SELECTIVE INSURANCE GROUP INC
Form 10-Q
July 30, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended: June 30, 2009

or

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

For the transition period from __________ to __________.

Commission File Number: 001-33067

SELECTIVE INSURANCE GROUP, INC.

(Exact name of registrant as specified in its charter)

New Jersey	22-2168890
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
40 Wantage Avenue Branchville, New Jersey	07890
(Address of Principal Executive Offices)	(Zip Code)

(973) 948-3000
(Registrant s Telephone Number, Including Area Code)

(Former name, former address and former fiscal year, if changed since last report)

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

Yes þ No o

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

Yes o No o

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

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

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

Yes o No þ

As of June 30, 2009, there were 53,010,764 shares of common stock, par value $2.00 per share, outstanding.

SELECTIVE INSURANCE GROUP, INC.

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PART I. FINANCIAL INFORMATION

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

($ in thousands, except share amounts)	Unaudited June 30, 2009	December 31, 2008
ASSETS		
Investments:		
Fixed maturity securities, held-to-maturity at carry value (fair value of: $1,862,148 2009; $1,178 2008)	**$ 1,880,424**	1,163
Fixed maturity securities, available-for-sale at fair value (amortized cost of: $1,319,332 2009; $3,123,346 2008)	**1,316,116**	3,034,278
Equity securities, available-for-sale at fair value (cost of: $78,342 2009; $125,947 2008)	**81,687**	132,131
Short-term investments at cost which approximates fair value	**195,033**	198,111
Equity securities, trading at fair value		2,569
Other investments	**145,727**	172,057
Total investments	**3,618,987**	3,540,309
Cash and cash equivalents	**12,106**	18,643
Interest and dividends due or accrued	**35,113**	36,538
Premiums receivable, net of allowance for uncollectible accounts of: $5,899 2009; $4,237 2008	**498,591**	480,894
Other trade receivables, net of allowance for uncollectible accounts of: $227 2009; $299 2008	**20,957**	19,461
Reinsurance recoverable on paid losses and loss expenses	**5,125**	6,513
Reinsurance recoverable on unpaid losses and loss expenses	**241,276**	224,192
Prepaid reinsurance premiums	**101,398**	96,617
Current federal income tax	**10,688**	26,327
Deferred federal income tax	**129,123**	146,801
Property and equipment at cost, net of accumulated depreciation and amortization of: $138,443 2009; $132,609 2008	**48,053**	51,697
Deferred policy acquisition costs	**218,016**	212,319
Goodwill	**29,637**	29,637
Other assets	**61,805**	51,384
Total assets	**$ 5,030,875**	4,941,332
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Reserve for losses	**$ 2,282,893**	2,256,329
Reserve for loss expenses	**394,987**	384,644
Unearned premiums	**867,977**	844,334
Notes payable	**261,592**	273,878
Commissions payable	**40,438**	48,560

Accrued salaries and benefits	**126,264**	147,050
Other liabilities	**110,349**	96,044
Total liabilities	**4,084,500**	4,050,839
Stockholders Equity:		
Preferred stock of $0 par value per share:		
Authorized shares: 5,000,000; no shares issued or outstanding		
Common stock of $2 par value per share:		
Authorized shares: 360,000,000		
Issued: 95,568,225 2009; 95,263,508 2008	**191,136**	190,527
Additional paid-in capital	**225,393**	217,195
Retained earnings	**1,119,416**	1,128,149
Accumulated other comprehensive loss	**(42,187)**	(100,666)
Treasury stock at cost (shares: 42,557,461 2009; 42,386,921 2008)	**(547,383)**	(544,712)
Total stockholders equity	**946,375**	890,493
Commitments and contingencies		
Total liabilities and stockholders equity	**$ 5,030,875**	4,941,332

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

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SELECTIVE INSURANCE GROUP, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

	Quarter ended June 30,		Six Months ended June 30,	
(in thousands, except per share amounts)	**2009**	**2008**	**2009**	**2008**
Revenues:				
Net premiums written	$ **365,263**	389,394	**741,046**	781,348
Net increase in unearned premiums and prepaid reinsurance premiums	**(6,952)**	(12,140)	**(18,862)**	(20,707)
Net premiums earned	**358,311**	377,254	**722,184**	760,641
Net investment income earned	**26,368**	38,515	**42,085**	76,381
Net realized (losses) gains				
Other-than-temporary impairments	**(12,534)**	(9,784)	**(39,634)**	(9,784)
Other-than-temporary impairments on fixed maturity securities transferred to other comprehensive income	**59**		**59**	
Other net realized investment gains	**1,181**	11,707	**4,256**	13,222
Total net realized investment (losses) gains	**(11,294)**	1,923	**(35,319)**	3,438
Other income	**14,864**	15,661	**28,864**	31,940
Total revenues	**388,249**	433,353	**757,814**	872,400
Expenses:				
Losses incurred	**194,577**	209,915	**403,666**	420,045
Loss expenses incurred	**44,472**	42,889	**87,577**	85,835
Policy acquisition costs	**114,522**	122,966	**227,628**	250,643
Dividends to policyholders	**812**	1,579	**1,277**	2,114
Interest expense	**4,843**	5,127	**9,867**	10,436
Other expenses	**16,392**	14,792	**36,090**	40,640
Total expenses	**375,618**	397,268	**766,105**	809,713
Income (loss) before federal income tax	**12,631**	36,085	**(8,291)**	62,687
Federal income tax expense (benefit):				
Current	**(1,703)**	12,883	**3,991**	24,018
Deferred	**(1,354)**	(5,449)	**(15,093)**	(10,485)
Total federal income tax (benefit) expense	**(3,057)**	7,434	**(11,102)**	13,533
Net income	$ **15,688**	28,651	**2,811**	49,154

Earnings per share:					
Basic net income	**$**	**0.30**	0.55	**0.05**	0.94
Diluted net income	**$**	**0.29**	0.54	**0.05**	0.92
Dividends to stockholders	**$**	**0.13**	0.13	**0.26**	0.26

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

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SELECTIVE INSURANCE GROUP, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

	Six Months Ended June 30,			
($ in thousands, except per share amounts)	**2009**		**2008**	
Common stock:				
Beginning of year	**$ 190,527**		189,306	
Dividend reinvestment plan (shares: 70,839 2009; 40,645 2008)	**141**		81	
Convertible debentures (shares: 45,759 2008)			92	
Stock purchase and compensation plans (shares: 233,878 2009; 247,357 2008)	**468**		494	
End of period	**191,136**		189,973	
Additional paid-in capital:				
Beginning of year	**217,195**		192,627	
Dividend reinvestment plan	**751**		847	
Convertible debentures			645	
Stock purchase and compensation plans	**7,447**		13,948	
End of period	**225,393**		208,067	
Retained earnings:				
Beginning of year	**1,128,149**		1,105,946	
Cumulative-effect adjustment due to adoption of FAS 159, net of deferred income tax effect of $3,344			6,210	
Cumulative-effect adjustment due to adoption, on April 1, 2009, of FSP FAS 115-2 and FAS 124-2, net of deferred income tax effect of $1,282	**2,380**			
Net income	**2,811**	**2,811**	49,154	49,154
Cash dividends to stockholders ($0.26 per share 2009; $0.26 per share 2008)	**(13,924)**		(14,023)	
End of period	**1,119,416**		1,147,287	
Accumulated other comprehensive (loss) income:				
Beginning of year	**(100,666)**		86,043	
Cumulative-effect adjustment due to adoption of FAS 159, net of deferred income tax effect of $(3,344)			(6,210)	
Cumulative-effect adjustment due to adoption, on April 1, 2009, of FSP FAS 115-2 and FAS 124-2, net of deferred income tax effect of $(1,282)	**(2,380)**			
Other comprehensive income (loss), increase (decrease) in:				
Unrealized (losses) gains on investment securities:				

Non-credit portion of other-than-temporary impairment losses recognized in other comprehensive income, net of deferred income tax effect of $(9)	**(18)**			
Other net unrealized gains (losses) on investment securities, net of deferred income tax effect of: $32,472 2009; $(34,803) 2008	**60,306**		(64,633)	
Total unrealized gains (losses) on investment securities	**60,288**	**60,288**	(64,633)	(64,633)
Defined benefit pension plans, net of deferred income tax effect of: $308 2009; $38 2008	**571**	**571**	70	70
End of period	**(42,187)**		15,270	
Comprehensive income (loss)		**63,670**		(15,409)
Treasury stock:				
Beginning of year	**(544,712)**		(497,879)	
Acquisition of treasury stock (shares: 170,540 2009; 1,958,984 2008)	**(2,671)**		(45,006)	
End of period	**(547,383)**		(542,885)	
Total stockholders equity	**$ 946,375**		1,017,712	

Selective Insurance Group, Inc. also has authorized, but not issued, 5,000,000 shares of preferred stock, without par value, of which 300,000 shares have been designated Series A junior preferred stock, without par value.
The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

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SELECTIVE INSURANCE GROUP, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOW

