834	\$ 34.28
Granted	106,950	\$ 38.61
Vested and unrestricted	(104,283)	\$ 36.27
Outstanding at end of period	301,501	\$ 35.13

As of September 30, 2010, there was \$7,507 of unrecognized compensation expense related to non-vested restricted stock awards that is expected to be recognized over a weighted average period of 1.9 years. The total fair value of the shares that were vested and unrestricted during the nine months ended September 30, 2010 and 2009 was \$3,782 and \$3,412, respectively.

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Notes to Unaudited Consolidated Financial Statements****(Dollars in thousands except per share and share data)**

For the nine months ended September 30, 2010 and 2009, the Company recorded compensation expense related to restricted stock of \$1,970 and \$1,875, net of income tax benefits of \$1,060 and \$1,009, respectively.

**5. Investments**

The gross unrealized gains and losses on investments in fixed maturity securities and equity securities, including interests in mutual funds, were as follows for the periods indicated:

	As of September 30, 2010				
	Cost or Amortized Cost	Gross Unrealized Gains	Non-OTTI Unrealized Losses	OTTI Unrealized Losses (4)	Estimated Fair Value
U.S. Treasury securities	\$ 47,732	\$ 449	\$	\$	\$ 48,181
Obligations of states and political subdivisions	411,749	20,321	(225)		431,845
Residential mortgage-backed securities (1)	253,454	17,687	(14)		271,127
Commercial mortgage-backed securities	66,588	3,401			69,989
Other asset-backed securities	21,121	1,447			22,568
Corporate and other securities	182,266	11,776	(13)		194,029
Subtotal, fixed maturity securities	982,910	55,081	(252)		1,037,739
Equity securities (2)	13,524	457	(23)		13,958
Totals	\$ 996,434	\$ 55,538	\$ (275)	\$	\$ 1,051,697

	As of December 31, 2009				
	Cost or Amortized Cost	Gross Unrealized Gains	Non-OTTI Unrealized Losses	OTTI Unrealized Losses (4)	Estimated Fair Value
U.S. Treasury securities	\$ 12,738	\$ 203	\$ (409)	\$	\$ 12,532
Obligations of states and political subdivisions	468,319	16,218	(1,116)		483,421
Residential mortgage-backed securities (1)	289,736	11,271	(546)		300,461
Commercial mortgage-backed securities	73,431	594	(1,109)		72,916
Other asset-backed securities	22,781	879	(1,360)		22,300
Corporate and other securities	122,439	4,737	(477)		126,699
Subtotal, fixed maturity securities	989,444	33,902	(5,017)		1,018,329
Equity securities (2)	9,736	140			9,876

Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

Totals	\$	999,180	\$	34,042	\$	(5,017)	\$	1,028,205
--------	----	---------	----	--------	----	---------	----	-----------

---

(1) Residential mortgage-backed securities consists primarily of obligations of U.S. Government agencies including collateralized mortgage obligations and mortgage-backed securities guaranteed and/or insured by the following issuers: Government National Mortgage Association (GNMA), Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA) and the Federal Home Loan Bank (FHLB). The total of these fixed maturity securities was \$253,329 and \$289,447 at amortized cost and \$271,000 and \$300,172 at fair value as of September 30, 2010 and December 31, 2009, respectively.

(2) Equity securities includes interests in mutual funds of \$11,029 and \$9,736 at cost and \$11,487 and \$9,876 at fair value as of September 30, 2010 and December 31, 2009, respectively, held to fund the Company's executive deferred compensation plan.

(3) The Company's investment portfolio included 35 and 89 securities in an unrealized loss position at September 30, 2010 and December 31, 2009, respectively.

(4) Amounts in this column represent all other-than-temporary impairment ( OTTI ) recognized in accumulated other comprehensive income.

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Notes to Unaudited Consolidated Financial Statements****(Dollars in thousands except per share and share data)**

The amortized cost and the estimated fair value of fixed maturity securities, by maturity, are shown below for the periods indicated. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	As of September 30, 2010	
	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 102,901	\$ 103,519
Due after one year through five years	250,941	264,424
Due after five years through ten years	175,104	188,651
Due after ten years through twenty years	103,115	107,536
Due after twenty years	9,686	9,925
Asset-backed securities	341,163	363,684
Totals	\$ 982,910	\$ 1,037,739

The gross realized gains (losses) on sales of fixed maturity and equity securities were as follows for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Gross realized gains				
Fixed maturity securities	\$ 618	\$ 151	\$ 1,227	\$ 151
Short term securities				1
Gross realized losses				
Fixed maturity securities	(255)	(171)	(924)	(171)
Equity securities			(8)	(318)
Net realized gains (losses) on investments	\$ 363	\$ (20)	\$ 295	\$ (337)

Proceeds from fixed maturities maturing were \$15,024 and \$4,700 for the three months ended September 30, 2010 and 2009, respectively. Proceeds from fixed maturities maturing were \$40,524 and \$10,022 for the nine months ended September 30, 2010 and 2009, respectively.

In the normal course of business, the Company enters into transactions involving various types of financial instruments, including investments in fixed maturities and equity securities. Investment transactions have credit exposure to the extent that a counter party may default on an obligation to the Company. Credit risk is a consequence of carrying, trading and investing in securities. To manage credit risk, the Company focuses on higher quality fixed income securities, reviews the credit strength of all companies in which it invests, limits its exposure in any one investment and monitors the portfolio quality, taking into account credit ratings assigned by recognized statistical rating organizations.





Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Notes to Unaudited Consolidated Financial Statements****(Dollars in thousands except per share and share data)**

The following tables as of September 30, 2010 and December 31, 2009 illustrate the gross unrealized losses included in the Company's investment portfolio and the fair value of those securities aggregated by investment category. The tables also illustrate the length of time that the securities have been in a continuous unrealized loss position.

	Less than 12 Months		As of September 30, 2010 12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Obligations of states and political subdivisions	\$ 17,876	\$ 71	\$ 4,464	\$ 154	\$ 22,340	\$ 225
Residential mortgage-backed securities	222	3	337	11	559	14
Corporate and other securities	1,977	13			1,977	13
Subtotal, fixed maturity securities	20,075	87	4,801	165	24,876	252
Equity securities	2,472	23			2,472	23
Total temporarily impaired securities	\$ 22,547	\$ 110	\$ 4,801	\$ 165	\$ 27,348	\$ 275

	Less than 12 Months		As of December 31, 2009 12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
U.S. Treasury securities	\$ 9,832	\$ 409	\$	\$	\$ 9,832	\$ 409
Obligations of states and political subdivisions	47,585	257	13,483	859	61,068	1,116
Residential mortgage-backed securities	33,753	523	855	23	34,608	546
Commercial mortgage-backed securities	4,940	67	38,260	1,042	43,200	1,109
Other asset-backed securities			6,616	1,360	6,616	1,360
Corporate and other securities	26,217	315	5,143	162	31,360	477
Total temporarily impaired securities	\$ 122,327	\$ 1,571	\$ 64,357	\$ 3,446	\$ 186,684	\$ 5,017

As of September 30, 2010, the Company held insured investment securities of approximately \$266,195 which represented approximately 25.3% of the Company's total investment portfolio. Approximately \$55,344 of these securities are pre-refunded, meaning that funds have been set aside in escrow to satisfy the future interest and principal obligations of the bond.

The following table shows the Company's insured investment securities that are backed by financial guarantors including pre-refunded securities as of September 30, 2010. The Company does not have any direct investment holdings in a financial guarantee insurance company.

Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

As of September 30, 2010

<b>Financial Guarantor</b>	<b>Total</b>	<b>Pre-refunded Securities</b>	<b>Exposure Net of Pre-refunded Securities</b>
<b>Municipal bonds</b>			
Ambac Assurance Corporation	\$ 29,478	\$ 3,467	\$ 26,011
Financial Guaranty Insurance Company	282	282	
Assured Guaranty Municipal Corporation	102,344	38,940	63,404
National Public Finance Guaranty Corporation	125,932	12,655	113,277
Total municipal bonds	258,036	55,344	202,692
<b>Other asset-backed securities</b>			
Ambac Assurance Corporation	4,292		4,292
Financial Guaranty Insurance Company	3,867		3,867
Total other asset-backed securities	8,159		8,159
<b>Total</b>	<b>\$ 266,195</b>	<b>\$ 55,344</b>	<b>\$ 210,851</b>

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Notes to Unaudited Consolidated Financial Statements****(Dollars in thousands except per share and share data)**

The following table shows the Company's insured investments by Moody's rating where it is available both with and without the impact of the insurance guarantee as of September 30, 2010.

Rating	As of September 30, 2010	
	Rating With Insurance	Rating Without Insurance
Aaa	\$ 3,946	\$ 3,946
Aa1	26,589	26,589
Aa2	81,304	75,289
Aa3	90,574	79,318
A1	12,080	14,251
A2	11,169	17,057
A3	13,140	16,337
Baa1	282	282
Ba1		6,015
Total	\$ 239,084	\$ 239,084

**Other-Than-Temporary Impairments**

ASC 320, *Investments - Debt and Equity Securities* requires entities to separate an OTTI of a debt security into two components when there are credit related losses associated with the impaired debt security for which the Company asserts that it does not have the intent to sell the security, and it is more likely than not that it will not be required to sell the security before recovery of its cost basis. Prior to April 1, 2009, the Company had to determine whether it had the intent and ability to hold the investment for a sufficient period of time for the value to recover. When the analysis of the above factors resulted in the Company's conclusion that declines in market values were other-than-temporary, the cost of the security was written down to market value and the reduction in value was reflected as a realized loss.

Effective under ASC 320, the amount of the OTTI related to a credit loss is recognized in earnings, and the amount of the OTTI related to other factors is recorded as a component of other comprehensive income (loss). In instances where no credit loss exists but it is more likely than not that the Company will have to sell the debt security prior to the anticipated recovery, the decline in market value below amortized cost is recognized as an OTTI in earnings. In periods after the recognition of an OTTI on debt securities, the Company accounts for such securities as if they had been purchased on the measurement date of the OTTI at an amortized cost basis equal to the previous amortized cost basis less the OTTI recognized in earnings. For debt securities for which OTTI was recognized in earnings, the difference between the new amortized cost basis and the cash flows expected to be collected will be accreted or amortized into net investment income.

The Company holds no subprime mortgage debt securities. All of the Company's holdings in mortgage-backed securities are either U.S. Government or Agency guaranteed or are rated investment grade by either Moody's or Standard & Poor's.

The unrealized losses in the Company's fixed income and equity portfolio as of September 30, 2010 were reviewed for potential other-than-temporary asset impairments. The Company held no securities at September 30, 2010 with a material (20% or greater) unrealized loss for four or more consecutive quarters. Specific qualitative analysis was also performed for any additional securities appearing on the Company's Watch List, if any. Qualitative analysis considered such factors as the financial condition and the near term prospects of the issuer, whether the debtor is current on its contractually obligated interest and principal payments, changes to the rating of the security by a rating agency and the historical volatility of the fair value of the security.

The qualitative analysis performed by the Company concluded that the unrealized losses recorded on the investment portfolio at September 30, 2010 resulted from fluctuations in market interest rates and other temporary market conditions as opposed to fundamental changes in the credit quality of the issuers of such securities. Therefore, decreases in fair values of the Company's securities are viewed as being temporary.

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Notes to Unaudited Consolidated Financial Statements****(Dollars in thousands except per share and share data)**

During the nine months ended September 30, 2010 and 2009, there was no significant deterioration in the credit quality of any of the Company's holdings and no OTTI charges were recorded related to the Company's portfolio of investment securities.

Based upon the qualitative analysis performed, the Company's decision to hold these securities, the Company's current level of liquidity and its positive operating cash flows, management believes it is more likely than not that it will not be required to sell any of its securities before the anticipated recovery in the fair value to its amortized cost basis.

ASC 320, *Investments - Debt and Equity Securities* requires that the Company record, as of the beginning of the interim period of adoption, a cumulative effect adjustment to reclassify the noncredit component of a previously recognized OTTI from retained earnings to other comprehensive income (loss). At September 30, 2010 and December 31, 2009, there were no amounts included in accumulated other comprehensive income related to securities which were considered by the Company to be other-than-temporarily impaired.

**Net Investment Income**

The components of net investment income were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Interest and dividends on fixed maturities	\$ 10,343	\$ 11,351	\$ 32,530	\$ 32,843
Dividends on equity securities	62	38	160	109
Interest on cash and cash equivalents	27	47	59	198
Interest on short-term securities and other invested assets	3	3	9	74
Total investment income	10,435	11,439	32,758	33,224
Investment expenses	327	346	1,001	1,003
Net investment income	\$ 10,108	\$ 11,093	\$ 31,757	\$ 32,221

**Fair Value Measurements**

ASC 820, *Fair Value Measurements and Disclosure* provides a revised definition of fair value, establishes a framework for measuring fair value, and expands financial statement disclosure requirements for fair value information. Under ASC 820, fair value is defined as the price that

## Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants (an exit price). ASC 820 establishes a fair value hierarchy that distinguishes between inputs based on market data from independent sources ( observable inputs ) and a reporting entity's internal assumptions based upon the best information available when external market data is limited or unavailable ( unobservable inputs ). The fair value hierarchy in ASC 820 prioritizes fair value measurements into three levels based on the nature of the inputs as follows:

Level 1 Valuations based on quoted prices in active markets for identical assets and liabilities;

Level 2 Valuations based on observable inputs that do not meet the criteria for Level 1, including quoted prices in inactive markets and quoted prices in active markets for similar, but not identical instruments; and

Level 3 Valuations based on unobservable inputs.