(in thousands)	Six Months ended June 30, 2009	2008
Operating Activities		
Net income	$ **2,811**	49,154
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**13,910**	14,197
Stock-based compensation expense	**5,599**	9,137
Undistributed losses of equity method investments	**29,404**	1,047
Net realized (losses) gains	**35,319**	(3,438)
Postretirement life curtailment benefit	**(4,217)**	
Deferred tax	**(15,093)**	(10,485)
Unrealized loss on trading securities	**(262)**	1,631
Changes in assets and liabilities:		
Increase in reserves for losses and loss expenses, net of reinsurance recoverable on unpaid losses and loss expenses	**20,354**	75,033
Increase in unearned premiums, net of prepaid reinsurance and advance premiums	**18,894**	20,350
Decrease in net federal income tax recoverable	**15,639**	3,095
Increase in premiums receivable	**(17,697)**	(28,317)
Increase in other trade receivables	**(1,496)**	(1,727)
(Increase) decrease in deferred policy acquisition costs	**(5,697)**	789
Decrease in interest and dividends due or accrued	**1,086**	1,212
Decrease in reinsurance recoverable on paid losses and loss expenses	**1,388**	1,700
Decrease in accrued salaries and benefits	**(14,573)**	(4,301)
Decrease in accrued insurance expenses	**(7,703)**	(20,756)
Purchase of trading securities		(5,813)
Sale of trading securities	**2,831**	6,100
Other-net	**(6,506)**	7,479
Net adjustments	**71,180**	66,933
Net cash provided by operating activities	**73,991**	116,087
Investing Activities		
Purchase of fixed maturity securities, held-to-maturity	**(157,752)**	
Purchase of fixed maturity securities, available-for-sale	**(512,726)**	(239,887)
Purchase of equity securities, available-for-sale	**(75,609)**	(16,095)
Purchase of other investments	**(10,595)**	(25,976)
Purchase of short-term investments	**(1,160,667)**	(1,061,242)
Sale of fixed maturity securities, held-to-maturity	**5,622**	
Sale of fixed maturity securities, available-for-sale	**371,667**	80,056
Sale of short-term investments	**1,163,746**	1,033,334

Redemption and maturities of fixed maturity securities, held-to-maturity	**123,213**	1,818
Redemption and maturities of fixed maturity securities, available-for-sale	**63,897**	158,685
Sale of equity securities, available-for-sale	**123,269**	34,585
Proceeds from other investments	**15,498**	3,798
Purchase of property and equipment	**(2,986)**	(3,851)
Net cash used in investing activities	**(53,423)**	(34,775)
Financing Activities		
Dividends to stockholders	**(13,378)**	(13,009)
Acquisition of treasury stock	**(2,671)**	(45,006)
Principal payment of notes payable	**(12,300)**	(12,300)
Net proceeds from stock purchase and compensation plans	**2,402**	4,457
Excess tax benefits from share-based payment arrangements	**(1,158)**	1,319
Principal payments of convertible bonds		(8,754)
Net cash used in financing activities	**(27,105)**	(73,293)
Net (decrease) increase in cash and cash equivalents	**(6,537)**	8,019
Cash and cash equivalents, beginning of year	**18,643**	8,383
Cash and cash equivalents, end of period	**$ 12,106**	16,402

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

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NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. Organization

Selective Insurance Group, Inc., through its subsidiaries, (collectively referred to as we, us, or our) offers property and casualty insurance products and human resource administration outsourcing products and services. Selective Insurance Group, Inc. (referred to as the Parent) was incorporated in New Jersey in 1977 and its main offices are located in Branchville, New Jersey. The Parent s common stock is publicly traded on the NASDAQ Global Select Market under the symbol SIGI.

We classify our business into three operating segments:

- Insurance Operations, which sells property and casualty insurance products and services primarily in 22 states in the Eastern and Midwestern U.S.;
- Investments; and
- Human Resource Administration Outsourcing (HR Outsourcing).

These segments reflect a change from our historical segments of: Insurance Operations, Investments, and Diversified Insurance Services (which included federal flood insurance administrative services (Flood) and HR Outsourcing). In the process of periodically reviewing our operating segments, we have considered the provisions set forth in accordance with Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information* (FAS 131), and, in the first quarter of 2009, reclassified our Flood operations to be included within our Insurance Operations segment, which reflects the way we are now managing this business. We believe these reporting changes better enable investors to view us the way our management views our operations. Our revised segments are reflected throughout this report for all periods presented.

NOTE 2. Basis of Presentation

These interim unaudited consolidated financial statements (Financial Statements) include the accounts of the Parent and its subsidiaries, and have been prepared in conformity with: (i) U.S. generally accepted accounting principles (GAAP); and (ii) the rules and regulations of the U.S. Securities and Exchange Commission (SEC) regarding interim financial reporting. The preparation of Financial Statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported financial statement balances, as well as the disclosure of contingent assets and liabilities. Actual results could differ from those estimates. All significant intercompany accounts and transactions between the Parent and its subsidiaries are eliminated in consolidation.

These Financial Statements reflect all adjustments that, in our opinion, are normal, recurring, and necessary for a fair presentation of our results of operations and financial condition. The Financial Statements cover the second quarters ended June 30, 2009 (Second Quarter 2009) and June 30, 2008 (Second Quarter 2008) and the six-month periods ended June 30, 2009 (Six Months 2009) and June 30, 2008 (Six Months 2008). The Financial Statements do not include all of the information and disclosures required by GAAP and the SEC for audited financial statements. Results of operations for any interim period are not necessarily indicative of results for a full year. Consequently, the Financial Statements should be read in conjunction with the consolidated financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2008 (2008 Annual Report).

NOTE 3. Adoption of Accounting Pronouncements

In February 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) FAS 157-2, *Effective Date of FASB Statement No. 157* (FSP FAS 157-2). FSP FAS 157-2 delayed the application of FASB Statement No. 157 *Fair Value Measurement* (FAS 157) until January 1, 2009 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis. The adoption of FSP FAS 157-2 did not have an impact on our results of operations or financial condition.

In May 2008, the FASB issued Statement of Financial Accounting Standards No. 163, *Accounting for Financial Guarantee Insurance Contracts an interpretation of FASB Statement No. 60* (FAS 163). FAS 163 applies to financial guarantee insurance and reinsurance contracts that are: (i) issued by enterprises that are included within the scope of FASB Statement of Financial Accounting Standards No. 60, *Accounting and Reporting by Insurance Enterprises*; and (ii) not accounted for as derivative instruments. FAS 163 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The adoption of FAS 163 did not have an impact on our results of operations or financial condition.

In May 2008, the FASB issued FSP No. APB 14-1, *Accounting for Convertible Debt Instruments that may be Settled in Cash upon Conversion (Including Partial Cash Settlement)* (FSP 14-1). FSP 14-1 applies to convertible debt instruments that, by their stated terms, may be completely or partially settled in cash (or other assets) upon conversion, unless the embedded conversion option is required to be separately accounted for as a derivative under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. FSP 14-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The adoption of FSP 14-1 did not have a material impact on our financial condition or results of operations for any period presented.

In June 2008, the FASB issued FSP No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities* (FSP 03-6-1). FSP 03-6-1 addresses the treatment of unvested share-based payment awards containing nonforfeitable rights to dividends or dividend equivalents in the calculation of earnings per share and is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. The adoption of FSP 03-6-1 did not have a material impact on our calculation of earnings per share for any period presented.

In December 2008, the FASB issued FSP FAS 132(R)-1 (FSP FAS 132(R)-1) which amends FASB Statement No. 132 (revised 2003), *Employers Disclosures about Pensions and Other Post-retirement Benefits*, to provide guidance on an employer s disclosures about plan assets of a defined benefit pension or other postretirement plan. FSP FAS 132(R)-1 requires employers of public and nonpublic entities to disclose more information about the following:

- How investment allocation decisions are made (including investment policies and strategies, as well as the company s strategy for funding the benefit obligations);
- The major categories of plan assets, including cash and cash equivalents; equity securities (segregated by industry type, company size, or investment objective); debt securities (segregated by those issued by national, state, and local governments); corporate debt securities; asset-backed securities; structured debt; derivatives (segregated by the type of underlying risk in the contract); investment funds (segregated by type of fund); and real estate;
- Fair-value measurements, and the fair-value techniques and inputs used to measure plan assets similar to the requirements set forth under FAS 157 (i.e.: Level 1, 2 & 3); and
- Significant concentrations of risk within plan assets.

The disclosure requirements are effective for years ending after December 15, 2009.

In April 2009, the FASB issued FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP FAS 157-4). FSP FAS 157-4 addresses the factors that determine whether there has been a significant decrease in the volume and level of activity for an asset or liability when compared to the normal market activity. Under FSP FAS 157-4, if the reporting entity has determined that the volume and level of activity has significantly decreased and transactions are not orderly, further analysis is required and significant adjustments to the quoted prices or transactions may be needed. FSP FAS 157-4 is effective for interim and annual reporting periods ending after June 15, 2009. The adoption of FSP FAS 157-4 on April 1, 2009, did not have a material impact on our financial condition or results of operations. We have included the disclosures required by this FSP in the following notes to the consolidated financial statements where applicable.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP FAS 115-2 and FAS 124-2), which is effective for interim and annual periods ending after June 15, 2009. FSP FAS 115-2 and 124-2 introduces the concept of credit and non-credit other-than-temporary impairment (OTTI) charges on fixed maturity securities. Under this FSP, when an OTTI of a fixed maturity security has occurred, the amount of the OTTI charge recognized in earnings depends on whether a company: (i) intends to sell the security; or (ii) will more likely than not will be required to sell the security before recovery of its amortized cost basis. If the debt security meets either of these two criteria, the OTTI recognized in earnings is equal to the entire difference between the security s amortized cost basis and its fair value at the impairment measurement date. For impairments of fixed maturity securities that do not meet these two criteria, the net amount recognized in earnings is equal to the difference between the amortized cost of the debt security and its projected net present value of future cash flows (referred to as the credit impairment). Any difference between the fair value and the projected net present value of future cash flows at the impairment measurement date is recorded in other comprehensive income (OCI) (referred to as the non-credit impairment). Prior to our adoption of FSP FAS 115-2 and FAS 124-2 on April 1, 2009, an OTTI recognized in earnings for fixed maturity securities was equal to the total difference between its amortized cost and fair value at the time of impairment. Under FSP FAS 115-2 and FAS 124-2, we were also required to analyze securities held as of the adoption date which have had past OTTI charges in order to quantify a cumulative effect adjustment to the opening balance of retained earnings with a corresponding adjustment to accumulated OCI upon adoption. This cumulative effect adjustment amounted to $2.4 million, net of deferred tax, which decreased accumulated OCI and increased retained earnings. Also upon adoption of FSP FAS 115-2 and FAS 124-2, we increased the amortized cost of these securities by $3.7 million, representing non-credit related impairments recognized in earnings prior to the adoption of FSP FAS 115-2 and FAS 124-2. FSP FAS 115-2 and 124-2 is effective for interim and annual reporting periods ending after June 15, 2009. See Note 4. Investments below for information regarding our credit and non-credit OTTI charges. In addition, we have included the disclosures required by this FSP in the following notes to the consolidated financial statements where applicable.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (FSP FAS 107-1 and APB 28-1) to provide guidance on additional disclosures surrounding fair value of financial instruments required when a publicly traded company issues financial information for interim reporting periods. The disclosure requirements are effective for interim reporting periods ending after June 15, 2009. We have included the required disclosures of FSP FAS 107-1 and APB 28-1 in the following notes to the consolidated financial statements where applicable.

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 165, *Subsequent Events* (FAS 165). Requirements concerning the accounting and disclosure of subsequent events under FAS 165 are not significantly different from those contained in existing auditing standards and, as a result, our adoption of FAS 165 did not have a material impact on our financial condition or results of operations. Under FAS 165, we are required to disclose that we have analyzed subsequent events through July 30, 2009, the date on which these Financial Statements are issued.

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 166, *Accounting for Transfers of Financial Assets* (FAS 166). FAS 166 amends Statement of Financial Accounting Standards No. Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. FAS 166:
(i) eliminates the concept of a qualifying special-purpose entity (SPE); (ii) alters the requirements for transferring assets off of the reporting company s balance sheet; (iii) requires additional disclosure about a transferor s involvement in transferred assets; and (iv) eliminates special treatment of guaranteed mortgage securitizations. FAS 166 is effective for fiscal years beginning after November 15, 2009. We do not expect that the adoption of FAS 166 will have a material impact on our financial condition or results of operations.

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In June 2009, the FASB issued Statement of Financial Accounting Standards No. 167, *Amendments to FASB Interpretation No*. (46) (FAS 167). FAS 167 amends FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities* by requiring the reporting entity to perform a qualitative analysis that results in a variable interest entity (VIE) being consolidated if the reporting entity: (i) has the power to direct activities of the VIE that significantly impact the VIE s financial performance; and (ii) has an obligation to absorb losses or receive benefits that may be significant to the VIE. FAS 167 further requires enhanced disclosures, including disclosure of significant judgments and assumptions as to whether a VIE must be consolidated, and how involvement with a VIE affects the company s financial statements. FAS 167 is effective for fiscal years beginning after November 15, 2009. We do not expect that the adoption of FAS 167 will have a material impact on our financial condition or results of operations.

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 168*, FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles A Replacement of FASB Statement No. 162* (FAS 168). FAS 168 establishes the FASB Accounting Standards Codification (the Codification) as the source of authoritative GAAP for nongovernmental entities. When effective, the Codification will supersede all existing non-SEC accounting and reporting standards. Rules and interpretive releases of the SEC under authority of federal security laws will remain authoritative GAAP for SEC registrants. FAS 168 and the Codification are effective for financial statements issued for interim and annual periods ending after September 15, 2009. As the Codification will not change existing GAAP, the adoption of FAS 168 will not have an impact on our financial condition or results of operations.

NOTE 4. Statement of Cash Flows

Our cash paid during the year for interest and federal income taxes, as well as non-cash financing activities, was as follows for Six Months 2009 and Six Months 2008:

($ in thousands)	**Six Months 2009**	Six Months 2008
Cash paid (received) during the period for:		
Interest	**$ 10,004**	10,643
Federal income tax	**(10,500)**	19,600
Supplemental schedule of non-cash financing transactions:		
Conversion of convertible debentures		169

NOTE 5. Investments

(a) Net unrealized gains (losses) on investments included in other comprehensive income (loss) by asset class are as follows:

($ in thousands)	**June 30, 2009**	December 31, 2008
Available-for-sale (AFS) securities:		
Fixed maturity securities	**$ (3,216)**	(89,068)
Equity securities	**3,345**	(3,370)
Other investments		(1,478)
Total AFS securities	**129**	(93,916)
Held-to-maturity (HTM) securities:		
Fixed maturity securities	**4,599**	
Total HTM securities	**4,599**	
Total net unrealized gains (losses)	**4,728**	(93,916)

Deferred income tax (expense) benefit		**(1,655)**	32,871
Cumulative effect adjustment due to adoption of FSP FAS 115-2 and FAS 124-2, net of deferred income tax		**2,380**	
Cumulative effect adjustment due to adoption of FAS 159, net of tax			6,210
Net unrealized gains (losses), net of deferred income tax	**$**	**5,453**	(54,835)
Increase (decrease) in net unrealized gains, net of deferred income tax expense (benefit)	**$**	**60,288**	(148,895)

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(b) The carrying value, unrecognized holding gains and losses, and fair values of HTM fixed maturity securities were as follows:

June 30, 2009 ($ in thousands)	**Amortized Cost**	**Net Unrealized Gains (Losses)**	**Carrying Value**	**Unrecognized Holding Gains**	**Unrecognized Holding Losses**	**Fair Value**
U.S. government and government agencies[1]	$ 187,912	6,478	194,390	1,063	(1,961)	193,492
Obligations of states and political subdivisions	1,231,509	38,246	1,269,755	4,072	(19,388)	1,254,439
Corporate securities	112,965	(6,556)	106,409	3,908	(1,776)	108,541
Asset-backed securities (ABS)	40,101	(7,252)	32,849	1,643	(280)	34,212
Commercial mortgage-backed securities (CMBS)	133,006	(28,588)	104,418	3,459	(9,604)	98,273
Residential mortgage-backed securities (RMBS)	170,332	2,271	172,603	1,954	(1,366)	173,191
Total HTM fixed maturity securities	$ 1,875,825	4,599	1,880,424	16,099	(34,375)	1,862,148

1 U.S. government includes corporate securities fully guaranteed by the Federal Deposit Insurance Corporation (FDIC).

December 31, 2008 ($ in thousands)	**Carrying Value**	**Unrecognized Holding Gains**	**Unrecognized Holding Losses**	**Fair Value**
Obligations of states and political subdivisions	$ 1,146	71	(58)	1,159
Mortgage-backed securities (MBS)	17	2		19
Total HTM fixed maturity securities	$ 1,163	73	(58)	1,178

The increase in our HTM securities in 2009 is primarily attributable to a $1.9 billion transfer of previously-designated AFS securities to a HTM designation. In accordance with FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (FAS 115), we are required to reassess the classification designation of each security we hold at each balance sheet date. The reclassification of these securities is permitted because we have determined that we have the ability and the intent to hold these securities as an investment until maturity or call. We transferred these previously designated AFS securities to a HTM designation to preserve capital. When a security is transferred from AFS to HTM, the difference between its par value and fair value at the date of transfer is amortized as a yield adjustment in accordance with FASB Statement No. 91*, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*.

Unrecognized holding gains/losses of HTM securities are not reflected in the financial statements, as they represent market value fluctuations from the later of: (i) the date a security is designated as HTM; or (ii) the date that an OTTI charge is recognized on a HTM security, through the date of the balance sheet. However, the securities transferred have unrealized gains/losses that are reflected in accumulated OCI on the Consolidated Balance Sheet, net of subsequent amortization, which is being recognized over the life of the securities. Our HTM securities had an average duration of 3.6 years as of June 30, 2009.

(c) The cost/amortized cost, fair values, and unrealized gains (losses) of AFS securities were as follows:

June 30, 2009 ($ in thousands)	**Cost/ Amortized Cost**	**Unrealized Gains**	**Unrealized Losses**	**Fair Value**
U.S. government and government agencies[1]	$ 229,492	1,986	(42)	231,436
Obligations of states and political subdivisions	407,153	18,289	(527)	424,915
Corporate securities	296,584	8,364	(3,882)	301,066
ABS	24,283	187	(1,610)	22,860
CMBS	84,437	2,640	(722)	86,355
RMBS	277,383	2,375	(30,274)	249,484
AFS fixed maturity securities	1,319,332	33,841	(37,057)	1,316,116
AFS equity securities	78,342	7,200	(3,855)	81,687
Total AFS securities	$ 1,397,674	41,041	(40,912)	1,397,803

[1] U.S. government includes corporate securities fully guaranteed by the FDIC.