Fair values for the Company's fixed maturity securities are based on prices provided by its custodian bank and its investment manager. Both the custodian bank and the investment manager use a variety of independent, nationally recognized pricing services to determine market valuations. If the pricing service cannot provide fair value determinations, the Company obtains non-binding price quotes from broker-dealers. A minimum of two quoted prices is obtained for the majority of fixed maturity securities in the Company's investment portfolio. The Company's custodian bank is its primary provider of quoted prices from third-party pricing services and broker-dealers. To provide reasonable assurance of the validity of each price or quote, a secondary third-party pricing service or broker-dealer quote is obtained from the Company's investment manager. An examination of the pricing data is then performed for each security. If the variance between the primary and secondary price quotes for a security is within an accepted tolerance level, the quoted price obtained from the Company's custodian bank is used

Table of Contents

**Safety Insurance Group, Inc. and Subsidiaries**

**Notes to Unaudited Consolidated Financial Statements**

**(Dollars in thousands except per share and share data)**

in the Company's financial statements for the security. If the variance between the primary and secondary price quotes exceeds an accepted tolerance level, the Company obtains a quote from an alternative source, if possible, and documents and resolves any differences between the pricing sources. In addition, the Company may request that its investment manager and their traders provide input as to which vendor is providing prices that their traders believe are reflective of fair value for the security. Following this process, the Company may decide to value the security in its financial statements using the secondary or alternative source if it believes that pricing is more reflective of the security's value than the primary pricing provided by its custodian bank. The Company analyzes market valuations received to verify reasonableness, to understand the key assumptions used and their sources, and to determine an appropriate ASC 820 fair value hierarchy level based upon trading activity and the observability of market inputs. Based on this evaluation and investment class analysis, each price is classified into Level 1, 2 or 3.

Fair values of instruments are based on (i) quoted prices in active markets for identical assets (Level 1), (ii) quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-derived valuations in which all significant inputs are observable in active markets (Level 2) or (iii) valuations derived from valuation techniques in which one or more significant inputs are unobservable in the marketplace (Level 3).

The Company's Level 1 securities consist of equity securities whose values are based on quoted prices in active markets for identical assets. The Company's Level 2 securities are comprised of fixed maturity securities whose fair value was determined using observable market inputs. Fair values for securities for which quoted market prices were unavailable were estimated based upon reference to observable inputs such as benchmark interest rates, market comparables, and other relevant inputs. Investments valued using these inputs include U.S. Treasury securities and obligations of U.S. Government agencies, obligations of international government agencies, obligations of states and political subdivisions, corporate securities, commercial and residential mortgage-backed securities, and other asset-backed securities. Inputs into the fair value application that are utilized by asset class include but are not limited to:

- *States and political subdivisions:* overall credit quality, including assessments of market sectors and the level and variability of sources of payment such as general obligation, revenue or lease; credit support such as insurance, state or local economic and political base, prefunded and escrowed to maturity covenants.
- *Corporate fixed maturities:* overall credit quality, the establishment of a risk adjusted credit spread over the applicable risk free yield curve for discounted cash flow valuations; assessments of the level of industry economic sensitivity, company financial policies, indenture restrictive covenants, and/or security and collateral.
- *Residential mortgage-backed securities, U.S. agency pass-throughs, collateralized mortgage obligations ( CMOs ), non U.S. agency CMOs:* estimates of prepayment speeds based upon historical prepayment rate trends, underlying collateral interest rates, original weighted average maturity, vintage year, borrower credit quality characteristics, interest rate and yield curve forecasts, U.S. government support programs, tax policies, and delinquency/default trends.
- *Commercial mortgage-backed securities:* overall credit quality, including assessments of the level and variability of credit support and collateral type such as office, retail, or lodging, predictability of cash flows for the deal structure, prevailing economic market conditions.



## Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

- *Other asset-backed securities:* overall credit quality, estimates of prepayment speeds based upon historical trends and characteristics of underlying loans, including assessments of the level and variability of collateral, revenue generating agreements, area licenses agreements, product sourcing agreements and equipment and property leases.

All unadjusted estimates of fair value for fixed maturities priced by the pricing services as described above are included in the amounts disclosed in Level 2.

In order to ensure the fair value determination is representative of an exit price (consistent with ASC 820), the Company's procedures for validating quotes or prices obtained from third-parties include, but are not limited to, obtaining a minimum of two price quotes for each fixed maturity security if possible, as discussed above, the periodic testing of sales activity to determine if there are any significant differences between the market price used to value the security as of the balance sheet date and the sales price of the security for sales that occurred around the balance sheet date, and the periodic review of reports provided by its investment manager regarding those securities with ratings changes and securities placed on the Company's Watch List. In addition, valuation techniques utilized by pricing services and prices obtained from external sources are reviewed by the Company's external investment manager, whose investment professionals are familiar with the securities being

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Notes to Unaudited Consolidated Financial Statements****(Dollars in thousands except per share and share data)**

priced and the markets in which they trade to ensure the fair value determination is representative of an exit price (consistent with ASC 820).

The Company's entire portfolio was priced based upon quoted market prices or other observable inputs as of September 30, 2010. There were no significant changes to the valuation process during the nine months ending September 30, 2010. As of September 30, 2010 and December 31, 2009, no quotes or prices obtained were adjusted by management. All broker quotes obtained were non-binding.

The following tables summarize our total fair value measurements for investments for the periods indicated.

	Total	As of September 30, 2010		
		Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
U.S. Treasury securities	\$ 48,181	\$	\$ 48,181	\$
Obligations of states and political subdivisions	431,845		431,845	
Residential mortgage-backed securities	271,127		271,127	
Commercial mortgage-backed securities	69,989		69,989	
Other asset-backed securities	22,568		22,568	
Corporate and other securities	194,029		194,029	
Equity securities	13,958	13,958		
Total investment securities	\$ 1,051,697	\$ 13,958	\$ 1,037,739	\$

	Total	As of December 31, 2009		
		Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
U.S. Treasury securities	\$ 12,532	\$	\$ 12,532	\$
Obligations of states and political subdivisions	483,421		483,421	
Residential mortgage-backed securities	300,461		300,461	
Commercial mortgage-backed securities	72,916		72,916	
Other asset-backed securities	22,300		19,796	2,504
Corporate and other securities	126,699		126,699	
Equity securities	9,876	9,876		
Total investment securities	\$ 1,028,205	\$ 9,876	\$ 1,015,825	\$ 2,504

The following table summarizes the changes in the Company's Level 3 fair value measurements for the three months ended September 30, 2010.

	Other Asset-Backed Securities
Balance at July 1, 2010	\$ 3,182

Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

Net gains and losses included in earnings	
Net gains included in other comprehensive income	685
Purchases and sales	
Transfers in (out) of Level 3	(3,867)
Balance at September 30, 2010	\$
Amount of total losses included in earnings attributable to the change in unrealized losses related to assets still held at September 30, 2010	\$

Table of Contents**Safety Insurance Group, Inc. and Subsidiaries****Notes to Unaudited Consolidated Financial Statements****(Dollars in thousands except per share and share data)**

The following table summarizes the changes in the Company's Level 3 fair value measurements for the nine months ended September 30, 2010.

	<b>Other Asset-Backed Securities</b>
Balance at January 1, 2010	\$ 2,504
Net gains and losses included in earnings	
Net gains included in other comprehensive income	1,363
Purchases and sales	
Transfers in (out) of Level 3	(3,867)
Balance at September 30, 2010	\$
Amount of total losses included in earnings attributable to the change in unrealized losses related to assets still held at September 30, 2010	\$

Transfers in and out of Level 3 are attributable to changes in the ability to observe significant inputs in determining fair value exit pricing. On January 1 and July 1, 2010, the Company's Level 3 securities consisted of one asset-backed security whose price was based solely on a single broker quote which was deemed to be obtained through unobservable inputs. During the quarter ended September 30, 2010, a cash tender offer was received for this security. As a result, the fair value of the security at September 30, 2010 was deemed to be based on observable inputs and accordingly, was transferred into Level 2. This security was sold during October 2010.

**6. Loss and Loss Adjustment Expense Reserves**

The following table sets forth a reconciliation of beginning and ending reserves for losses and LAE, as shown in the Company's consolidated financial statements for the periods indicated:

	<b>Nine Months Ended September 30,</b>	
	<b>2010</b>	<b>2009</b>
Reserves for losses and LAE at beginning of year	\$ 439,706	\$ 467,559
Less reinsurance recoverable on unpaid losses and LAE	(64,874)	(76,489)
Net reserves for losses and LAE at beginning of year	374,832	391,070
Incurred losses and LAE, related to:		
Current year	297,800	291,612
Prior years	(32,895)	(30,057)
Total incurred losses and LAE	264,905	261,555
Paid losses and LAE related to:		
Current year	174,087	158,475

Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

Prior years		<b>109,310</b>		114,787
Total paid losses and LAE		<b>283,397</b>		273,262
Net reserves for losses and LAE at end of period		<b>356,340</b>		379,363
Plus reinsurance recoverables on unpaid losses and LAE		<b>56,726</b>		67,443
Reserves for losses and LAE at end of period	\$	<b>413,066</b>	\$	446,806

At the end of each period, the reserves were re-estimated for all prior accident years. The Company's prior year reserves decreased by \$32,895 and \$30,057 for the nine months ended September 30, 2010 and 2009, respectively, and resulted from re-estimations of prior years ultimate loss and LAE liabilities. The decrease in prior years reserves during the 2010 period is primarily composed of reductions of \$23,066 in the Company's retained automobile reserves and \$5,038 in reserves assumed from Commonwealth Automobile Reinsurers ( CAR ). The decrease in prior year reserves during the 2009 period is primarily composed of reductions of \$15,706 in the Company's retained automobile reserves, \$8,780 in reserves assumed from CAR, and \$4,139 in the Company's retained homeowners reserves.

Table of Contents

**Safety Insurance Group, Inc. and Subsidiaries**

**Notes to Unaudited Consolidated Financial Statements**

**(Dollars in thousands except per share and share data)**

The Company's private passenger automobile line of business prior year reserves decreased by \$23,129 for the nine months ended September 30, 2010. The decrease was primarily due to improved retained private passenger results of \$16,622 for the accident years 2005 through 2009, and improved assumed CAR results for the private passenger automobile pool of \$3,507 for accident years 2007 through 2009. The Company's private passenger automobile line of business prior year reserves decreased by \$20,699 for the nine months ended September 30, 2009. The decrease was primarily due to improved retained private passenger results of \$10,975 for accident years 2004 through 2008, and improved assumed CAR results for the private passenger automobile pool of \$7,168 for accident years 2005 through 2008. The improved retained private passenger results were primarily due to fewer incurred but not yet reported claims than previously estimated and better than previously estimated severity on the Company's established bodily injury and property damage case reserves. The improved CAR results were due primarily to improved CAR private passenger loss ratios as published and reported by the CAR Loss Reserving Committee.

Due to the nature of the risks that the Company underwrites and has historically underwritten, management does not believe that it has an exposure to asbestos or environmental pollution liabilities.

**7. Commitments and Contingencies**

Various claims, generally incidental to the conduct of normal business, are pending or alleged against the Company from time to time. In the opinion of management, based in part on the advice of legal counsel, the ultimate resolution of such claims will not have a material adverse effect on the Company's consolidated financial statements. However, if estimates of the ultimate resolutions of those proceedings are revised, liabilities related to those proceedings could be adjusted in the near term.

Massachusetts law requires that insurers licensed to do business in Massachusetts participate in the Massachusetts Insurers Insolvency Fund ( "Insolvency Fund" ). Members of the Insolvency Fund are assessed a proportionate share of the obligations and expenses of the Insolvency Fund in connection with an insolvent insurer. It is anticipated that there will be additional assessments from time to time relating to various insolvencies. Although the timing and amounts of any future assessments are not known, based upon existing knowledge, management's opinion is that such future assessments will not have a material effect upon the financial position of the Company.

On November 21, 2008, the Massachusetts Office of the Attorney General (the "AG" ) delivered a civil investigative demand (the "CID" ) to Safety Insurance Company. The CID directed the Company to produce certain information related to its policies and practices in connection with underwriting insurance policies on motorcycles and adjusting total loss claims under such policies. Other insurance companies are also being investigated by the AG related to their policies and practices related to motorcycle insurance.

The focus of the AG's investigation was on the insured values determined by Safety Insurance Company for purposes of charging premiums for physical damage insurance coverage. In 2008, coverage for motorcycles represented 1.9% of the Company's total private passenger automobile

## Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

insurance. The Company has been cooperating with the AG and responding to the CID and various related additional requests for information by the AG since that time.

In connection with the matters addressed by the CID, the AG delivered a letter to Safety Insurance Company dated February 2, 2009, in which the AG stated that it has reason to believe that Safety Insurance Company has violated the Massachusetts Consumer Protection Act, G.L. c. 93A, §2, by engaging in unfair and deceptive acts and practices regarding motorcycle insurance. Specifically, the AG stated it has reason to believe that the Company overcharged its customers for motorcycle insurance and engaged in related unfair claims settlement practices. By issuing this letter the AG met a statutory prerequisite to filing a civil complaint under the Massachusetts Consumer Protection Act against the Company.

On January 14, 2010, the Company announced it had reached an agreement with the AG to change the way in which the Company calculated motorcycle premiums for certain types of coverage dating back to January 1, 2002. Under the terms of the settlement, the Company agreed to pay refunds to certain motorcycle policyholders. The Company has deposited \$7,408 into a trust fund to be used to pay the amount of those refunds and has paid \$330 to the Commonwealth of Massachusetts, which includes reimbursement of costs and expenses related to the implementation of the settlement by the AG. Of the total settlement to date, \$7,547 was recorded as an increase to the Company's Underwriting, operating and other expenses for the year ended December 31, 2009 and \$191 of additional refunds subsequently identified by the AG and deposited to the trust fund by the

Table of Contents

**Safety Insurance Group, Inc. and Subsidiaries**

**Notes to Unaudited Consolidated Financial Statements**

**(Dollars in thousands except per share and share data)**

Company in July 2010 was recorded as Underwriting, operating and other expenses for the nine months ended September 30, 2010.