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December 31, 2008 ($ in thousands)	**Cost/ Amortized Cost**	**Unrealized Gains**	**Unrealized Losses**	**Fair Value**
U.S. government and government agencies[1]	$ 235,540	16,611		252,151
Obligations of states and political subdivisions	1,739,349	38,863	(20,247)	1,757,965
Corporate securities	389,386	7,277	(30,127)	366,536
ABS	76,758	6	(15,346)	61,418
MBS	682,313	8,332	(94,437)	596,208
AFS fixed maturity securities	3,123,346	71,089	(160,157)	3,034,278
AFS equity securities	125,947	24,845	(18,661)	132,131
Total AFS securities	$ 3,249,293	95,934	(178,818)	3,166,409

1 U.S. government includes corporate securities fully guaranteed by the FDIC.

Unrealized gains/losses represent market value fluctuations from the later of: (i) the date a security is designated as AFS; or (ii) the date that an OTTI charge is recognized on an AFS security, through the date of the balance sheet. These unrealized gains and losses are recorded in accumulated OCI on the Consolidated Balance Sheets.

(d) The following tables summarize, for all securities in an unrealized/unrecognized loss position at June 30, 2009 and December 31, 2008, the fair value and gross pre-tax net unrealized/unrecognized loss by asset class and by length of time those securities have been in a loss position:

	Less than 12 months[1]			**12 months or longer[1]**		
June 30, 2009 ($ in thousands)	**Fair Value**	**Unrealized (Losses)[2]**	**Unrecognized (Losses)[3]**	**Fair Value**	**Unrealized Losses[2]**	**Unrecognized Losses[3]**
AFS securities						
U.S. government and government agencies[4]	$ 30,036	(42)				
Obligations of states and political subdivisions	26,657	(357)		5,843	(170)	
Corporate securities	15,243	(238)		40,755	(3,645)	
ABS				17,235	(1,610)	
CMBS	32,289	(722)				
RMBS	54,215	(1,930)		53,275	(28,344)	
Total fixed maturity securities	158,440	(3,289)		117,108	(33,769)	
Equity securities	32,099	(3,855)				
Sub-total	$ 190,539	(7,144)		117,108	(33,769)	

HTM securities						
U.S. government and government agencies[4]	$ 50,406	145	(1,186)			
Obligations of states and political subdivisions	257,703	(5,361)	(2,868)	31,252	(421)	(409)
Corporate securities	52,785	(7,615)	1,551	6,312	(724)	38
ABS	16,222	(6,708)	795	2,669	(354)	(7)
CMBS	34,318	(13,668)	2,293	9,555	(15,138)	(9,254)
RMBS	29,299	(142)	(647)	5,331	(1,208)	(716)
Sub-total	440,733	(33,349)	(62)	55,119	(17,845)	(10,348)
Total	$ 631,272	(40,493)	(62)	172,227	(51,614)	(10,348)

1 The month count for aging of unrealized losses was reset back to historical unrealized loss month counts for securities impacted by the adoption of FSP FAS 115-2 and FAS 124-2 and for securities that were transferred from an AFS to an HTM category.

2 Gross unrealized gains/(losses) include non-OTTI unrealized amounts and OTTI losses recognized in accumulated OCI at June 30, 2009. In addition, this column includes remaining unrealized gain or loss amounts on securities that were transferred to a HTM designation in the first quarter of 2009 for those securities that are in a net unrealized/unrecognized loss position at June 30, 2009.

3

Unrecognized holding gains/(losses) represent market value fluctuations from the later of: (i) the date a security is designated as HTM; or (ii) the date that an OTTI charge is recognized on a HTM security.

[4] U.S. government includes corporate securities fully guaranteed by the FDIC.

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December 31, 2008[1] ($ in thousands)		**Less than 12 months** Fair Value	Unrealized Losses	**12 months or longer** Fair Value	Unrealized Losses
AFS securities					
U.S. government and government agencies[2]	$				
Obligations of states and political subdivisions		354,615	(11,565)	128,130	(8,682)
Corporate securities		162,339	(20,109)	30,087	(10,018)
ABS		42,142	(7,769)	15,336	(7,577)
Agency MBS		2,910	(8)	6,092	(1,241)
Non-agency MBS		178,235	(28,095)	90,937	(65,093)
Total fixed maturity securities		740,241	(67,546)	270,582	(92,611)
Equity securities		61,147	(18,661)		
Other investments		4,528	(1,478)		
Total securities in a temporary unrealized loss position	$	805,916	(87,685)	270,582	(92,611)

1 2008 HTM securities are not presented in this table, as their fair value was approximately $1.2 million and therefore not material.

2 U.S. government includes corporate securities fully guaranteed by the FDIC.

Unrealized losses decreased compared to December 31, 2008, primarily because of general improvement in the overall marketplace for our fixed maturity portfolio and the reduction in our equity portfolio as discussed below. As of June 30, 2009, 255 fixed maturity securities and 17 equity securities were in an unrealized loss position. At December 31, 2008, 355 fixed maturity securities, 45 equity securities, and one other investment security were in an unrealized loss position.

We have reviewed the securities in the tables above in accordance with our OTTI policy, which is discussed in the Critical Accounting Policies section of Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations below. The overall Standard and Poor s credit quality rating of our fixed maturity securities is AA+ and these securities are performing according to their contractual terms. The assessment of whether a decline in value is temporary includes our current judgment as to the financial position and future prospects of the entity that issued the investment security. Broad changes in the overall market or interest rate environment generally will not lead to a credit related write-down. If our judgment about an individual security changes in the future, we may ultimately record a credit loss after having originally concluded that one did not exist, which could have a material impact on our net income and financial position in future periods.

We perform impairment assessments for the structured securities in our fixed maturity portfolio (including, but not limited to, commercial mortgage-backed securities (CMBS), residential mortgage-backed securities (RMBS), asset-backed securities (ABS), and collateralized debt obligations (CDOs)), including an evaluation of the underlying collateral of these structured securities. This assessment takes into consideration the length of time the security has been in an unrealized loss position, but primarily focuses on the performance of the underlying collateral under various economic and default scenarios that may involve subjective judgments and estimates by management. Our OTTI modeling of structured securities involves various factors, such as projected default rates, the nature and realizable value of the collateral, the ability of the security to make scheduled payments, historical performance and other relevant economic and performance factors. If an OTTI determination is made, we perform a discounted cash flow analysis to ascertain the amount of the credit impairment.

In performing our OTTI analysis for corporate debt securities, we analyzed the general market condition of each issuer s industry, particularly the financial services sector, as well as the geographic area of the issuer given the current economic environment. In addition, we looked for evidence of significant deterioration in the issuer s credit worthiness. We have determined that the unrealized losses above related to corporate debt securities at June 30, 2009 are attributed to the current volatile market conditions and not to the creditworthiness of any individual issuer. We do not have the intent to sell these debt securities and do not believe we will be required to sell these securities before recovery and, as such, we do not consider the unrealized losses above to contain other-than-temporary credit impairments as of June 30, 2009.

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In performing our OTTI analysis for equity securities, we give consideration to, among many factors, the financial position and future prospects of the issuer, general market conditions, rating agency analyses, the length of time that the security has been in an unrealized loss position, and our intent to hold the security in the near term. We have determined that the fair value decline of $3.9 million of equity securities held in an unrealized loss position at June 30, 2009 is attributable to reduced asset values globally and not a reflection of the financial condition any issuer. We anticipate recovery of their value in the near term.

(e) Fixed-maturity securities at June 30, 2009, by contractual maturity are shown below. Mortgage-backed securities are included in the maturity tables using the estimated average life of each security. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

Listed below are HTM fixed maturity securities at June 30, 2009:

($ in thousands)	Carrying Value	Fair Value
Due in one year or less	$ 293,663	288,893
Due after one year through five years	836,668	840,890
Due after five years through ten years	709,581	692,362
Due after ten years through fifteen years	40,512	40,003
Total HTM fixed maturity securities	$ 1,880,424	1,862,148

Listed below are AFS fixed maturity securities at June 30, 2009:

($ in thousands)	Fair Value
Due in one year or less	$ 91,679
Due after one year through five years	662,030
Due after five years through ten years	531,248
Due after ten years through fifteen years	27,304
Due after fifteen years	3,855
Total AFS fixed maturity securities	$ 1,316,116

(f) Other investments include the following:

($ in thousands)	June 30, 2009	December 31, 2008
Alternative investments	$ **142,541**	165,017
Other securities	**3,186**	7,040
Total other investments	$ **145,727**	172,057

Our alternative investments primarily utilize the following strategies:

Alternative Investment Strategies	**Carrying Value**	
($ in thousands)	**June 30, 2009**	**December 31, 2008**
Energy / Power Generation	$ **31,669**	35,839
Distressed Debt	**28,066**	29,773
Secondary Market	**20,671**	24,077
Private Equity	**19,991**	22,846

Real Estate	**19,711**	23,446
Mezzanine Financing	**17,073**	23,166
Venture Capital	**5,360**	5,870
Total	**$ 142,541**	165,017

At June 30, 2009, we have contractual obligations that expire at various dates through 2023 that may require us to invest up to an additional $106.8 million in alternative investments. There is no certainty that any such additional investment will be required.