The Company worked with the Attorney General's office to identify the policies on which refunds would be issued and the amount of refunds to be paid to each individual policyholder. During the quarter ended September 30, 2010, the Company first notified approximately 21 thousand policyholders of the amount of individual refunds offered and requested receipt of appropriate releases from them in order to access the trust fund to issue refund checks. As of October 28, 2010, a total of approximately \$5,830 in refund checks has been issued to about 14 thousand policyholders. The final total of refunds paid may be more or less than currently estimated; however, in management's opinion, any future expenses related to the settlement will not have a material adverse effect upon the overall financial position of the Company.

**8. Debt**

On August 14, 2008, we entered into an Amended and Restated Revolving Credit Agreement (the "New Credit Agreement") with RBS Citizens, NA ("RBS Citizens"). The New Credit Agreement amended and restated the terms of our existing Revolving Credit Agreement with RBS Citizens prior to its expiration date of August 17, 2008. The New Credit Agreement extends the maturity date to August 14, 2013 and provides a \$30,000 revolving credit facility with an accordion feature allowing for future expansion of the committed amount up to \$50,000. Loans under the credit facility bear interest at the Company's option at either (i) the LIBOR rate plus 1.25% per annum or (ii) the higher of RBS Citizens prime rate or 0.5% above the federal funds rate plus 1.25% per annum. Interest only is payable prior to maturity.

The Company's obligations under the credit facility are secured by pledges of its assets and the capital stock of its operating subsidiaries. The credit facility is guaranteed by the Company's non-insurance company subsidiaries. The credit facility contains covenants including requirements to maintain minimum risk based capital ratios and statutory surplus of Safety Insurance Company as well as limitations or restrictions on indebtedness, liens, and other matters. Among other covenants, the credit facility restricts the Company's payment of dividends (i) if a default under the credit facility is continuing or would result therefrom or (ii) in an amount in excess of 50% of the Company's prior year's net income, as determined in accordance with GAAP. As of September 30, 2010, the Company was in compliance with all such covenants. In addition, the credit facility includes customary events of default, including a cross-default provision permitting the lenders to accelerate the facility if the Company (i) defaults in any payment obligation under debt having a principal amount in excess of \$10,000 or (ii) fails to perform any other covenant permitting acceleration of all such debt.

The Company had no amounts outstanding on its credit facility at September 30, 2010 and December 31, 2009. The credit facility commitment fee included in interest expenses was computed at a rate of 0.25% on the \$30,000 commitment at September 30, 2010 and 2009.

**9. Income Taxes**



Federal income tax expense for the nine months ended September 30, 2010 and 2009 has been computed using estimated effective tax rates. These rates are revised, if necessary, at the end of each successive interim period to reflect the current estimates of the annual effective tax rates.

ASC 740, *Income Taxes*, was adopted by the Company on January 1, 2007. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. ASC 740 requires that the Company determine whether the benefits of its tax positions have a more likely than not chance of being sustained upon audit based upon the technical merits of the tax position. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. As a result of the implementation of ASC 740, the Company recognized no adjustment to its consolidated balance sheet or statement of operations. The Company believes that the positions taken on its income tax returns for open tax years will be sustained upon examination by the Internal Revenue Service ( IRS ). Therefore, the Company has not recorded a liability under ASC 740.

During the nine months ended September 30, 2010, there were no material changes to the amount of the Company's unrecognized tax benefits or to any assumptions regarding the amount of its ASC 740 liability.

Table of Contents

**Safety Insurance Group, Inc. and Subsidiaries**

**Notes to Unaudited Consolidated Financial Statements**

**(Dollars in thousands except per share and share data)**

As of September 30, 2010 and December 31, 2009, the Company was no longer subject to examination of its U.S. federal tax returns for years prior to 2006. The Company is not currently under examination by the IRS. During the year 2009, the Massachusetts Department of Revenue concluded its review of the 2005 and 2006 tax periods. The resulting audit adjustments were immaterial to the Company's financial position.

**10. Share Repurchase Program**

On August 3, 2007, the Board of Directors approved a share repurchase program of up to \$30,000 of the Company's outstanding common shares. On March 19, 2009, the Board of Directors increased this existing share repurchase program by authorizing repurchase of up to \$60,000 of the Company's outstanding common shares. On August 4, 2010, the Board of Directors again increased the existing share repurchase program by authorizing repurchase of up to \$90,000 of the Company's outstanding common shares. Under the program, the Company may repurchase shares of its common stock for cash in public or private transactions, in the open market or otherwise, at management's discretion. The timing of such repurchases and actual number of shares repurchased will depend on a variety of factors including price, market conditions and applicable regulatory and corporate requirements. The program does not require the Company to repurchase any specific number of shares and may be modified, suspended or terminated at any time without prior notice.

During the nine months ended September 30, 2010, the Company purchased 162,907 shares of its common shares on the open market under the program at a cost of \$5,814. During the nine months ended September 30, 2009, the Company purchased 1,332,535 of its common shares on the open market under the program at a cost of \$42,196. As of September 30, 2010 the Company had purchased 1,727,455 shares on the open market at a cost of \$55,526. As of December 31, 2009, the Company had purchased 1,564,548 of its common shares on the open market under the program at a cost of \$49,712. There was no activity under the program during the quarter ended September 30, 2010.

**11. Subsequent Events**

The Company has evaluated subsequent events for recognition or disclosure in the consolidated financial statements filed on Form 10-Q with the SEC and no events have occurred that require recognition or disclosure.

Table of Contents

**Item 2.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*The following discussion should be read in conjunction with our accompanying consolidated financial statements and notes thereto, which appear elsewhere in this document. In this discussion, all dollar amounts are presented in thousands, except share and per share data.*

*The following discussion contains forward-looking statements. We intend statements which are not historical in nature to be, and are hereby identified as forward-looking statements to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. In addition, the Company's senior management may make forward-looking statements orally to analysts, investors, the media and others. This safe harbor requires that we specify important factors that could cause actual results to differ materially from those contained in forward-looking statements made by or on behalf of us. We cannot promise that our expectations in such forward-looking statements will turn out to be correct. Our actual results could be materially different from and worse than our expectations. See Forward-Looking Statements below for specific important factors that could cause actual results to differ materially from those contained in forward-looking statements*

**Executive Summary and Overview**

In this discussion, Safety refers to Safety Insurance Group, Inc. and our Company, we, us and our refer to Safety Insurance Group, Inc. and its consolidated subsidiaries. Our subsidiaries consist of Safety Insurance Company ( Safety Insurance ), Safety Indemnity Insurance Company ( Safety Indemnity ), Safety Property and Casualty Insurance Company ( Safety P&C ), Whiteshirts Asset Management Corporation ( WAMC ), and Whiteshirts Management Corporation, which is WAMC's holding company.

We are a leading provider of private passenger automobile insurance in Massachusetts. In addition to private passenger automobile insurance (which represented 69.2% of our direct written premiums in 2009), we offer a portfolio of other insurance products, including commercial automobile (12.0% of 2009 direct written premiums), homeowners (14.7% of 2009 direct written premiums), dwelling fire, umbrella and business owner policies (totaling 4.1% of 2009 direct written premiums). Operating exclusively in Massachusetts and New Hampshire through our insurance company subsidiaries, Safety Insurance, Safety Indemnity, and Safety P&C, (together referred to as the Insurance Subsidiaries), we have established strong relationships with independent insurance agents, who numbered 861 in 999 locations throughout Massachusetts during 2009. We have used these relationships and our extensive knowledge of the Massachusetts market to become the second largest private passenger automobile and the third largest commercial automobile insurance carrier in Massachusetts, capturing an approximate 11.7% and 11.0% share, respectively, of the Massachusetts private passenger and commercial automobile markets in 2010, according to the Commonwealth Automobile Reinsurers ( CAR ) Cession Volume Analysis Report of October 22, 2010, based on automobile exposures. These statistics total, for each vehicle insured, the number of months during the year insurance for that vehicle is in effect, to arrive at an aggregate number of car-months for each insurer; this aggregate number, divided by 12, equals the insurer's number of car-years, a measure we refer to in this discussion as automobile exposures.

## Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

Our Insurance Subsidiaries began writing private passenger automobile and homeowners insurance in New Hampshire on October 15, 2008. For the nine months ended September 30, 2010 and the year ended December 31, 2009, we wrote \$1,962 and \$978, respectively, in direct written premiums in New Hampshire.

### *Massachusetts Automobile Insurance Market*

We have been subject to extensive regulation in the private passenger automobile insurance industry in Massachusetts, which represented 69.2% of our direct written premiums in 2009. Owners of registered automobiles in Massachusetts are required to maintain minimum automobile insurance coverage. Prior to April 1, 2008, the Commissioner of Insurance (the Commissioner) had fixed and established the maximum rates that could be charged for private passenger automobile insurance. Prior to April 1, 2008, as a servicing carrier of CAR, we were required to issue a policy to all qualified applicants. CAR operates at an underwriting deficit. This deficit is allocated among every Massachusetts automobile insurance company, including us, based on a complex formula that takes into consideration a company's voluntary market share, the rate at which it cedes business to CAR, and the company's utilization of a credit system CAR designed to encourage carriers to reduce their use of CAR. In addition, based on our market share prior to April 1, 2009, we had been assigned certain licensed producers by CAR that were unable to obtain a voluntary contract with another insurer. We call these agents Exclusive Representative Producers, or ERPs.

On July 16, 2007, the Commissioner issued two decisions that significantly changed how private passenger automobile insurance was regulated in Massachusetts. In the first decision, the Commissioner approved and set a time table for the

Table of Contents

implementation of new CAR rules pursuant to which the reinsurance program run by CAR was replaced with an assigned risk plan, the Massachusetts Automobile Insurance Plan ( MAIP ). Under these new rules, as of April 1, 2009 we no longer were assigned ERPs whose business we had to insure (subject to the option of ceding it to CAR) and instead, we were assigned individual policies by CAR. The MAIP began with business effective on or after April 1, 2008 for new business and those risks that had 10 or more Safe Driver Points. Beginning April 1, 2009, all business was eligible for MAIP except those risks that have no violations or accidents in the preceding three year period (so called Clean in three risks). The last policy effective date on which any risk could be ceded to CAR was March 31, 2009.

The Commissioner's decision to implement an assigned risk plan brought to a close a lengthy period of regulatory and judicial consideration of the Massachusetts private passenger residual market.

In the second decision referenced above, the Commissioner announced that she would not fix and establish the maximum premium rates that can be charged for private passenger automobile insurance policies issued or renewed after April 1, 2008. In a letter accompanying the decision, the Commissioner stated that in place of the fixed and established system, she would institute a system that introduces competitive pricing to the Massachusetts private passenger automobile insurance market, which the Commissioner described as managed competition ( Managed Competition ). On October 5, 2007, the Commissioner issued a Competitive Rating Regulation; 211 CMR 79.00: Private Passenger Motor Vehicle Insurance Rates that describes the technical details of Managed Competition (the Regulation ). The Regulation governs the rate filing that an insurer can file.

In addition, the Regulation prohibits the following rating and underwriting factors:

- *Rating Factors:* Insurers are prohibited from using credit information, sex, marital status, race, creed, national origin, religion, occupation, income, education, home ownership and age (except to produce the reduction in rates for insureds age 65 and over).
- *Underwriting Factors:* Insurers are prohibited from refusing to issue or renew a private passenger auto insurance policy based on credit information, sex, marital status, race, creed, national origin, religion, age, occupation, income, principal place of garaging, education and home ownership.

The Commissioner issued a number of bulletins addressing issues related to the implementation of Managed Competition (the Rating Bulletins ). Rating Bulletin 2009-13 limits voluntary market rates to a level no higher than the rates in the residual market. Rating Bulletin 2008-17 describes how companies may place risks among company affiliates within an insurer group.

On May 27, 2010, the Massachusetts Office of the Attorney General (the AG ) issued proposed regulations that, if adopted, would apply to the sale, marketing, claims processing, rating, and underwriting for private passenger automobile insurance offered or provided in the Commonwealth of Massachusetts. The proposed regulations describe various acts by insurers and insurance producers which would be considered to be unfair trade practices, under Massachusetts unfair trade practices act, M.G.L. c. 93A. The AG held two public hearings on the proposed regulations in June, and may issue final regulations later in 2010. We are not able at this time to determine what effect these proposed regulations will have on our business over the long term.

## Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

CAR runs a reinsurance pool for commercial automobile policies and beginning January 1, 2006, CAR implemented a Limited Servicing Carrier Program ( LSC ) for ceded commercial automobile policies. CAR approved Safety Insurance and five other servicing carriers through a Request for Proposal to process ceded commercial automobile business, which is spread equitably among the six servicing carriers. Each Massachusetts commercial automobile insurer must bear a portion of the losses of the commercial reinsurance pool that is serviced by the six servicing carriers in the LSC program. Subject to the Commissioner's review, CAR sets the premium rates for commercial automobile policies reinsured through CAR and this reinsurance pool can generate an underwriting result that is a profit or deficit based upon CAR's rate level. This underwriting result is allocated among every Massachusetts commercial automobile insurance company, including us, based on a company's commercial automobile voluntary market share.

CAR also runs a reinsurance pool for Taxi, Limousine and Car Service risks (the Taxi/Limo Program ). On April 25, 2007, Safety submitted through a Request for Proposal a bid to process a portion of the Taxi/Limo Program. CAR approved Safety as one of the two servicing carriers for this program beginning January 1, 2008.

Under Managed Competition, we decreased our rates an average 6.7% in 2008. During 2009, we increased our rates an average of 2.6% in a series of rate filings during the year. We began using three rating tiers effective April 1, 2009. We filed and were approved for a 0.3% rate decrease effective June 1, 2009 and a 2.9% rate increase effective October 1, 2009. We also filed and have been approved for a rate increase of 0.4% and began using four rating tiers effective January 1, 2010. A Companion Policy

Table of Contents

Client Tier, which is policyholders that have a non-private passenger automobile policy with us, receives a rate decrease of 2.5% from our filed base rates. A Loyal Automobile Client Tier, which is policyholders who have been insured with Safety two or more years, receives our filed base rates. A New Insurance Client Tier, which is policyholders with 12 or more months of continuous coverage or who qualify for a multi-car discount, receives a rate increase of 2.5% from our filed base rates. A New Policyholder Tier, which is policyholders that don't qualify for the other three tiers, receives MAIP rates. We filed and were approved for a 1.9% increase in our rates effective April 19, 2010 and we also filed and were approved for a 0.5% decrease in our rates effective June 15, 2010. Our rates include a 13.0% commission rate for agents. Our direct written premiums decreased by 2.4% in 2009 primarily as a result of Managed Competition rate decreases effective on and after April 1, 2008.

*Statutory Accounting Principles*

Our results are reported in accordance with GAAP, which differ from amounts reported in accordance with statutory accounting principles (SAP) as prescribed by insurance regulatory authorities, which in general reflect a liquidating, rather than going concern concept of accounting. Specifically, under GAAP:

- Policy acquisition costs such as commissions, premium taxes and other variable costs incurred in connection with writing new and renewal business are capitalized and amortized on a pro rata basis over the period in which the related premiums are earned, rather than expensed as incurred, as required by SAP.
- Certain assets are included in the consolidated balance sheets whereas, under SAP, such assets are designated as nonadmitted assets, and charged directly against statutory surplus. These assets consist primarily of premium receivables that are outstanding over ninety days, federal deferred tax assets in excess of statutory limitations, furniture, equipment, leasehold improvements and prepaid expenses.
- Amounts related to ceded reinsurance are shown gross of ceded unearned premiums and reinsurance recoverables, rather than netted against unearned premium reserves and loss and loss adjustment expense reserves, respectively, as required by SAP.
- Fixed maturities securities, which are classified as available-for-sale, are reported at current fair values, rather than at amortized cost, or the lower of amortized cost or market, depending on the specific type of security, as required by SAP.
- The differing treatment of income and expense items results in a corresponding difference in federal income tax expense. Changes in deferred income taxes are reflected as an item of income tax benefit or expense, rather than recorded directly to surplus as regards policyholders, as required by SAP. Admittance testing may result in a charge to unassigned surplus for non-admitted portions of deferred tax assets. Under GAAP reporting, a valuation allowance may be recorded against the deferred tax asset and reflected as an expense.

*Insurance Ratios*

The property and casualty insurance industry uses the combined ratio as a measure of underwriting profitability. The combined ratio is the sum of the loss ratio (losses and loss adjustment expenses incurred as a percent of net earned premiums) plus the expense ratio (underwriting expenses as a percent of net earned premiums, calculated on a GAAP basis). The combined ratio reflects only underwriting results and does not include income from investments or finance and other service income. Underwriting profitability is subject to significant fluctuations due to competition, catastrophic events, weather, economic and social conditions, and other factors.

## Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

Our GAAP insurance ratios are outlined in the following table.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
<b>GAAP ratios:</b>				
Loss ratio	<b>63.5%</b>	61.8%	<b>64.8%</b>	65.4%
Expense ratio	<b>31.8</b>	31.6	<b>31.4</b>	30.7
Combined ratio	<b>95.3%</b>	93.4%	<b>96.2%</b>	96.1%

### *Stock-Based Compensation*

Long-term incentive compensation is provided under the our 2002 Management Omnibus Incentive Plan (the Incentive Plan ) which provides for a variety of stock-based compensation awards, including nonqualified stock options, incentive stock options, stock appreciation rights, and restricted stock ( RS ) awards.



Table of Contents

The maximum number of shares of common stock with respect to which awards may be granted is 2,500,000. Shares of stock covered by an award under the Incentive Plan that are forfeited will again be available for issuance in connection with future grants of awards under the plan. At September 30, 2010, there were 813,484 shares available for future grant. The Board of Directors and the Compensation Committee intend to issue more awards under the Incentive Plan in the future.

A summary of stock based awards granted under the Incentive Plan during the nine months ended September 30, 2010 is as follows:

Type of Equity Awarded	Effective Date	Number of Awards Granted	Fair Value per Share (1)	Vesting Terms
RS	March 9, 2010	77,360	\$ 38.78	3 years, 30%-30%-40%
RS	March 9, 2010	4,000	\$ 38.78	No vesting period (2)
RS	March 23, 2010	25,590	\$ 38.09	5 years, 20% annually

(1) The fair value per share of the restricted stock grant is equal to the closing price of our common stock on the grant date.

(2) The shares cannot be sold, assigned, pledged, or otherwise transferred, encumbered or disposed of until the recipient is no longer a member of our Board of Directors.

*Reinsurance*

We reinsure with other insurance companies a portion of our potential liability under the policies we have underwritten, thereby protecting us against an unexpectedly large loss or a catastrophic occurrence that could produce large losses, primarily in our homeowners line of business. We use various software products to measure our exposure to catastrophe losses and the probable maximum loss to us for catastrophe losses such as hurricanes. The models include estimates for our share of the catastrophe losses generated in the residual market for property insurance by the Massachusetts Property Insurance Underwriting Association ( FAIR Plan ). In the aftermath of Hurricane Katrina in 2005, the reinsurance market has seen from the various software modelers, increases in the estimate of damage from hurricanes in the southern and northeast portions of the United States due to revised estimations of increased hurricane activity and increases in the estimation of demand surge in the periods following a significant event. We continue to adjust our reinsurance programs as a result of the changes to the models. As of January 1, 2010, our catastrophe reinsurance provides gross per occurrence reinsurance coverage up to \$450,000. As a result of the changes to the models, and our revised reinsurance program, our catastrophe reinsurance protects us in the event of a 130-year storm (that is, a storm of a severity expected to occur once in a 130-year period). Swiss Re, our primary reinsurer, maintains an A.M. Best rating of A (Excellent). All of our other reinsurers have an A.M. Best rating of A (Excellent) or better except for Validus, which is rated A- (Excellent).

We are a participant in CAR, a state-established body that runs the residual market reinsurance programs for both private passenger and commercial automobile insurance in Massachusetts under which premiums, expenses, losses and loss adjustment expenses on ceded business are shared by all insurers writing automobile insurance in Massachusetts. We also participate in the FAIR Plan in which premiums, expenses, losses and loss adjustment expenses on homeowners business that cannot be placed in the voluntary market are shared by all insurers writing homeowners insurance in Massachusetts. The FAIR Plan has grown dramatically over the past few years as insurance carriers have reduced their exposure to coastal property. The FAIR Plan's exposure to catastrophe losses increased and as a result, the FAIR Plan decided to buy reinsurance to reduce their exposure to catastrophe losses. On July 1, 2010, the FAIR Plan purchased \$1,000,000 of catastrophe reinsurance for property losses in excess of \$200,000. At September 30, 2010, we had no material amounts recoverable from any reinsurer, excluding \$43,812 recoverable from CAR.

On March 10, 2005, our Board of Directors adopted a resolution that prohibits Safety from purchasing finite reinsurance (reinsurance that transfers only a finite or limited amount of risk to the reinsurer) without approval by the Board. To date, the Company has never purchased a finite reinsurance contract.

*Effects of Inflation*

We do not believe that inflation has had a material effect on our consolidated results of operations, except insofar as inflation may affect interest rates.

Table of Contents

**Critical Accounting Policies and Estimates**

*Loss and Loss Adjustment Expense Reserves.*

Significant periods of time can elapse between the occurrence of an insured loss, the reporting to us of that loss and our final payment of that loss. To recognize liabilities for unpaid losses, we establish reserves as balance sheet liabilities. Our reserves represent estimates of amounts needed to pay reported and unreported losses and the expenses of investigating and paying those losses, or loss adjustment expenses. Every quarter, we review our previously established reserves and adjust them, if necessary.

When a claim is reported, claims personnel establish a case reserve for the estimated amount of the ultimate payment. The amount of the reserve is primarily based upon an evaluation of the type of claim involved, the circumstances surrounding each claim and the policy provisions relating to the loss. The estimate reflects the informed judgment of such personnel based on general insurance reserving practices and on the experience and knowledge of the claims person. During the loss adjustment period, these estimates are revised as deemed necessary by our claims department based on subsequent developments and periodic reviews of the cases.

In accordance with industry practice, we also maintain reserves for estimated losses incurred but not yet reported ( IBNR ). IBNR reserves are determined in accordance with commonly accepted actuarial reserving techniques on the basis of our historical information and experience. We review and make adjustments to incurred but not yet reported reserves quarterly.

When reviewing reserves, we analyze historical data and estimate the impact of various loss development factors, such as our historical loss experience and that of the industry, trends in claims frequency and severity, our mix of business, our claims processing procedures, legislative enactments, judicial decisions, legal developments in imposition of damages, and changes and trends in general economic conditions, including the effects of inflation. A change in any of these factors from the assumption implicit in our estimate can cause our actual loss experience to be better or worse than our reserves, and the difference can be material. There is no precise method, however, for evaluating the impact of any specific factor on the adequacy of reserves, because the eventual development of reserves is affected by many factors.

Management determines our loss and LAE reserves estimate based upon the analysis of our actuaries. A reasonable estimate is derived by selecting a point estimate within a range of indications as calculated by our actuaries using generally accepted actuarial techniques. The key assumption in most actuarial analysis is that past patterns of frequency and severity will repeat in the future, unless a significant change in the factors described above takes place. Our key factors and resulting assumptions are the ultimate frequency and severity of claims, based upon the most recent ten years of claims reported to the Company, and the data CAR reports to us to calculate our share of the residual market, as of the date of the applicable balance sheet. For each accident year and each coverage within a line of business our actuaries calculate the ultimate losses incurred. Our total reserves are the difference between the ultimate losses incurred and the cumulative loss and loss adjustment payments made to date. Our IBNR reserves are calculated as the difference between our total reserves and the outstanding case reserves at the end of the accounting period. To determine ultimate losses, our actuaries calculate a range of indications and select a point estimation using such actuarial techniques as:

- *Paid Loss Indications:* This method projects ultimate loss estimates based upon extrapolations of historic paid loss trends. This method tends to be used on short tail lines such as automobile physical damage.

## Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

- *Incurred Loss Indications:* This method projects ultimate loss estimates based upon extrapolations of historic incurred loss trends. This method tends to be used on long tail lines of business such as automobile liability and homeowner's liability.
- *Bornhuetter-Ferguson Indications:* This method projects ultimate loss estimates based upon extrapolations of an expected amount of IBNR, which is added to current incurred losses or paid losses. This method tends to be used on small, immature, or volatile lines of business, such as our BOP and umbrella lines of business.
- *Bodily Injury Code Indications:* This method projects ultimate loss estimates for our private passenger and commercial automobile bodily injury coverage based upon extrapolations of the historic number of accidents and the historic number of bodily injury claims per accident. Projected ultimate bodily injury claims are then segregated into expected claims by type of injury (e.g. soft tissue injury vs. hard tissue injury) based on past experience. An ultimate severity, or average paid loss amounts, is estimated based upon extrapolating historic trends. Projected ultimate loss estimates using this method are the aggregate of estimated losses by injury type.

Such techniques assume that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting our ultimate losses, total reserves and resulting IBNR reserves. It is possible that the final outcome may fall above or below these amounts as a result of a number of factors, including immature data, sparse data, or significant growth in a line of business. Using these methodologies our actuaries established a range of reasonably possible

## Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

### Table of Contents

estimations for net reserves of approximately \$314,669 to \$363,928 as of September 30, 2010. In general, the low and high values of the ranges represent reasonable minimum and maximum values of the indications based on the techniques described above. Our selected point estimate of net loss and LAE reserves based upon the analysis of our actuaries was \$356,340 as of September 30, 2010.

The following tables present the point estimation of the recorded reserves and the range of estimations by line of business for net loss and LAE reserves as of September 30, 2010. We have recorded reserves closer to the high end of the ranges of our projections.

Line of Business	Low	Recorded	High
Private passenger automobile	\$ 213,290	\$ 240,450	\$ 243,897
Commercial automobile	43,067	47,515	48,985
Homeowners	39,952	48,902	50,589
All other	18,360	19,473	20,457
<b>Total</b>	<b>\$ 314,669</b>	<b>\$ 356,340</b>	<b>\$ 363,928</b>

The following table presents our total net reserves and the corresponding case reserves and IBNR reserves for each line of business as of September 30, 2010.

Line of Business	Case	IBNR	Total
Private passenger automobile	\$ 229,400	\$ 417	\$ 229,817
CAR assumed private passenger auto	8,627	2,006	10,633
Commercial automobile	30,655	4,441	35,096
CAR assumed commercial automobile	7,450	4,969	12,419
Homeowners	26,014	7,515	33,529
FAIR Plan assumed homeowners	7,482	7,891	15,373
All other	10,184	9,289	19,473
<b>Total net reserves for losses and LAE</b>	<b>\$ 319,812</b>	<b>\$ 36,528</b>	<b>\$ 356,340</b>

Our IBNR reserves for CAR assumed commercial automobile business are 40.0% of our total reserves for CAR assumed commercial automobile business as of September 30, 2010 due to the reporting delays in the information we receive from CAR, as described further in the section *CAR Loss and Loss Adjustment Expense Reserves*. Our IBNR reserves for FAIR Plan assumed homeowners are 51.3% of our total reserves for FAIR Plan assumed homeowners at September 30, 2010 due to similar reporting delays in the information we receive from FAIR Plan.