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(g) The components of net investment income earned were as follows:

	Quarter ended June 30,		Six Months ended June 30,	
($ in thousands)	**2009**	**2008**	**2009**	**2008**
Fixed maturity securities	$ **35,972**	36,424	**72,233**	72,830
Equity securities, dividend income	**496**	1,520	**1,011**	2,679
Trading securities, change in fair value		257	**262**	(1,631)
Short-term investments	**312**	1,290	**924**	2,727
Other investments	**(8,787)**	393	**(29,164)**	2,300
Investment expenses	**(1,625)**	(1,369)	**(3,181)**	(2,524)
Net investment income earned	$ **26,368**	38,515	**42,085**	76,381

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

Second Quarter 2009 ($ in thousands)	**Gross**	**Included in OCI**	**Recognized in earnings**
Fixed maturity securities			
Corporate securities	**$ 1,270**		**1,270**
ABS	**376**	**(826)**	**1,202**
CMBS	**1,417**	**706**	**711**
RMBS	**8,830**	**179**	**8,651**
Total fixed maturity securities	**11,893**	**59**	**11,834**
Equity securities	**641**		**641**
OTTI losses	**$ 12,534**	**59**	**12,475**

Second Quarter 2008 ($ in thousands)	**Gross**	**Included in OCI**	**Recognized in earnings**
Fixed maturity securities			
Corporate securities	$ 1,611		1,611
ABS	7,312		7,312
CMBS			
RMBS	861		861
Total fixed maturity securities	9,784		9,784
Equity securities			
OTTI losses	$ 9,784		9,784

Six Months 2009

($ in thousands)	Gross	Included in OCI	Recognized in earnings
Fixed maturity securities			
Corporate securities	$ 1,270		1,270
ABS	1,527	(826)	2,353
CMBS	1,417	706	711
RMBS	33,975	179	33,796
Total fixed maturity securities	38,189	59	38,130
Equity securities	1,445		1,445
OTTI losses	$ 39,634	59	39,575

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Six Months 2008 **($ in thousands)**	**Gross**	**Included in OCI**	**Recognized in earnings**
Fixed maturity securities			
Corporate securities	$ 1,611		1,611
ABS	7,312		7,312
CMBS			
RMBS	861		861
Total fixed maturity securities	9,784		9,784
Equity securities			
OTTI losses	$ 9,784		9,784

The following table sets forth, as of the dates indicated, credit loss impairments on fixed maturity securities for which a portion of the OTTI charge was recognized in OCI, and the corresponding changes in such amounts:

($ in thousands)	
Balance, March 31, 2009	$
Credit losses remaining in retained earnings after adoption of FSP FAS 115-2 and 124-2	9,395
Addition for the amount related to credit loss for which an OTTI was not previously recognized	
Reductions for securities sold during the period	
Reductions for securities for which the amount previously recognized in OCI was recognized in earnings because of intention or potential requirement to sell before recovery of amortized cost	
Additional increases to the amount related to credit loss for which an OTTI was previously recognized	1,996
Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected	
Balance, June 30, 2009	$ 11,391

A description of the methodology and significant inputs used to measure the amount of OTTI recognized in earnings in Second Quarter and Six Months 2009 is as follows:

For structured securities, we utilized underlying data for each security, including information from credit agencies to determine projected future cash flows. These projections included base case and stress testing scenarios that modify expected default rates, loss severities, and prepayment assumptions. The significant inputs in the models include, among other things, the expected default rates, delinquency rates, and foreclosure costs. Based on these projections, we determined expected recovery values for each security, incorporating both base case and stress testing case scenarios. The amortized cost basis of the securities were adjusted down, if required, to the projected discounted cash flow value calculated in the OTTI review process. These downward adjustments are considered credit impairments and are charged through earnings and included:

$8.7 million and $33.8 million of RMBS credit OTTI charges in Second Quarter and Six Months 2009, respectively. These charges related to declines in the related cash flows of the collateral. Based on our assumptions of the expected default rates and the value of the collateral, we do not believe it is probable that we will receive all contractual cash flows for these securities;

$0.7 million for both Second Quarter and Six Months 2009 of CMBS credit OTTI charges. These charges related to declines in the related cash flows of the collateral. Based on our assumptions of the expected default rates and the value of the collateral, we do not believe it is probable that we will receive all contractual cash flows for these securities; and

$1.2 million and $2.4 million of ABS credit OTTI charges in Second Quarter and Six Months 2009, respectively. These charges related primarily to two bonds from the same issuer that were previously written down, which experienced a technical default in the first quarter of 2009 by violating indenture covenants. There has been no payment default on these securities, but we believe a payment default is imminent and have recorded impairment charges for the securities. These charges also include additional credit impairment losses on another security that was previously written down in 2008.

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$1.3 million for Second Quarter 2009 of corporate debt credit OTTI charges. These charges are primarily related to a financial institution issuer that we believe to be on the verge of bankruptcy. This security was subsequently sold in the third quarter of 2009 at an additional loss of $1.1 million.

$0.6 million and $1.4 million of equity charges in Second Quarter and Six Months 2009, respectively, related to two banks, one energy company, and a membership warehouse chain of stores. We believe the share price weakness of these securities is more reflective of general overall financial market conditions, as we are not aware of any significant deterioration in the fundamentals of these four companies. However, the length of time these securities have been in an unrealized loss position, and the overall distressed trading levels of many coal stocks in the energy sector, banking stocks in the financial services sector, and retail/wholesale store stocks make a recovery to our cost basis unlikely in the near term.

(i) The components of net realized (losses) gains, excluding OTTI charges, were as follows:

	Quarter ended June 30,		Six Months ended June 30,	
($ in thousands)	**2009**	2008	**2009**	2008
HTM fixed maturity securities				
Gains	$ **112**		**138**	10
Losses	**(125)**		**(294)**	
AFS fixed maturity securities				
Gains	**9,090**	525	**13,598**	1,058
Losses	**(7,055)**	(3,360)	**(8,959)**	(4,514)
AFS equity securities				
Gains	**9,043**	15,100	**28,706**	17,697
Losses	**(8,695)**	(558)	**(27,744)**	(1,029)
Other investments				
Gains				
Losses	**(1,189)**		**(1,189)**	
Total other net realized investment gains (losses)	**1,181**	11,707	**4,256**	13,222
Total OTTI charges recognized in earnings	**(12,475)**	(9,784)	**(39,575)**	(9,784)
Total net realized (losses) gains	$ **(11,294)**	1,923	**(35,319)**	3,438

Realized gains and losses on the sale of investments are determined on the basis of the cost of the specific investments sold. In addition to calls and maturities on HTM securities, during Second Quarter 2009, we sold one HTM security with a carrying value of $6.0 million for a loss of $0.2 million. This security had experienced significant deterioration in the issuer s creditworthiness.

Proceeds from the sale of AFS securities were $240.6 million in Second Quarter 2009 and $494.9 million in Six Months 2009. Sales of AFS fixed maturity securities that resulted in realized losses during Second Quarter 2009 were driven by further declines in issuer creditworthiness and liquidity.

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We sold equity securities in both the first and second quarters of 2009. During Second Quarter 2009, A.M. Best changed our ratings outlook from Stable to Negative due, in part, to concerns over the risk in our investment portfolio. To reduce this risk, we sold $31.1 million of equity securities for a net loss of $0.6 million, which included gross gains of $7.7 million and gross losses of $8.3 million. In addition, certain equity securities were sold in the first quarter of 2009, resulting in a net realized loss of approximately $0.2 million, in an effort to reduce overall portfolio risk. The decision to sell these equity positions was in response to an overall year-to-date market decline of approximately 24% by the end of the first week of March. In addition, the Parent s market capitalization at that time had decreased more than 50% since the latter part of January, which we believe to be due partially to investment community views of our equity and equity-like investments. Our equity-like investments include alternative investments, many of which report results to us on a one quarter lag. Consequently, we believe the investment community may wait to evaluate our results based on the knowledge they have of last quarter s general market conditions. As a result, we determined it was prudent to mitigate a portion of our overall equity exposure. In determining which securities were to be sold, we contemplated, among other things, security-specific considerations with respect to downward earnings trends corroborated by recent analyst reports, primarily in the energy, commodity, and pharmaceutical sectors.

NOTE 6. Fair Value Measurements

The following tables provide quantitative disclosures regarding the fair value of our financial instruments:

	June 30, 2009		December 31, 2008	
($ in thousands)	**Carrying Amount**	**Fair Value**	Carrying Amount	Fair Value
Financial assets				
Fixed maturity securities:				
HTM	$ **1,880,424**	**1,862,148**	1,163	1,178
AFS	**1,316,116**	**1,316,116**	3,034,278	3,034,278
Equity securities:				
AFS	**81,687**	**81,687**	132,131	132,131
Trading			2,569	2,569
Short-term investments	**195,033**	**195,033**	198,111	198,111
Other securities	**3,186**	**3,186**	7,040	7,040
Financial liabilities				
Notes payable:[1]				
8.87% Senior Notes Series B	**12,300**	**12,810**	24,600	25,592
7.25% Senior Notes	**49,898**	**40,862**	49,895	42,221
6.70% Senior Notes	**99,394**	**71,400**	99,383	72,000
7.50% Junior Notes	**100,000**	**80,480**	100,000	59,680
Total notes payable	**261,592**	**205,552**	273,878	199,493

[1] Our notes payable are subject to certain debt covenants that were met in their entirety in 2008 and Six Months 2009. For further

discussion regarding the debt covenants, refer to Note 9, Indebtedness in the 2008 Annual Report.

Fair values of our financial assets were generated using various valuation techniques. For valuations of securities in our equity portfolio and U.S. Treasury notes held in our fixed maturity portfolio, we utilized a market approach, wherein we used quoted prices in an active market for identical assets (i.e., Level 1 prices). The source of our Level 1 prices for these securities was an external pricing service, which we validated against other external pricing sources. For the majority of our fixed maturity portfolio and several non-publicly traded equity securities, we also utilized a market approach, using primarily matrix pricing prepared by external pricing services. We validate these prices against other external pricing sources in order to determine the fair value of the positions, as well as to determine their placement within the fair value hierarchy (Level 1, Level 2, or Level 3) as defined in FAS 157.