The following table presents information by line of business for our total net reserves and the corresponding retained (i.e. direct less ceded) reserves and assumed reserves as of September 30, 2010.

Line of Business	Retained	Assumed	Net
Private passenger automobile	\$ 229,817		
CAR assumed private passenger automobile		\$ 10,633	
<b>Net private passenger automobile</b>			<b>\$ 240,450</b>
Commercial automobile	35,096		
CAR assumed commercial automobile		12,419	

Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

Net commercial automobile				<b>47,515</b>
Homeowners	<b>33,529</b>			
FAIR Plan assumed homeowners		<b>15,373</b>		
Net homeowners				<b>48,902</b>
All other	<b>19,473</b>			<b>19,473</b>
Total net reserves for losses and LAE	\$	<b>317,915</b>	\$	<b>38,425</b>
			\$	<b>356,340</b>

Table of Contents

*CAR Loss and Loss Adjustment Expense Reserves*

We are a participant in CAR and assume a significant portion of losses and LAE on business ceded by the industry participants to CAR. We estimate reserves for assumed losses and LAE that have not yet been reported to us by CAR. Our estimations are based upon the same factors we use for our own reserves, plus additional factors due to the nature of and the information we receive from CAR.

The CAR deficit, which consists of premium ceded to CAR less CAR losses and LAE, is allocated among every automobile insurance company writing business in Massachusetts based on a complex formula (the Participation Ratio ) that takes into consideration a company's voluntary market share, the amount of business it cedes to CAR and credits the company earns under a system CAR has designed to encourage carriers to voluntarily write business in selected under-priced classes and territories.

We receive a Settlement of Balances report from CAR that reports our share of CAR premium, losses and LAE on a lagged basis, seventy-five days after the end of every quarter. CAR-published financial data is always at least one quarter behind the financial data we report. For example, when we reported our financial results for the year ended December 31, 2009, we had nine months of reported 2009 CAR financial data, and we had to estimate and record as IBNR reserves what CAR would report to us for the last three months of the year.

We receive our final calendar year Participation Ratio report from CAR eight months after the end of that year, and thus we have to estimate for six quarters our share of the CAR deficit. For example, for the year ended December 31, 2009 we had to estimate our 2009 policy year CAR Participation Ratio beginning with the first quarter of 2009 through the second quarter of 2010.

Because of the lag in CAR estimates, and in order to try to validate to the extent possible the information CAR does provide, we must try to estimate the effects of the actions of our competitors in order to establish our Participation Ratio. Before final Participation Ratios are available, we estimate the size of CAR and the resulting deficit based on historical analysis of CAR results and estimations of our competitors' cession strategies. Even after our final Participation Ratio is available from CAR, we must continue to estimate the size of CAR and the resulting deficit based upon data published by CAR and our own continuing analysis. As a result, changes in our reserves for CAR may continue to occur until all claims are finally settled. The Loss Reserving Committee at CAR meets 70 days after the end of each quarter to estimate the CAR deficit for all active policy years and publishes estimations, which we use to estimate our share of the deficit. The estimation that CAR calculates is based on data it collects from 19 servicing carriers which settle, reserve and report claims using a variety of methods. Any delays or errors in the collection of this data could have a significant impact on the accuracy of CAR's estimations.

Although we rely to a significant extent in setting our reserves on the information CAR provides, we are cautious in our use of that information, both because of the delays described above and because the CAR estimates incorporate data CAR receives from all other CAR servicing carriers in Massachusetts. We do not have direct access to that data or firsthand knowledge of how those carriers are currently conducting their operations. As a result, we are cautious in recording CAR reserves for the calendar years for which we have to estimate our Participation Ratio and these reserves are subject to significant judgments and estimates.

The portion of reserves based upon CAR estimates for private passenger automobile line of business has declined over time as a result of the institution of the MAIP and phase-out of the private passenger automobile CAR reinsurance pool on April 1, 2009, as described elsewhere in this report.

*Sensitivity Analysis*

Establishment of appropriate reserves is an inherently uncertain process. There can be no certainty that currently established reserves based on our key assumptions regarding frequency and severity in our lines of business, or our assumptions regarding our share of the CAR loss will prove adequate in light of subsequent actual experience. To the extent that reserves are inadequate and are strengthened, the amount of such increase is treated as a charge to earnings in the period that the deficiency is recognized. To the extent that reserves are redundant and are released, the amount of the release is a credit to earnings in the period the redundancy is recognized. For the nine months ended September 30, 2010, a 1 percentage-point change in the loss and LAE ratio would result in a change in reserves of \$4,085. Each 1 percentage-point change in the loss and loss expense ratio would have had a \$2,655 effect on net income, or \$0.18 per diluted share.



Table of Contents

Our assumptions consider that past experience, adjusted for the effects of current developments and anticipated trends, are an appropriate basis for establishing our reserves. Our individual key assumptions could each have a reasonable possible range of plus or minus 5 percentage-points for each estimation, although there is no guarantee that our assumptions will not have more than a 5 percentage point variation. The following sensitivity tables present information for each of our primary lines of business on the effect each 1 percentage-point change in each of our key assumptions on unpaid frequency and severity could have on our retained (i.e., direct minus ceded) loss and LAE reserves and net income for the nine months ended September 30, 2010. In evaluating the information in the table, it should be noted that a 1 percentage-point change in a single assumption would change estimated reserves by 1 percentage-point. A 1 percentage-point change in both our key assumptions would change estimated reserves within a range of plus or minus 2 percentage-points.

	-1 Percent Change in Frequency	No Change in Frequency	+1 Percent Change in Frequency
<b>Private passenger automobile retained loss and LAE reserves</b>			
-1 Percent Change in Severity			
Estimated decrease in reserves	\$ (4,596)	\$ (2,298)	\$
Estimated increase in net income	2,987	1,494	
No Change in Severity			
Estimated (decrease) increase in reserves	(2,298)		2,298
Estimated increase (decrease) in net income	1,494		(1,494)
+1 Percent Change in Severity			
Estimated increase in reserves		2,298	4,596
Estimated decrease in net income		(1,494)	(2,987)
<b>Commercial automobile retained loss and LAE reserves</b>			
-1 Percent Change in Severity			
Estimated decrease in reserves	(702)	(351)	
Estimated increase in net income	456	228	
No Change in Severity			
Estimated (decrease) increase in reserves	(351)		351
Estimated increase (decrease) in net income	228		(228)
+1 Percent Change in Severity			
Estimated increase in reserves		351	702
Estimated decrease in net income		(228)	(456)
<b>Homeowners retained loss and LAE reserves</b>			
-1 Percent Change in Severity			
Estimated decrease in reserves	(671)	(335)	
Estimated increase in net income	436	218	
No Change in Severity			
Estimated (decrease) increase in reserves	(335)		335
Estimated increase (decrease) in net income	218		(218)
+1 Percent Change in Severity			
Estimated increase in reserves		335	671
Estimated decrease in net income		(218)	(436)
<b>All other retained loss and LAE reserves</b>			
-1 Percent Change in Severity			
Estimated decrease in reserves	(389)	(195)	
Estimated increase in net income	253	127	
No Change in Severity			
Estimated (decrease) increase in reserves	(195)		195
Estimated increase (decrease) in net income	127		(127)
+1 Percent Change in Severity			
Estimated increase in reserves		195	389

Estimated decrease in net income	(127)	(253)
----------------------------------	-------	-------

Table of Contents

Our estimated share of CAR loss and LAE reserves is based on assumptions about our Participation Ratio, the size of CAR, and the resulting deficit (similar assumptions apply with respect to the FAIR Plan). Our assumptions consider that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for establishing our CAR reserves. Each of our assumptions could have a reasonably possible range of plus or minus 5 percentage-points for each estimation.

The following sensitivity table presents information of the effect each 1 percentage-point change in our assumptions on our share of reserves for CAR and other residual markets could have on our assumed loss and LAE reserves and net income for the nine months ended September 30, 2010. In evaluating the information in the table, it should be noted that a 1 percentage-point change in our assumptions would change estimated reserves by 1 percentage-point.

	-1 Percent Change in Estimation	+1 Percent Change in Estimation
<b>CAR assumed private passenger automobile</b>		
Estimated (decrease) increase in reserves	\$ (106)	\$ 106
Estimated increase (decrease) in net income	69	(69)
<b>CAR assumed commercial automobile</b>		
Estimated (decrease) increase in reserves	(124)	124
Estimated increase (decrease) in net income	81	(81)
<b>FAIR Plan assumed homeowners</b>		
Estimated (decrease) increase in reserves	(154)	154
Estimated increase (decrease) in net income	100	(100)

*Reserve Development Summary*

The changes we have recorded in our reserves in the past illustrate the uncertainty of estimating reserves. Our prior year reserves decreased by \$32,895, and \$30,057 for the nine months ended September 30, 2010 and 2009, respectively.

The following table presents a comparison of prior year development of our net reserves for losses and LAE for the nine months ended September 30, 2010 and 2009. Each accident year represents all claims for an annual accounting period in which loss events occurred, regardless of when the losses are actually reported, booked or paid. Our financial statements reflect the aggregate results of the current and all prior accident years.

Accident Year	Nine Months Ended September 30,	
	2010	2009
2000 & prior	\$ (385)	\$ (467)
2001	(266)	(828)
2002	(587)	(1,207)
2003	(1,273)	(1,071)
2004	(1,548)	(2,755)
2005	(3,626)	(5,017)
2006	(6,358)	(6,765)

Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

2007		(6,866)		(4,717)
2008		(7,199)		(7,230)
2009		(4,787)		
All prior years	\$	(32,895)	\$	(30,057)

The decreases in prior years reserves during the nine months ended September 30, 2010 and 2009 resulted from re-estimations of prior year ultimate loss and LAE liabilities. The 2010 decrease is primarily composed of reductions of \$23,066 in our retained automobile reserves and \$5,038 in CAR assumed reserves. The 2009 decrease is primarily composed of reductions of \$15,706 in our retained automobile reserves, \$8,780 in CAR assumed reserves and \$4,139 in our retained homeowners reserves.

Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

Table of Contents

The following table presents information by line of business for prior year development of our net reserves for losses and LAE for the nine months ended September 30, 2010.

Accident Year	Private Passenger Automobile	Commercial Automobile	Homeowners	All Other	Total
2000 & prior	\$ (331)	\$ (54)	\$	\$	\$ (385)
2001	(244)	(22)			(266)
2002	(493)	(66)		(28)	(587)
2003	(801)	(276)		(196)	(1,273)
2004	(917)	(416)	15	(230)	(1,548)
2005	(2,551)	(590)	(217)	(268)	(3,626)
2006	(3,574)	(1,748)	(695)	(341)	(6,358)
2007	(4,735)	(707)	(972)	(452)	(6,866)
2008	(5,673)	(578)	(330)	(618)	(7,199)
2009	(3,810)	(518)	(431)	(28)	(4,787)
All prior years	\$ (23,129)	\$ (4,975)	(2,630)	(2,161)	\$ (32,895)

To further clarify the effects of changes in our reserve estimates for CAR and other residual markets, the next two tables break out the information in the table above by source of the business (i.e., non-residual market vs. residual market).

The following table presents information by line of business for prior year development of retained reserves for losses and LAE for the nine months ended September 30, 2010; that is, all our reserves except for business ceded or assumed from CAR and other residual markets.

Accident Year	Retained Private Passenger Automobile	Retained Commercial Automobile	Retained Homeowners	Retained All Other	Total
2000 & prior	\$ (315)	\$ (54)	\$	\$	\$ (369)
2001	(208)	(17)			(225)
2002	(418)	(55)		(28)	(501)
2003	(735)	(251)		(196)	(1,182)
2004	(903)	(423)		(230)	(1,556)
2005	(2,524)	(534)	(208)	(268)	(3,534)
2006	(3,387)	(1,565)	(669)	(341)	(5,962)
2007	(3,998)	(523)	(892)	(452)	(5,865)
2008	(4,291)	(265)		(618)	(5,174)
2009	(2,422)	(178)		(28)	(2,628)
All prior years	\$ (19,201)	\$ (3,865)	(1,769)	(2,161)	\$ (26,996)

Table of Contents

The following table presents information by line of business for prior year development of reserves assumed from CAR and other residual markets for losses and LAE for the nine months ended September 30, 2010.

Accident Year	CAR Assumed Private Passenger Automobile	CAR Assumed Commercial Automobile	FAIR Plan Homeowners	Total
2000 & prior	\$ (16)	\$ (5)	\$ (16)	\$ (16)
2001	(36)	(5)		(41)
2002	(75)	(11)		(86)
2003	(66)	(25)		(91)
2004	(14)	7	15	8
2005	(27)	(56)	(9)	(92)
2006	(187)	(183)	(26)	(396)
2007	(737)	(184)	(80)	(1,001)
2008	(1,382)	(313)	(330)	(2,025)
2009	(1,388)	(340)	(431)	(2,159)
All prior years	\$ (3,928)	\$ (1,110)	\$ (861)	\$ (5,899)

Our private passenger automobile line of business prior year reserves decreased by \$23,129 for the nine months ended September 30, 2010. The decrease was primarily due to improved retained private passenger results of \$16,622 for the accident years 2005 through 2009, and improved assumed CAR results for the private passenger automobile pool of \$3,507 for accident years 2007 through 2009. The improved retained private passenger results were primarily due to fewer IBNR claims than previously estimated and better than previously estimated severity on our established bodily injury and property damage case reserves. The improved CAR results were due primarily to improved CAR private passenger loss ratios as published and reported by the CAR Loss Reserving Committee.

Our commercial automobile line of business prior year reserves decreased by \$4,975 for the nine months ended September 30, 2010 due primarily to fewer IBNR claims than previously estimated.

Our retained homeowners line of business prior year reserves decreased by \$1,769 for the nine months ended September 30, 2010. Our FAIR Plan homeowners reserve decreased by \$861 for the nine months ended September 30, 2010.

In estimating all our loss reserves, including CAR, we follow the guidance prescribed by ASC 944 *Financial Services-Insurance*.

For further information, see Results of Operations: *Losses and Loss Adjustment Expenses*.

*Other-Than-Temporary Impairments.*

## Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

We use a systematic methodology to evaluate declines in fair values below cost or amortized cost of our investments. This methodology ensures that we evaluate available evidence concerning any declines in a disciplined manner.

In our determination of whether a decline in fair value below amortized cost is an other-than-temporary impairment ( OTTI ), we consider and evaluate several factors and circumstances including the issuer's overall financial condition, the issuer's credit and financial strength ratings, a weakening of the general market conditions in the industry or geographic region in which the issuer operates, a prolonged period (typically six months or longer) in which the fair value of an issuer's securities remains below our amortized cost, and any other factors that may raise doubt about the issuer's ability to continue as a going concern.

We adopted ASC 320, *Investments - Debt and Equity Securities* effective April 1, 2009. ASC 320 requires entities to separate an other-than-temporary impairment of a debt security into two components when there are credit related losses associated with the impaired debt security for which the Company asserts that it does not have the intent to sell the security, and it is more likely than not that it will not be required to sell the security before recovery of its cost basis. Prior to April 1, 2009, we had to determine whether we had the intent and ability to hold the investment for a sufficient period of time for the value to recover. When the analysis of the above factors resulted in our conclusion that declines in market values were other-than-temporary, the cost of the security was written down to market value and the reduction in value was reflected as a realized loss. The adoption of ASC 320 did not have an impact on our consolidated results of operations or financial position.

Table of Contents

Effective under ASC 320, the amount of the OTTI related to a credit loss is recognized in earnings, and the amount of the OTTI related to other factors is recorded as a component of other comprehensive income (loss). In instances where no credit loss exists but it is more likely than not that we will have to sell the debt security prior to the anticipated recovery, the decline in market value below amortized cost is recognized as an OTTI in earnings. In periods after the recognition of an OTTI on debt securities, we account for such securities as if they had been purchased on the measurement date of the OTTI at an amortized cost basis equal to the previous amortized cost basis less the OTTI recognized in earnings. For debt securities for which OTTI was recognized in earnings, the difference between the new amortized cost basis and the cash flows expected to be collected will be accreted or amortized into net investment income

For further information, see Results of Operations: *Net Realized Gains (Losses) on Investments*.

**Results of Operations****Three and Nine Months Ended September 30, 2010 Compared to Three and Nine Months Ended September 30, 2009**

The following table shows certain of our selected financial results.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Direct written premiums	\$ 157,038	\$ 143,210	\$ 471,527	\$ 438,269
Net written premiums	\$ 150,004	\$ 137,260	\$ 450,623	\$ 419,176
Net earned premiums	\$ 139,190	\$ 133,059	\$ 408,490	\$ 399,715
Investment income	10,108	11,093	31,757	32,221
Net realized gains (losses) on investments	363	(20)	295	(337)
Finance and other service income	4,770	4,197	13,642	12,578
Total revenue	154,431	148,329	454,184	444,177
Loss and loss adjustment expenses	88,455	82,280	264,905	261,555
Underwriting, operating and related expenses	44,229	42,061	128,354	122,681
Interest expense	22	23	66	66
Total expenses	132,706	124,364	393,325	384,302
Income before income taxes	21,725	23,965	60,859	59,875
Income tax expense	6,258	6,941	17,529	15,992
Net income	\$ 15,467	\$ 17,024	\$ 43,330	\$ 43,883
Earnings per weighted average common share:				
Basic	\$ 1.03	\$ 1.11	\$ 2.87	\$ 2.80
Diluted	\$ 1.03	\$ 1.11	\$ 2.87	\$ 2.79
Cash dividends paid per common share	\$ 0.50	\$ 0.40	\$ 1.30	\$ 1.20

*Direct Written Premiums.* Direct written premiums for the quarter ended September 30, 2010 increased by \$13,828, or 9.7%, to \$157,038 from \$143,210 for the comparable 2009 period. Direct written premiums for the nine months ended September 30, 2010 increased by \$33,258, or 7.6%, to \$471,527 from \$438,269 for the comparable 2009 period. The 2010 increases occurred primarily in our personal automobile and homeowners lines, which experienced increases of 4.1% and 3.1%, respectively, in average written premium per exposure and increases of 2.5% and 20.7%, respectively, in written exposures for the nine months ended September 30, 2010 from the comparable 2009 period. The increase in



## Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

homeowners exposures is primarily the result of our pricing strategy of offering account discounts to policyholders who insure both an automobile and home with us. Partially offsetting these increases was a 5.0% decrease in average written premium per exposure and a 2.6% decrease in written exposures in our commercial automobile line for the nine months ended September 30, 2010 from the comparable 2009 period. This decrease is primarily a result of reduced exposures from ERPs submitting business through the CAR LSC program and general economic conditions which have reduced the size of the overall commercial automobile insurance market in Massachusetts.

*Net Written Premiums.* Net written premiums for the quarter ended September 30, 2010 increased by \$12,744, or 9.3%, to \$150,004 from \$137,260 for the comparable 2009 period. Net written premiums for the nine months ended September 30, 2010 increased by \$31,447, or 7.5%, to \$450,623 from \$419,176 for the comparable 2009 period. The 2010 increase was primarily due to the factors that increased direct written premiums.

## Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

### Table of Contents

*Net Earned Premiums.* Net earned premiums for the quarter ended September 30, 2010 increased by \$6,131, or 4.6%, to \$139,190 from \$133,059 for the comparable 2009 period. Net earned premiums for the nine months ended September 30, 2010 increased by \$8,775, or 2.2%, to \$408,490 from \$399,715 for the comparable 2009 period. The 2010 increase was due to the factors that increased direct written premiums combined with decreases in earned premiums ceded to CAR, and partially offset by decreases in earned premiums assumed from CAR. Earned premiums assumed from and ceded to CAR decreased as a result of the phase-out of the CAR personal automobile reinsurance pool, which was fully replaced by an assigned risk plan, the MAIP, beginning with personal automobile policy effective dates after March 31, 2009.

The effect of assumed and ceded premiums on net written and net earned premiums is presented in the following table.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
<b>Written Premiums</b>				
Direct	\$ 157,038	\$ 143,210	\$ 471,527	\$ 438,269
Assumed	2,617	3,059	9,557	12,447
Ceded	(9,651)	(9,009)	(30,461)	(31,540)
Net written premiums	\$ 150,004	\$ 137,260	\$ 450,623	\$ 419,176
<b>Earned Premiums</b>				
Direct	\$ 147,440	\$ 139,101	\$ 430,506	\$ 415,810
Assumed	2,463	5,778	10,251	22,377
Ceded	(10,713)	(11,820)	(32,267)	(38,472)
Net earned premiums	\$ 139,190	\$ 133,059	\$ 408,490	\$ 399,715

*Net Investment Income.* Net investment income for the quarter ended September 30, 2010 decreased by \$985, or 8.9%, to \$10,108 from \$11,093 for the comparable 2009 period. Net investment income for the nine months ended September 30, 2010 decreased by \$464, or 1.3%, to \$31,757 from \$32,221 for the comparable 2009 period. The 2010 decreases primarily resulted from lower short-term interest rates, risk reduction actions related to municipal bonds, and duration-shortening actions taken to protect the portfolio from rising interest rates. Net effective annualized yield on the investment portfolio decreased to 3.8% and 4.0%, respectively, for the quarter and nine months ended September 30, 2010 from 4.2% and 4.1%, respectively, for the comparable 2009 periods. Our duration decreased to 2.9 years at September 30, 2010 from 3.2 years at September 30, 2009.

*Net Realized Gains (Losses) on Investments.* Net realized gains on investments were \$363 for the quarter ended September 30, 2010 compared to net realized losses of \$20 for the comparable 2009 period. Net realized gains on investments were \$295 for the nine months ended September 30, 2010 compared to net realized losses of \$337 for the comparable 2009 period.

Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

Table of Contents

The gross unrealized gains and losses on investments in fixed maturity securities and equity securities, including interests in mutual funds, were as follows:

	As of September 30, 2010				
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Non-OTTI Losses	OTTI Unrealized Losses (3) (4)	Estimated Fair Value
U.S. Treasury securities	\$ 47,732	\$ 449	\$	\$	\$ 48,181
Obligations of states and political subdivisions	411,749	20,321	(225)		431,845
Residential mortgage-backed securities (1)	253,454	17,687	(14)		271,127
Commercial mortgage-backed securities	66,588	3,401			69,989
Other asset-backed securities	21,121	1,447			22,568
Corporate and other securities	182,266	11,776	(13)		194,029
Subtotal, fixed maturity securities	982,910	55,081	(252)		1,037,739
Equity securities (2)	13,524	457	(23)		13,958
Totals	\$ 996,434	\$ 55,538	\$ (275)	\$	\$ 1,051,697

(1) Residential mortgage-backed securities consists primarily of obligations of U.S. Government agencies including collateralized mortgage obligations and mortgage-backed securities guaranteed and/or insured by the following issuers: Government National Mortgage Association (GNMA), Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA) and the Federal Home Loan Bank (FHLB). The total of these fixed maturity securities was \$253,329 at amortized cost and \$271,000 at fair value as of September 30, 2010.

(2) Equity securities includes interests in mutual funds of \$11,029 at cost and \$11,487 at fair value as of September 30, 2010 held to fund the Company's executive deferred compensation plan.

(3) Our investment portfolio included 35 securities in an unrealized loss position at September 30, 2010.

(4) Amounts in this column represent OTTI recognized in accumulated other comprehensive income.

We continue to hold no subprime mortgage debt securities. All of our holdings in mortgage-backed securities are either U.S. Government or Agency guaranteed or are rated investment grade by either Moody's or Standard & Poor's.

The composition of our fixed income security portfolio by Moody's rating was as follows:

	As of September 30, 2010	
	Estimated Fair Value	Percent
U.S. Treasury securities and obligations of U.S. Government agencies	\$ 330,516	31.9%
Aaa/Aa	478,132	46.1
A	123,958	11.9
Baa	60,985	5.9
Ba	332	
Not rated (Standard & Poor's rating of A or higher)	43,816	4.2

Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

Total	\$	1,037,739	100.0%
-------	----	-----------	--------

Ratings are assigned by Moody's, or the equivalent Standard & Poor's if a Moody's rating is not available, as discussed above. Such ratings are generally assigned upon the issuance of the securities and are subject to revision on the basis of ongoing evaluations. Ratings in the table are as of the date indicated.

Table of Contents

The following table illustrates the gross unrealized losses included in our investment portfolio and the fair value of those securities, aggregated by investment category. The table also illustrates the length of time that they have been in a continuous unrealized loss position as of September 30, 2010.

	Less than 12 Months		As of September 30, 2010 12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Obligations of states and political subdivisions	\$ 17,876	\$ 71	\$ 4,464	\$ 154	\$ 22,340	\$ 225
Residential mortgage-backed securities	222	3	337	11	559	14
Corporate and other securities	1,977	13			1,977	13
Subtotal, fixed maturity securities	20,075	87	4,801	165	24,876	252
Equity securities	2,472	23			2,472	23
Total temporarily impaired securities	\$ 22,547	\$ 110	\$ 4,801	\$ 165	\$ 27,348	\$ 275

As of September 30, 2010, we held insured investment securities of approximately \$266,195, which represented approximately 25.3% of our total investment portfolio. Approximately \$55,344 of these securities are pre-refunded, meaning that funds have been set aside in escrow to satisfy the future interest and principal obligations of the bond.

The following table shows our insured investment securities that are backed by financial guarantors including pre-refunded securities as of September 30, 2010. We do not have any direct investment holdings in a financial guarantee insurance company.

Financial Guarantor	As of September 30, 2010		
	Total	Pre-refunded Securities	Exposure Net of Pre-refunded Securities
Municipal bonds			
Ambac Assurance Corporation	\$ 29,478	\$ 3,467	\$ 26,011
Financial Guaranty Insurance Company	282	282	
Assured Guaranty Municipal Corporation	102,344	38,940	63,404
National Public Finance Guaranty Corporation	125,932	12,655	113,277
Total municipal bonds	258,036	55,344	202,692
Other asset-backed securities			
Ambac Assurance Corporation	4,292		4,292
Financial Guaranty Insurance Company	3,867		3,867
Total other asset-backed securities	8,159		8,159
Total	\$ 266,195	\$ 55,344	\$ 210,851

Table of Contents

The following table shows our insured investments by Moody's rating where it is available both with and without the impact of the insurance guarantee as of September 30, 2010.

Rating	As of September 30, 2010	
	Rating With Insurance	Rating Without Insurance
Aaa	\$ 3,946	\$ 3,946
Aa1	26,589	26,589
Aa2	81,304	75,289
Aa3	90,574	79,318
A1	12,080	14,251
A2	11,169	17,057
A3	13,140	16,337
Baa1	282	282
Ba1		6,015
Total	\$ 239,084	\$ 239,084

We reviewed the unrealized losses in our fixed income and equity portfolio as of September 30, 2010 for potential other-than-temporary asset impairments. We held no securities at September 30, 2010 with a material (20% or greater) unrealized loss for four or more consecutive quarters. Specific qualitative analysis was performed for securities appearing on our Watch List, if any. Qualitative analysis considered such factors as the financial condition and the near term prospects of the issuer, whether the debtor is current on its contractually obligated interest and principal payments, changes to the rating of the security by a rating agency, and the historical volatility of the fair value of the security.

Of the \$275 gross unrealized losses as of September 30, 2010, \$239 relates to obligations of states and political subdivisions. The remaining \$36 of gross unrealized losses relates primarily to holdings of investment grade corporate and other fixed maturity and equity securities.