Fair values of our financial liabilities were generated using various valuation techniques. The fair values of our 7.25% Senior Notes due November 15, 2034, 6.70% Senior Notes due November 1, 2035, and 7.5% Junior Subordinated Notes due September 27, 2066, are based on quoted market prices. The fair value of our 8.87% Senior Notes due May 4, 2010 is estimated using a cash flow analysis based on our current incremental borrowing rate for the remaining term of the loan.

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The following tables provide quantitative disclosures of our financial assets that are measured at fair value on a recurring basis:

June 30, 2009 ($ in thousands) Description	Assets Measured at Fair Value at 6/30/09	Fair Value Measurements at 6/30/09 Using Quoted Prices in Active Markets for Identical Assets/ Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. government and government agencies[1]	$ 231,436	10,498	220,938	
Obligations of states and political subdivisions	424,915		424,915	
Corporate securities	301,066		301,066	
ABS	22,860		22,860	
CMBS	86,355		86,355	
RMBS	249,484		249,484	
Total fixed maturity securities	1,316,116	10,498	1,305,618	
Equity securities	81,687	81,687		
Short-term investments	195,033	195,033		
Other investments	3,186		3,186	
Total assets	$ 1,596,022	287,218	1,308,804	

1 U.S. government includes corporate securities fully guaranteed by the FDIC.

December 31, 2008 ($ in thousands) Description	Assets Measured at Fair Value at 12/31/08	Fair Value Measurements at 12/31/08 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Trading securities:				
Equity securities	$ 2,569	2,569		
AFS securities:				
Fixed maturity securities	3,034,278	94,811	2,939,467	

Equity securities		132,131	132,131	
Short-term investments		198,111	198,111	
Other investments		7,040		7,040
Total assets	$	3,374,129	427,622	2,946,507

Certain assets are measured at fair value on a nonrecurring basis. As of June 30, 2009, as the result of our OTTI analysis, we fair valued approximately $3.5 million of HTM securities, which are typically not carried at fair value. These securities consisted of: (i) two ABS securities, fair valued at $3.0 million; and (ii) two CMBS securities, fair valued at $0.5 million. All of these fair values were determined using Level 2 pricing.

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NOTE 7. Reinsurance

The following table contains a listing of direct, assumed, and ceded reinsurance amounts by income statement caption. For more information concerning reinsurance, refer to Note 7, Reinsurance in Item 8. Financial Statements and Supplementary Data in our 2008 Annual Report.

	Unaudited, Quarter ended June 30,		Unaudited, Six Months ended June 30,	
($ in thousands)	**2009**	**2008**	**2009**	**2008**
Premiums written:				
Direct	$ **427,209**	445,007	**858,850**	884,120
Assumed	**2,560**	2,790	**7,361**	7,657
Ceded	**(64,506)**	(58,403)	**(125,165)**	(110,429)
Net	$ **365,263**	389,394	**741,046**	781,348
Premiums earned:				
Direct	$ **413,401**	421,807	**831,833**	848,719
Assumed	**5,213**	7,634	**10,733**	15,555
Ceded	**(60,303)**	(52,187)	**(120,382)**	(103,633)
Net	$ **358,311**	377,254	**722,184**	760,641
Losses and loss expenses incurred:				
Direct	$ **259,636**	301,911	**529,345**	561,044
Assumed	**3,348**	5,296	**7,073**	10,313
Ceded	**(23,935)**	(54,403)	**(45,175)**	(65,477)
Net	$ **239,049**	252,804	**491,243**	505,880

The ceded premiums and losses related to our Flood operations are as follows:

National Flood Insurance Program	Unaudited, Quarter ended June 30,		Unaudited, Six Months ended June 30,	
($ in thousands)	**2009**	**2008**	**2009**	**2008**
Ceded premiums written	$ **(46,413)**	(43,585)	$ **(88,830)**	(81,363)
Ceded premiums earned	**(42,708)**	(37,558)	**(84,426)**	(74,065)
Ceded losses and loss expenses incurred	**(9,222)**	(46,249)	**(11,100)**	(51,319)

NOTE 8. Segment Information

We have classified our operations into three segments, the disaggregated results of which are reported to and used by senior management to manage our operations:

Insurance Operations, which is evaluated based on statutory underwriting results (net premiums earned (NPE), incurred losses and loss expenses, policyholders dividends, policy acquisition costs, and other underwriting expenses), and statutory combined ratios;

Investments, which is evaluated based on net investment income and net realized gains and losses; and

HR Outsourcing, which is evaluated based on the results of operations in accordance with GAAP, with a focus on return on revenues (net income divided by revenues).

As discussed in Note 1, we revised our segments in the first quarter of 2009 to reflect how senior management evaluates our results. As part of this realignment, our Flood operations are now included in our Insurance Operations segment, leaving our HR Outsourcing operations as a separate segment. The results of our HR Outsourcing operations are included in Other income and Other expense in our Consolidated Statements of Income. We do not aggregate any of our operating segments. All historical data presented has been restated to reflect our current operating segments.

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Our subsidiaries provide services to each other in the normal course of business. These transactions totaled $2.3 million in Second Quarter 2009 and $4.5 million in Six Months 2009 compared to $3.5 million in Second Quarter 2008 and $6.9 million in Six Months 2008. These transactions were eliminated in all consolidated statements herein. In computing the results of each segment, we do not make adjustments for interest expense, net general corporate expenses, or federal income taxes. We do not maintain separate investment portfolios for the segments and, therefore, do not allocate assets to the segments.

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

Revenue by segment	**Unaudited, Quarter ended June 30,**		**Unaudited, Six Months ended June 30,**	
($ in thousands)	**2009**	**2008**	**2009**	**2008**
Insurance Operations:				
Net premiums earned:				
Commercial automobile	$ **75,339**	77,758	**151,185**	156,982
Workers compensation	**66,590**	77,502	**136,967**	155,968
General liability	**91,853**	99,932	**186,077**	203,201
Commercial property	**48,970**	48,575	**97,855**	98,511
Business owners policy	**15,551**	14,383	**30,761**	28,525
Bonds	**4,560**	4,718	**9,183**	9,493
Other	**2,382**	2,329	**4,762**	4,608
Total commercial lines	**305,245**	325,197	**616,790**	657,288
Personal automobile	**33,034**	32,942	**65,886**	65,547
Homeowners	**17,618**	16,975	**34,724**	33,546
Other	**2,414**	2,140	**4,784**	4,260
Total personal lines	**53,066**	52,057	**105,394**	103,353
Total net premiums earned	**358,311**	377,254	**722,184**	760,641
Miscellaneous income	**3,797**	1,775	**5,063**	2,466
Total Insurance Operations revenues	**362,108**	379,029	**727,247**	763,107
Investments:				
Net investment income	**26,368**	38,515	**42,085**	76,381
Net realized (loss) gain on investments	**(11,294)**	1,923	**(35,319)**	3,438
Total investment revenues	**15,074**	40,438	**6,766**	79,819
HR Outsourcing	**11,054**	13,498	**23,773**	28,616
Total all segments	**388,236**	432,965	**757,786**	871,542
Other income	**13**	388	**28**	858
Total revenues	$ **388,249**	433,353	**757,814**	872,400

Income before federal income tax	**Unaudited, Quarter ended June 30,**		**Unaudited, Six Months ended June 30,**	
($ in thousands)	**2009**	**2008**	**2009**	**2008**
Insurance Operations:				
Commercial lines underwriting	$ **8,186**	1,118	**8,014**	6,680
Personal lines underwriting	**(2,154)**	(184)	**(4,945)**	(3,947)
Underwriting income, before federal income tax	**6,032**	934	**3,069**	2,733
GAAP combined ratio	**98.3%**	99.8	**99.6%**	99.6
Statutory combined ratio	**98.8%**	98.7	**99.5%**	98.5
Investments:				
Net investment income	**26,368**	38,515	**42,085**	76,381
Net realized (loss) gain on investments	**(11,294)**	1,923	**(35,319)**	3,438
Total investment income, before federal income tax	**15,074**	40,438	**6,766**	79,819
HR Outsourcing:				
Income before federal income tax	**384**	840	**444**	1,577
Total all segments	**21,490**	42,212	**10,279**	84,129
Interest expense	**(4,843)**	(5,127)	**(9,867)**	(10,436)
General corporate and other expenses	**(4,016)**	(1,000)	**(8,703)**	(11,006)
Income (loss) before federal income tax	$ **12,631**	36,085	**(8,291)**	62,687

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NOTE 9. Federal Income Taxes

(a) A reconciliation of federal income tax on pre-tax earnings at the corporate rate to the effective tax rate is as follows:

($ in thousands)	Unaudited, Quarter ended June 30, 2009	2008	Unaudited, Six Months ended June 30, 2009	2008
Tax at statutory rate of 35%	$ **4,421**	12,630	**(2,902)**	21,940
Tax-advantaged interest	**(4,651)**	(4,810)	**(9,471)**	(9,286)
Dividends received deduction	**(79)**	(237)	**(184)**	(519)
Interim period tax rate adjustment	**(2,142)**	(36)	**1,563**	1,026
Other	**(606)**	(113)	**(108)**	372
Federal income tax (benefit) expense	$ **(3,057)**	7,434	**(11,102)**	13,533

NOTE 10. Retirement Plans

The following tables show the costs of the Retirement Income Plan for Selective Insurance Company of America (Retirement Income Plan) and the retirement life insurance component (Retirement Life Plan) of the Selective Insurance Company of America Welfare Benefits Plan. For more information concerning these plans, refer to Note 15, Retirement Plans in Item 8. Financial Statements and Supplementary Data in our 2008 Annual Report.