The unrealized losses recorded on the investment portfolio at September 30, 2010 resulted from fluctuations in market interest rates and other temporary market conditions as opposed to fundamental changes in the credit quality of the issuers of such securities. Given our current level of liquidity, the fact that we do not intend to sell these securities, and that it is more likely than not that we will not be required to sell these securities prior to recovery of the cost basis of these securities, these decreases in values are viewed as being temporary.

During the nine months ended September 30, 2010 and 2009, there was no significant deterioration in the credit quality of any of our holdings and no other-than-temporary impairment charges were recorded related to our portfolio of investment securities.

ASC 820, *Fair Value Measurements and Disclosure* provides a revised definition of fair value, establishes a framework for measuring fair value and expands financial statement disclosure requirements for fair value information. Under ASC 820, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants (an exit price). ASC 820 establishes a fair value hierarchy that distinguishes between inputs based on market data from independent sources ( observable inputs ) and a reporting entity's internal assumptions based upon the best information available when external market data is limited or unavailable ( unobservable inputs ). The fair value hierarchy in ASC 820 prioritizes fair value measurements into three levels based on the nature of the inputs as follows:

## Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

Level 1 Valuations based on quoted prices in active markets for identical assets and liabilities;

Level 2 Valuations based on observable inputs that do not meet the criteria for Level 1, including quoted prices in inactive markets and quoted prices in active markets for similar, but not identical instruments; and

Level 3 Valuations based on unobservable inputs.

Fair values for our fixed maturity securities are based on prices provided by our custodian bank and our investment manager. Both our custodian bank and our investment manager use a variety of independent, nationally recognized pricing services to determine market valuations. If the pricing service cannot provide fair value determinations, we obtain non-binding

Table of Contents

price quotes from broker-dealers. A minimum of two quoted prices is obtained for the majority of fixed maturity securities in our investment portfolio. Our custodian bank is our primary provider of quoted prices from third-party pricing services and broker-dealers. To provide reasonable assurance of the validity of each price or quote, a secondary third-party pricing service or broker-dealer quote is obtained from our investment manager. An examination of the pricing data is then performed for each security. If the variance between the primary and secondary price quotes for a security is within an accepted tolerance level, the quoted price obtained from our custodian bank is used in our financial statements for the security. If the variance between the primary and secondary price quotes exceeds an accepted tolerance level, we obtain a quote from an alternative source, if possible, and we document and resolve any differences between the pricing sources. In addition, we may request that our investment manager and their traders provide input as to which vendor is providing prices that their traders believe are reflective of fair value for the security. Following this process, we may decide to value the security in our financial statements using the secondary or alternative source if we believe that pricing is more reflective of the security's value than the primary pricing provided by our custodian bank. We analyze market valuations received to verify reasonableness, to understand the key assumptions used and their sources, and to determine an appropriate ASC 820 fair value hierarchy level based upon trading activity and the observability of market inputs. Based on this evaluation and investment class analysis, each price is classified into Level 1, 2 or 3.

Fair values of instruments are based on (i) quoted prices in active markets for identical assets (Level 1), (ii) quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-derived valuations in which all significant inputs are observable in active markets (Level 2) or (iii) valuations derived from valuation techniques in which one or more significant inputs are unobservable in the marketplace (Level 3).

Our Level 1 securities consist of equity securities whose values are based on quoted prices in active markets for identical assets. Our Level 2 securities are comprised of fixed maturity securities whose fair value was determined using observable market inputs. Fair values for securities for which quoted market prices were unavailable were estimated based upon reference to observable inputs such as benchmark interest rates, market comparables, and other relevant inputs. Investments valued using these inputs include U.S. Treasury securities and obligations of U.S. Government agencies, obligations of international government agencies, obligations of states and political subdivisions, corporate securities, commercial and residential mortgage-backed securities, and other asset-backed securities. Inputs into the fair value application that are utilized by asset class include but are not limited to:

- *States and political subdivisions:* overall credit quality, including assessments of market sectors and the level and variability of sources of payment such as general obligation, revenue or lease; credit support such as insurance, state or local economic and political base, prefunded and escrowed to maturity covenants.
- *Corporate fixed maturities:* overall credit quality, the establishment of a risk adjusted credit spread over the applicable risk free yield curve for discounted cash flow valuations; assessments of the level of industry economic sensitivity, company financial policies, indenture restrictive covenants, and/or security and collateral.
- *Residential mortgage-backed securities, U.S. agency pass-throughs, collateralized mortgage obligations ( CMOs ), non U.S. agency CMOs:* estimates of prepayment speeds based upon historical prepayment rate trends, underlying collateral interest rates, original weighted average maturity, vintage year, borrower credit quality characteristics, interest rate and yield curve forecasts, U.S. government support programs, tax policies, and delinquency/default trends.
- *Commercial mortgage-backed securities:* overall credit quality, including assessments of the level and variability of credit support and collateral type such as office, retail, or lodging, predictability of cash flows for the deal structure, prevailing economic market conditions.
- *Other asset-backed securities:* overall credit quality, estimates of prepayment speeds based upon historical trends and characteristics of underlying loans, including assessments of the level and variability of collateral, revenue generating agreements, area licenses agreements, product sourcing agreements and equipment and property leases.



All unadjusted estimates of fair value for fixed maturities priced by the pricing services as described above are included in the amounts disclosed in Level 2.

In order to ensure the fair value determination is representative of an exit price (consistent with ASC 820), our procedures for validating quotes or prices obtained from third-parties include, but are not limited to, obtaining a minimum of two price quotes for each fixed maturity security if possible, as discussed above, the periodic testing of sales activity to determine if there are any significant differences between the market price used to value the security as of the balance sheet date and the sales price of the security for sales that occurred around the balance sheet date, and the periodic review of reports provided by our investment manager regarding those securities with ratings changes and securities placed on our Watch List. In addition, valuation techniques utilized by pricing services and prices obtained from external sources are reviewed by our external

Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

Table of Contents

investment manager, whose investment professionals are familiar with the securities being priced and the markets in which they trade to ensure the fair value determination is representative of an exit price (consistent with ASC 820).

Our entire portfolio was priced based upon quoted market prices or other observable inputs as of September 30, 2010. There were no significant changes to the valuation process during the nine months ending September 30, 2010. As of September 30, 2010 and December 31, 2009, no quotes or prices obtained were adjusted by management. All broker quotes obtained were non-binding.

The following table summarizes our total fair value measurements and the fair value measurements based on the Level of inputs for investments as of September 30, 2010.

	Total	As of September 30, 2010		
		Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
U.S. Treasury securities	\$ 48,181	\$	\$ 48,181	\$
Obligations of states and political subdivisions	431,845		431,845	
Residential mortgage-backed securities	271,127		271,127	
Commercial mortgage-backed securities	69,989		69,989	
Other asset-backed securities	22,568		22,568	
Corporate and other securities	194,029		194,029	
Equity securities	13,958	13,958		
Total investment securities	\$ 1,051,697	\$ 13,958	\$ 1,037,739	\$

The following table summarizes the changes in our Level 3 fair value measurements for the quarter ended September 30, 2010.

	Other Asset-Backed Securities
Balance at July 1, 2010	\$ 3,182
Net gains and losses included in earnings	
Net gains included in other comprehensive income	685
Purchases and sales	
Transfers in (out) of Level 3	(3,867)
Balance at September 30, 2010	\$
Amount of total losses included in earnings attributable to the change in unrealized losses related to assets still held at September 30, 2010	\$

The following table summarizes the changes in our Level 3 fair value measurements for the nine months ended September 30, 2010.

	Other Asset-Backed Securities
Balance at January 1, 2010	\$ 2,504
Net gains and losses included in earnings	

Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

Net gains included in other comprehensive income	<b>1,363</b>
Purchases and sales	
Transfers in (out) of Level 3	<b>(3,867)</b>
Balance at September 30, 2010	\$
Amount of total losses included in earnings attributable to the change in unrealized losses related to assets still held at September 30, 2010	\$

Transfers in and out of Level 3 are attributable to changes in the ability to observe significant inputs in determining fair value exit pricing. On January 1 and July 1, 2010, our Level 3 securities consisted of one asset-backed security whose price was based solely on a single broker quote which was deemed to be obtained through unobservable inputs. During the quarter ended September 30, 2010, a cash tender offer was received for this security. As a result, the fair value of the security at September 30,

Table of Contents

2010 was deemed to be based on observable inputs and accordingly, was transferred into Level 2. This security was sold during October 2010.

*Finance and Other Service Income.* Finance and other service income includes revenues from premium installment charges, which we recognize when earned, and other miscellaneous income and fees. Finance and other service income increased by \$573, or 13.7%, to \$4,770 for the quarter ended September 30, 2010 from \$4,197 for the comparable 2009 period. Finance and other service income increased by \$1,064, or 8.5%, to \$13,642 for the nine months ended September 30, 2010 from \$12,578 for the comparable 2009 period.

*Losses and Loss Adjustment Expenses.* Losses and loss adjustment expenses incurred for the quarter ended September 30, 2010 increased by \$6,175, or 7.5%, to \$88,455 from \$82,280 for the comparable 2009 period. Losses and loss adjustment expenses incurred for the nine months ended September 30, 2010 increased by \$3,350, or 1.3%, to \$264,905 from \$261,555 for the comparable 2009 period. Our GAAP loss ratio for the quarter ended September 30, 2010 increased to 63.5% from 61.8% for the comparable 2009 period. Our GAAP loss ratio for the nine months ended September 30, 2010 decreased to 64.8% from 65.4% for the comparable 2009 period. Our GAAP loss ratio excluding loss adjustment expenses for the quarter ended September 30, 2010 increased to 54.4% from 52.0% for the comparable 2009 period. Our GAAP loss ratio excluding loss adjustment expenses for the nine months ended September 30, 2010 decreased to 55.5% from 55.9% for the comparable 2009 period. Total prior year favorable development included in the pre-tax results for the quarter and nine months ended September 30, 2010 was \$10,337 and \$32,895, respectively, compared to prior years favorable development of \$11,911 and \$30,057, respectively, for the comparable 2009 periods.

*Underwriting, Operating and Related Expenses.* Underwriting, operating and related expense for the quarter ended September 30, 2010 increased by \$2,168, or 5.2%, to \$44,229 from \$42,061 for the comparable 2009 period. Underwriting, operating and related expense for the nine months ended September 30, 2010 increased by \$5,673, or 4.6%, to \$128,354 from \$122,681 for the comparable 2009 period. Our GAAP expense ratios for the quarter ended September 30, 2010 increased to 31.8 % from 31.6% for the comparable 2009 period. Our GAAP expense ratios for the nine months ended September 30, 2010 increased to 31.4 % from 30.7% for the comparable 2009 period. The increase in the 2010 periods is primarily due to increases in agent commission expenses.

*Interest Expense.* Interest expense for the quarter ended September 30, 2010 was \$22, compared to \$23 for the comparable 2009 period. Interest expense for the nine months ended September 30, 2010 and 2009 was \$66. The credit facility commitment fee included in interest expense was \$19 for both the quarters ended September 30, 2010 and 2009 and \$56 for both the nine months ended September 30, 2010 and 2009.

*Income Tax Expense.* Our effective tax rate was 28.8% and 29.0% for the quarters ended September 30, 2010 and 2009, respectively. Our effective tax rate was 28.8% and 26.7% for the nine months ended September 30, 2010 and 2009, respectively. These effective rates were lower than the statutory rate of 35.0% primarily due to adjustments for tax-exempt investment income.

### **Liquidity and Capital Resources**

As a holding company, Safety's assets consist primarily of the stock of our direct and indirect subsidiaries. Our principal source of funds to meet our obligations and pay dividends to shareholders, therefore, is dividends and other permitted payments from our subsidiaries, principally Safety Insurance. Safety is the borrower under our credit facility.

## Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

Safety Insurance's sources of funds primarily include premiums received, investment income and proceeds from sales and redemptions of investments. Safety Insurance's principal uses of cash are the payment of claims, operating expenses and taxes, the purchase of investments and payment of dividends to Safety.

Net cash provided by operating activities was \$31,101 and \$40,873 during the nine months ended September 30, 2010 and 2009, respectively. Our operations typically generate positive cash flows from operations as most premiums are received in advance of the time when claim and benefit payments are required. These positive operating cash flows are expected to continue to meet our liquidity requirements.

Net cash provided by investing activities during the nine months ended September 30, 2010 and 2009 was \$10,091 and \$33,115, respectively, due primarily from sales, paydowns, calls and maturities of fixed maturity and short-term securities exceeding purchases of securities.

Net cash used for financing activities was \$24,779 and \$60,741 during the nine months ended September 30, 2010 and 2009, respectively. Net cash used for financing activities is primarily comprised of dividend payments to shareholders and the

Table of Contents

acquisition of treasury stock. Acquisition of treasury stock was \$5,814 during the nine months ending September 30, 2010, compared to \$42,196 during the comparable 2009 period.

*Credit Facility*

On August 14, 2008, we entered into an Amended and Restated Revolving Credit Agreement (the *New Credit Agreement*) with RBS Citizens, NA ( *RBS Citizens* ). The *New Credit Agreement* amended and restated the terms of our existing Revolving Credit Agreement with RBS Citizens prior to its expiration date of August 17, 2008. The *New Credit Agreement* extends the maturity date to August 14, 2013 and provides a \$30,000 revolving credit facility with an accordion feature allowing for future expansion of the committed amount up to \$50,000. Loans under the credit facility bear interest at our option of either (i) the LIBOR rate plus 1.25% per annum or (ii) the higher of RBS Citizens prime rate or 0.5% above the federal funds rate plus 1.25% per annum. Interest only is payable prior to maturity.