($ in thousands)	Retirement Income Plan Unaudited, Quarter ended June 30, 2009	2008	Retirement Life Plan Unaudited, Quarter ended June 30, 2009	2008
Components of Net Periodic Benefit Cost:				
Service cost	$ **2,003**	1,758		80
Interest cost	**2,771**	2,441	**74**	135
Expected return on plan assets	**(2,367)**	(2,960)		
Amortization of unrecognized prior service cost (credit)	**38**	38		(8)
Amortization of unrecognized net loss	**1,117**	24		
Net periodic cost	$ **3,562**	1,301	**74**	207

($ in thousands)	Retirement Income Plan Unaudited, Six Months ended June 30, 2009	2008	Retirement Life Plan Unaudited, Six Months ended June 30, 2009	2008
Components of Net Periodic Benefit Cost:				
Service cost	$ **4,007**	3,517	**32**	161
Interest cost	**5,542**	4,881	**191**	269
Expected return on plan assets	**(4,734)**	(5,921)		
Amortization of unrecognized prior service cost (credit)	**75**	75	**(44)**	(16)
Amortization of unrecognized net loss	**2,235**	49		
Curtailment benefit			**(4,217)**	

Net periodic cost (benefit)	$	**7,125**	2,601	**(4,038)**	414
Weighted-Average Expense Assumptions for the years ended December 31:					
Discount rate		**6.24%**	6.50	**6.24%**	6.50
Expected return on plan assets		**8.00%**	8.00	**%**	
Rate of compensation increase		**4.00%**	4.00	**4.00%**	4.00

In the first quarter of 2009, Selective Insurance Company of America eliminated the benefits under the Retirement Life Plan to active employees. This elimination resulted in a curtailment to the plan, the benefit of which was $4.2 million in Six Months 2009 and was comprised of: (i) a $2.8 million reversal of the Retirement Life Plan liability; and (ii) a $1.4 million reversal of prior service credits and net actuarial losses included in Accumulated Other Comprehensive Loss.

We presently anticipate contributing $8.0 million to the Retirement Income Plan in 2009, $4.4 million of which has been funded as of June 30, 2009.

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NOTE 11. Comprehensive Income (Loss)
The components of comprehensive income (loss), both gross and net of tax, for Second Quarter 2009 and Second Quarter 2008 are as follows:

Second Quarter 2009			
($ in thousands)	**Gross**	**Tax**	**Net**
Net income	**$ 12,631**	**(3,057)**	**15,688**
Components of other comprehensive income:			
Unrealized gains on securities:			
Unrealized holding gains during the period	**24,422**	**8,547**	**15,875**
Portion of OTTI recognized in OCI	**(27)**	**(9)**	**(18)**
Amortization of net unrealized gains on HTM securities	**1,411**	**494**	**917**
Reclassification adjustment for losses included in net income	**9,368**	**3,279**	**6,089**
Net unrealized gains	**35,174**	**12,311**	**22,863**
Defined benefit pension plans:			
Reversal of amortization items:			
Net actuarial loss	**1,117**	**391**	**726**
Prior service credit	**38**	**14**	**24**
Defined benefit pension plans	**1,155**	**405**	**750**
Comprehensive income	**$ 48,960**	**9,659**	**39,301**

Second Quarter 2008			
($ in thousands)	**Gross**	**Tax**	**Net**
Net income	$ 36,085	7,434	28,651
Components of other comprehensive loss:			
Unrealized losses on securities:			
Unrealized holding losses during the period	(56,493)	(19,773)	(36,720)
Reclassification adjustment for gains included in net income	(1,923)	(673)	(1,250)
Net unrealized losses	(58,416)	(20,446)	(37,970)
Defined benefit pension plans:			
Reversal of amortization items:			
Net actuarial loss	24	8	16
Prior service cost	30	11	19
Defined benefit pension plans	54	19	35
Comprehensive loss	$ (22,277)	(12,993)	(9,284)

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The components of comprehensive income (loss), both gross and net of tax, for Six Months 2009 and Six Months 2008 are as follows:

Six Months 2009

($ in thousands)	Gross	Tax	Net
Net income	**$ (8,291)**	**(11,102)**	**2,811**
Components of other comprehensive income:			
Unrealized gains on securities:			
Unrealized holding gains during the period	**56,275**	**19,696**	**36,579**
Portion of OTTI recognized in OCI	**(27)**	**(9)**	**(18)**
Amortization of net unrealized gains on HTM securities	**4,403**	**1,541**	**2,862**
Reclassification adjustment for losses included in net income	**32,100**	**11,235**	**20,865**
Net unrealized gains	**92,751**	**32,463**	**60,288**
Defined benefit pension plans:			
Reversal of amortization items:			
Net actuarial loss	**2,235**	**782**	**1,453**
Curtailment benefit	**(1,387)**	**(485)**	**(902)**
Prior service credit	**31**	**11**	**20**
Defined benefit pension plans	**879**	**308**	**571**
Comprehensive income	**$ 85,339**	**21,669**	**63,670**

Six Months 2008

($ in thousands)	Gross	Tax	Net
Net income	$ 62,687	13,533	49,154
Components of other comprehensive loss:			
Unrealized losses on securities:			
Unrealized holding losses during the period	(96,008)	(33,603)	(62,405)
Reclassification adjustment for gains included in net income	(3,428)	(1,200)	(2,228)
Net unrealized losses	(99,436)	(34,803)	(64,633)
Defined benefit pension plans:			
Reversal of amortization items:			
Net actuarial loss	49	17	32
Prior service cost	59	21	38
Defined benefit pension plans	108	38	70
Comprehensive loss	$ (36,641)	(21,232)	(15,409)

The balances of, and changes in, each component of accumulated OCI (net of taxes) as of June 30, 2009 are as follows:

Defined

June 30, 2009 ($ in thousands)		**Net Unrealized Gain (Loss)** **OTTI Related**	**HTM Related**	**All Other**	**Benefit Pension Plans**	**Total Accumulated OCI**
Balance, December 31, 2008	$			(54,836)	(45,830)	(100,666)
Reclassification of HTM securities			1,870			1,870
Adoption of FSP FAS 115-2 and FAS 124-2		(2,380)				(2,380)
Changes in component during period		(18)	2,862	55,574	571	58,989
Balance, June 30, 2009	$	(2,398)	4,732	738	(45,259)	(42,187)

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NOTE 12. Commitments and Contingencies

At June 30, 2009, we had contractual obligations to invest up to an additional $106.8 million in other investments that expire at various dates through 2023. There is no certainty that any such additional investment will be required.

NOTE 13. Litigation

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

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

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

Forward-Looking Statements

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

Introduction

We offer property and casualty insurance products and human resource administration outsourcing services through our various subsidiaries. We classify our businesses into three operating segments: (i) Insurance Operations, which consists of commercial lines (Commercial Lines) and personal lines, including our flood line of business (Personal Lines); (ii) Investments; and (iii) Human Resource Administration Outsourcing (HR Outsourcing). These segments reflect a change from our historical segments of: Insurance Operations, Investments, and Diversified Insurance Services (which included federal flood insurance administrative services (Flood) and HR Outsourcing). In the process of periodically reviewing our operating segments, we have considered the provisions set forth in accordance with Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information* (FAS 131), and have reclassified our Flood operations to be included within our Insurance Operations segment, which reflects the way we are now managing this business. We believe these reporting changes will better enable investors to view us the way our management views our operations and provide more consistency with how our peers report their business. Our revised segments are reflected throughout this report for all periods presented.

The purpose of the Management s Discussion and Analysis (MD&A) is to provide an understanding of the consolidated results of operations and financial condition and known trends and uncertainties that may have a material impact in future periods. Consequently, investors should read the MD&A in conjunction with the consolidated financial statements in our Annual report on Form 10-K for the year ended December 31, 2008 (2008 Annual Report).

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

- Critical Accounting Policies and Estimates;
- Financial Highlights of Results for Second Quarter 2009 and Six Months 2009;
- Results of Operations and Related Information by Segment;
- Federal Income Taxes;
- Financial Condition, Liquidity, and Capital Resources;
- Off-Balance Sheet Arrangements; and
- Contractual Obligations and Contingent Liabilities and Commitments.

Critical Accounting Policies and Estimates

These unaudited interim consolidated financial statements include amounts based on our informed estimates and judgments for those transactions that are not yet complete. Such estimates and judgments affect the reported amounts in the consolidated financial statements. Those estimates and judgments most critical to the preparation of the financial statements involved the following: (i) reserves for losses and loss expenses; (ii) deferred policy acquisition costs; (iii) pension and postretirement benefit plan actuarial assumptions; (iv) other-than-temporary investment impairments; (v) goodwill; and (vi) reinsurance. These estimates and judgments require the use of assumptions about matters that are highly uncertain and, therefore, are subject to change as facts and circumstances develop. If different estimates and judgments had been applied, materially different amounts might have been reported in the financial statements. For additional information regarding our critical accounting policies, refer to our 2008 Annual Report, pages 43 through 51, except for the other-than-temporary-impairment (OTTI) discussion, which is updated below.