Our obligations under the credit facility are secured by pledges of our assets and the capital stock of our operating subsidiaries. The credit facility is guaranteed by our non-insurance company subsidiaries. The credit facility contains covenants including requirements to maintain minimum risk-based capital ratios and statutory surplus of Safety Insurance as well as limitations or restrictions on indebtedness, liens, and other matters. Among other covenants, the credit facility restricts our payment of dividends (i) if a default under the credit facility is continuing or would result therefrom or (ii) in an amount in excess of 50% of our prior year's net income, as determined in accordance with GAAP. As of September 30, 2010, we were in compliance with all such covenants. In addition, the credit facility includes customary events of default, including a cross-default provision permitting the lenders to accelerate the facility if the Company (i) defaults in any payment obligation under debt having a principal amount in excess of \$10,000 or (ii) fails to perform any other covenant permitting acceleration of all such debt.

We had no amounts outstanding on our credit facility at September 30, 2010 and December 31, 2009. The credit facility commitment fee included in interest expenses was computed at a rate of 0.25% on the \$30,000 commitment at September 30, 2010 and 2009.

*Regulatory Matters*

The Insurance Subsidiaries are subject to various regulatory restrictions that limit the maximum amount of dividends available to be paid to their parent without prior approval of the Commissioner. The Massachusetts statute limits the dividends an insurer may pay in any twelve-month period, without the prior permission of the Commissioner, to the greater of (i) 10% of the insurer's surplus as of the preceding December 31 or (ii) the insurer's net income for the twelve-month period ending the preceding December 31, in each case determined in accordance with statutory accounting practices. Our insurance company subsidiaries may not declare an extraordinary dividend (defined as any dividend or distribution that, together with other distributions made within the preceding twelve months, exceeds the limits established by Massachusetts statute) until thirty days after the Commissioner has received notice of the intended dividend and has not objected. As historically administered by the Commissioner, this provision requires the Commissioner's prior approval of an extraordinary dividend. Under Massachusetts law, an insurer may pay cash dividends only from its unassigned funds, also known as earned surplus, and the insurer's remaining surplus must be both reasonable in relation to its outstanding liabilities and adequate to its financial needs. At year-end 2009, the statutory surplus of Safety Insurance was \$556,575, and its net income for 2009 was \$46,956. As a result, a maximum of \$55,657 is available in 2010 for such dividends without prior approval of the Commissioner. During the nine months ended September 30, 2010, Safety Insurance paid dividends to Safety of \$22,660.

## Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

The maximum dividend permitted by law is not indicative of an insurer's actual ability to pay dividends, which may be constrained by business and regulatory considerations, such as the impact of dividends on surplus, which could affect an insurer's ratings or competitive position, the amount of premiums that can be written and the ability to pay future dividends.

On February 16, 2010, our Board approved and declared a quarterly cash dividend on our common stock of \$0.40 per share, or \$6,024 which was paid on March 15, 2010 to shareholders of record on March 1, 2010. On May 5, 2010, our Board approved and declared a quarterly cash dividend of \$0.40 per share or \$6,038 which was paid on June 15, 2010 to shareholders of record on June 1, 2010. On August 4, 2010, our Board approved and declared a quarterly cash dividend on our common stock of \$0.50 per share or \$7,510 which was paid on September 15, 2010 to shareholders of record on September 1, 2010. On November 2, 2010, our Board approved and declared a quarterly cash dividend on our common stock of \$0.50 per share which will be paid on December 15, 2010 to shareholders of record on December 1, 2010. We plan to continue to declare and pay quarterly cash dividends in 2010, depending on our financial position and the regularity of our cash flows.

On August 3, 2007, our Board approved a share repurchase program of up to \$30,000 of Safety's outstanding common shares. On March 19, 2009, our Board increased this existing share repurchase program by authorizing repurchase of up to

Table of Contents

\$60,000 of Safety's outstanding common shares. On August 4, 2010, our Board again increased the existing share repurchase program by authorizing repurchase of up to \$90,000 of Safety's outstanding common shares. Under the program, Safety may repurchase shares of its common stock for cash in public or private transactions, in the open market or otherwise, at management's discretion. The timing of such repurchases and actual number of shares repurchased will depend on a variety of factors including price, market conditions and applicable regulatory and corporate requirements. The program does not require Safety to repurchase any specific number of shares and may be modified, suspended or terminated at any time without prior notice. During the nine months ended September 30, 2010, we purchased 162,907 shares of our common shares on the open market under the program at a cost of \$5,814. During the nine months ended September 30, 2009, we purchased 1,332,535 of our common shares on the open market under the program at a cost of \$42,196. As of September 30, 2010 the Company had purchased 1,727,455 shares on the open market at a cost of \$55,526. As of December 31, 2009, we had purchased 1,564,548 of our common shares on the open market under the program at a cost of \$49,712.

Management believes that the current level of cash flow from operations provides us with sufficient liquidity to meet our operating needs over the next 12 months. We expect to be able to continue to meet our operating needs after the next 12 months from internally generated funds. Since our ability to meet our obligations in the long term (beyond such twelve-month period) is dependent upon such factors as market changes, insurance regulatory changes and economic conditions, no assurance can be given that the available net cash flow will be sufficient to meet our operating needs. We expect that we would need to borrow or issue capital stock if we needed additional funds, for example, to pay for an acquisition or a significant expansion of our operations. There can be no assurance that sufficient funds for any of the foregoing purposes would be available to us at such time.

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Reform Act) was signed into law. The Reform Act makes sweeping changes to the regulation of financial services entities, products and markets. Although the provisions of the bill do not appear to directly affect our business, as detailed regulations are developed to implement the provisions of the bill, there may be changes in the regulatory environment that affect the way we conduct our operations or the cost of compliance, or both.

*Off-Balance Sheet Arrangements*

We have no material obligations under a guarantee contract meeting the characteristics identified in ASC 460, *Guarantees*. We have no material retained or contingent interests in assets transferred to an unconsolidated entity. We have no material obligations, including contingent obligations, under contracts that would be accounted for as derivative instruments. We have no obligations, including contingent obligations, arising out of a variable interest in an unconsolidated entity held by, and material to, us, where such entity provides financing, liquidity, market risk or credit risk support to, or engages in leasing, hedging or research and development services with us. We have no direct investments in real estate and no holdings of mortgages secured by commercial real estate. Accordingly, we have no material off-balance sheet arrangements.

**Forward-Looking Statements**

Forward-looking statements might include one or more of the following, among others:

- Projections of revenues, income, earnings per share, capital expenditures, dividends, capital structure or other financial items;



## Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

- Descriptions of plans or objectives of management for future operations, products or services;
- Forecasts of future economic performance, liquidity, need for funding and income;
- Descriptions of assumptions underlying or relating to any of the foregoing; and
- Future performance of credit markets.

Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. They often include words such as believe, expect, anticipate, intend, plan, estimate, aim, projects, or words of similar meaning and expressions that indicate future conditions, events, results or trends, or future or conditional verbs such as will, would, should, could, or may. All statements that address expectations or projections about the future, including statements about the Company's strategy for growth, product development, market position, expenditures and financial results, are forward-looking statements.

Forward-looking statements are not guarantees of future performance. By their nature, forward-looking statements are subject to risks and uncertainties. There are a number of factors, many of which are beyond our control, that could cause actual future conditions, events, results or trends to differ significantly and/or materially from historical results or those projected in the forward-looking statements. These factors include but are not limited to the competitive nature of our industry and the possible

Table of Contents

adverse effects of such competition. Although a number of national insurers that are much larger than we are do not currently compete in a material way in the Massachusetts private passenger automobile market, if one or more of these companies decided to aggressively enter the market it could have a material adverse effect on us. Other significant factors include conditions for business operations and restrictive regulations in Massachusetts, the possibility of losses due to claims resulting from severe weather, the possibility that the Commissioner may approve future Rule changes that change the operation of the residual market, the possibility that the AG's proposed regulations will be enacted and existing insurance-related laws and regulations will become further restrictive in the future, our possible need for and availability of additional financing, and our dependence on strategic relationships, among others, and other risks and factors identified from time to time in our reports filed with the SEC. Refer to Part I, Item 1A Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2009.

Some other factors, such as market, operational, liquidity, interest rate, equity and other risks, are described elsewhere in this Quarterly Report on Form 10-Q. Factors relating to the regulation and supervision of our Company are also described or incorporated in this report. There are other factors besides those described or incorporated in this report that could cause actual conditions, events or results to differ from those in the forward-looking statements.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date on which they are made. We do not undertake any obligation to update publicly or revise any forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made.

**Item 3. Quantitative and Qualitative Information about Market Risk (Dollars in thousands)**

*Market Risk.* Market risk is the risk that we will incur losses due to adverse changes in market rates and prices. We have exposure to market risk through our investment activities and our financing activities. Our primary market risk exposure is to changes in interest rates. We use both fixed and variable rate debt as sources of financing. We have not entered, and do not plan to enter, into any derivative financial instruments for trading or speculative purposes.

*Interest Rate Risk.* Interest rate risk is the risk that we will incur economic losses due to adverse changes in interest rates. Our exposure to interest rate changes primarily results from our significant holdings of fixed rate investments and from our financing activities. Our fixed maturity investments include U.S. and foreign government bonds, securities issued by government agencies, obligations of state and local governments and governmental authorities, corporate bonds and asset-backed securities, most of which are exposed to changes in prevailing interest rates.

We manage our exposure to risks associated with interest rate fluctuations through active review of our investment portfolio by our management and Board and consultation with third-party financial advisors. As a general matter, we do not attempt to match the durations of our assets with the durations of our liabilities, and the majority of our liabilities are short tail. Our goal is to maximize the total after-tax return on all of our investments. An important strategy that we employ to achieve this goal is to try to hold enough in cash and short-term investments in order to avoid liquidating longer-term investments to pay claims.

Based upon the results of interest rate sensitivity analysis, the following table shows the interest rate risk of our investments in fixed maturities, measured in terms of fair value (which is equal to the carrying value for all our fixed maturity securities).

	-100 Basis Point Change	No Change	+100 Basis Point Change
<b>As of September 30, 2010</b>			
Estimated fair value	\$ 1,065,469	\$ 1,037,739	\$ 1,005,232
Estimated increase (decrease) in fair value	\$ 27,730	\$	\$ (32,507)

With respect to floating rate debt, we are exposed to the effects of changes in prevailing interest rates. At September 30, 2010, we had no debt outstanding under our credit facility. Assuming the full utilization of our current available credit facility, a 2.0% increase in the prevailing interest rate on our variable rate debt would result in interest expense increasing approximately \$600 for 2010, assuming that all of such debt is outstanding for the entire year.

In addition, in the current market environment, our investments can also contain liquidity risks.

*Equity Risk.* Equity risk is the risk that we will incur economic losses due to adverse changes in equity prices. Our exposure to changes in equity prices results from our holdings of common stock and mutual funds held to fund the executive deferred compensation plan. We continuously evaluate market conditions and we expect in the future to purchase additional equity securities. We principally manage equity price risk through industry and issuer diversification and asset allocation techniques.

Table of Contents

**Item 4. Controls and Procedures**

**Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures**

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures [as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act )] as of the end of the period covered by this report. Based on that evaluation, our CEO and CFO have concluded that our disclosure controls and procedures are adequate and effective and ensure that all information required to be disclosed is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and that information required to be disclosed in such reports is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures.

**Changes in Internal Control over Financial Reporting**

There have been no changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Part II. OTHER INFORMATION**

**Item 1. Legal Proceedings - Please see Item 1 Financial Statements - Note 7, Commitments and Contingencies.**

**Item 1A. Risk Factors**

There have been no subsequent material changes from the risk factors previously disclosed in the Company's 2009 Annual Report on Form 10-K.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

(c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers

## Edgar Filing: SAFETY INSURANCE GROUP INC - Form 10-Q

On August 3, 2007, the Board of Directors approved a share repurchase program of up to \$30 million of Safety's outstanding common shares. On March 19, 2009, the Board of Directors increased this existing share repurchase program by authorizing repurchase of up to \$60 million of Safety's outstanding common shares. On August 4, 2010, the Board of Directors again increased the existing share repurchase program by authorizing repurchase of up to \$90 million of Safety's outstanding common shares. There is no time limit on the authorization. Under the program, Safety may repurchase shares of its common stock for cash in public or private transactions, in the open market or otherwise, at management's discretion. The timing of such repurchases and actual number of shares repurchased will depend on a variety of factors including price, market conditions and applicable regulatory and corporate requirements. The program does not require Safety to repurchase any specific number of shares and may be modified, suspended or terminated at any time without prior notice. There was no activity under this repurchase program for the quarter ended September 30, 2010.

**Item 3. Defaults upon Senior Securities - None.**

**Item 4. Removed and Reserved**

**Item 5. Other Information - None.**

**Item 6. Exhibits - The exhibits are contained herein as listed in the Exhibit Index.**

Table of Contents

**SIGNATURE**

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.

**SAFETY INSURANCE GROUP, INC.** (Registrant)

Date: November 5, 2010

By: */s/ WILLIAM J. BEGLEY, JR.*  
*William J. Begley, Jr.*  
*Vice President, Chief Financial Officer and Secretary*

Table of Contents

**SAFETY INSURANCE GROUP, INC.**

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description</b>
11.0	Statement re: Computation of Per Share Earnings. (1)
31.1	CEO Certification Pursuant to Rule 13a-14(a)/15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes Oxley Act of 2002. (2)
31.2	CFO Certification Pursuant to Rule 13a-14(a)/15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes Oxley Act of 2002. (2)
32.1	CEO Certification Pursuant to U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes Oxley Act of 2002. (2)
32.2	CFO Certification Pursuant to U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes Oxley Act of 2002. (2)

---

(1) Not included herein as the information is included as part of this Form 10-Q, Item 1 - Financial Statements, Note 3, Earnings per Weighted Average Common Share.

(2) Included herein.