Other-Than-Temporary Investment Impairments

An investment in a fixed maturity, equity security or an other investment (i.e., an alternative investment), is impaired if its fair value falls below its book value and the decline is considered to be other than temporary. We regularly review our entire investment portfolio for declines in fair value. If we believe that a decline in the value of an available-for-sale (AFS) security is temporary, we record the decline as an unrealized loss in accumulated other comprehensive income (OCI). Temporary declines in the value of a held-to-maturity (HTM) security are not recognized in the financial statements. Our assessment of a decline in fair value includes judgment as to the financial position and future prospects of the entity that issued the investment security, as well as a review of the security s underlying collateral. Broad changes in the overall market or interest rate environment generally will not lead to a write-down.

Our evaluation for OTTI of a fixed maturity security or a short-term investment includes, but is not limited to, the evaluation of the following factors:

- Whether the decline appears to be issuer or industry specific;
- The degree to which the issuer is current or in arrears in making principal and interest payments on the fixed maturity security;
- The issuer s current financial condition and ability to make future scheduled principal and interest payments on a timely basis;
- Stress testing of projected cash flows under various economic and default scenarios;
- Buy/hold/sell recommendations published by outside investment advisors and analysts; and
- Relevant rating history, analysis and guidance provided by rating agencies and analysts.

If there is a decline in fair value on a fixed maturity security that we intend to sell or, more-likely-than-not, may be required to sell, the impairment is considered other-than-temporary and is charged to earnings as a component of realized losses. However, if we do not intend to sell the security and if we do not believe we will be required to sell the security, we then determine whether the amortized cost basis of the security is expected to be recovered. If we do not expect recovery to occur, the impairment is considered other than temporary and is charged to earnings as a component of realized losses. When assessing the recoverability of the amortized cost basis, we compare the present value of the cash flows that we expect to be collected from the security to the amortized cost basis of the security. Any shortfall in the present value of the cash flows expected to be collected in relation to the amortized cost basis is referred to as a credit impairment. Any shortfall between the present value of expected cash flows to be collected in relation to the fair value of the security is referred to as a non-credit impairment. Credit impairments are charged to earnings as a component of realized losses while non-credit impairments are recorded to OCI as a component of unrealized losses.

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We perform impairment assessments for the structured securities in our fixed maturity portfolio (including, but not limited to, commercial mortgage-backed securities (CMBS), residential mortgage-backed securities (RMBS), asset-backed securities (ABS), and collateralized debt obligations (CDOs)), and corporate debt, including an evaluation of the underlying collateral of these structured securities. This assessment takes into consideration the length of time for which the security has been in an unrealized loss position, but primarily focuses on the performance of the underlying collateral under various economic and default scenarios that may involve subjective judgments and estimates by management. Our modeling of these securities involves various factors, such as projected default rates, the nature and realizable value of the collateral, the ability of the security to make scheduled payments, historical performance and other relevant economic and performance factors. If an OTTI determination is made, we perform a discounted cash flow analysis to ascertain the amount of the credit impairment.

Our evaluation for OTTI of an equity security, includes, but is not limited to, the evaluation of the following factors:

- Whether the decline appears to be issuer or industry specific;
- The relationship of market prices per share to book value per share at the date of acquisition and date of evaluation;
- The price-earnings ratio at the time of acquisition and date of evaluation;
- The financial condition and near-term prospects of the issuer, including any specific events that may influence the issuer s operations, coupled with our intention to hold the securities in the near term;
- The recent income or loss of the issuer;
- The independent auditors report on the issuer s recent financial statements;
- The dividend policy of the issuer at the date of acquisition and the date of evaluation;
- Any buy/hold/sell recommendations or price projections published by outside investment advisors;
- Any rating agency announcements; and
- The length of time and the extent to which the fair value has been less than the carrying value.

If there is a decline in fair value on an equity security that we do not intend to hold, or if we determine the decline is other than temporary, we write down the carrying value of the investment and record the charge through earnings as a component of realized losses.

Our evaluation for OTTI of an other investment (i.e., an alternative investment) includes, but is not limited to, conversations with the management of the alternative investment concerning the following:

- The current investment strategy;
- Changes made or future changes to be made to the investment strategy;
- Emerging issues that may affect the success of the strategy; and
- The appropriateness of the valuation methodology used regarding the underlying investments.

If there is a decline in fair value on an other investment that we do not intend to hold, or if we determine the decline is other than temporary, we write down the carrying value of the investment and record the charge through earnings as a component of realized losses.

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Financial Highlights of Results for Second Quarter 2009 and Six Months 2009

Financial Highlights	**Unaudited Quarter ended June 30,**		**Change % or Points**	**Unaudited Six Months ended June 30,**		**Change % or Points**
($ in thousands, except per share amounts)	**2009**	**2008**		**2009**	**2008**	
Revenues	**$ 388,249**	433,353	(10)%	**$ 757,814**	872,400	(13)%
Net income	**15,688**	28,651	(45)	**2,811**	49,154	(94)
Diluted net income per share	**0.29**	0.54	(46)	**0.05**	0.92	(95)
Diluted weighted-average outstanding shares	**53,234**	53,064		**53,181**	53,461	(1)
GAAP combined ratio	**98.3%**	99.8	(1.5)pts	**99.6%**	99.6	pts
Statutory combined ratio	**98.8%**	98.7	0.1	**99.5%**	98.5	1.0
Annualized return on average equity	**6.8%**	11.1	(4.3)pts	**0.6%**	9.4	(8.8)pts

Net income decreased in Second Quarter and Six Months 2009 compared to the same periods last year due to:

Pre-tax net investment income that decreased $12.1 million, to $26.4 million, in Second Quarter 2009 and by $34.3 million, to $42.1 million, in Six Months 2009. These decreases were primarily driven by losses on our other investments portfolio, which includes alternative investments. Alternative investment pre-tax losses of $8.9 million in Second Quarter 2009 compared to modest gains in Second Quarter 2008, and pre-tax losses of $29.4 million for Six Months 2009 compared to pre-tax gains of $2.2 million for Six Months 2008. These losses were a result of the continued volatility in the capital markets, dislocation of the credit markets, and reduced values of financial assets globally that has been ongoing since the third quarter of 2008. Our alternative investments, which are accounted for under the equity method, primarily consist of investments in limited partnerships that for the most part, report results to us, on a one quarter lag. As a result, the above mentioned pre-tax losses reflect the performance for the majority of these investments through March 31, 2009.

Pre-tax realized losses on investment securities that increased $13.2 million, to $11.3 million, in Second Quarter 2009 and $38.8 million, to $35.3 million, in Six Months 2009 compared to gains in both periods last year. Current year losses are driven by non-cash OTTI charges of $12.5 million in Second Quarter 2009 and $39.6 million in Six Months 2009 due to continuing market volatility and credit deterioration. OTTI charges were $9.8 million in Second Quarter and Six Months 2008. For additional information regarding our realized gains and losses, including the OTTI charges, refer to the section below entitled Investments.

Partially offsetting the items above were:

A $5.1 million increase in pre-tax underwriting gains in our Insurance Operations segment, to $6.0 million, in Second Quarter 2009, reflecting improved property losses and favorable prior year reserve development, primarily in our workers compensation line of business, partially offset by higher loss costs in the current accident year on our casualty lines. This quarter, for the first time in nearly four years, we experienced increased Commercial Lines renewal pure price. Each month of the quarter contributed to this increase with April, May, and June coming in at 0.4%, 0.4%, and 1.1%, respectively.

The aforementioned pre-tax items, as well as a lower expected tax rate in 2009, resulted in a reduction in federal tax expense of $10.5 million, to a federal tax benefit of $3.1 million, in Second Quarter 2009 and a reduction of $24.6 million, to a federal tax benefit of $11.1 million, for Six Months 2009. For additional information, see Note 9. Federal Income Taxes in Item 1. Financial Statements of this Form 10-Q.

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Results of Operations and Related Information by Segment

Insurance Operations

Our Insurance Operations segment writes property and casualty insurance business through seven insurance subsidiaries (the Insurance Subsidiaries). Our Insurance Operations segment sells property and casualty insurance products and services primarily in 22 states in the Eastern and Midwestern U.S. through approximately 960 independent insurance agencies. Our Insurance Operations segment consists of two components: (i) Commercial Lines, which markets primarily to businesses and represents approximately 85% of net premium written (NPW), and (ii) Personal Lines, which markets primarily to individuals and represents approximately 15% of NPW. The underwriting performance of these lines is generally measured by four different statutory ratios: (i) loss and loss expense ratio; (ii) underwriting expense ratio; (iii) dividend ratio; and (iv) combined ratio. For further details regarding these ratios, see the discussion in the Insurance Operations Results section of Item 1. Business. of our 2008 Annual Report. As mentioned above in the section entitled, Introduction, effective as of the first quarter of 2009, the results of our Flood operations are now included within our Insurance Operations segment, consistent with our management of these operations. This change to our segment reporting is reflected throughout this report for all periods presented.

Summary of Insurance Operations

All Lines ($ in thousands)	**Unaudited Quarter ended June 30, 2009**	**2008**	**Change % or Points**	**Unaudited Six Months ended June 30, 2009**	**2008**	**Change % or Points**
GAAP Insurance Operations Results:						
NPW	**$ 365,263**	389,394	(6)%	**741,046**	781,348	(5)%
Net premium earned (NPE)	**358,311**	377,254	(5)	**722,184**	760,641	(5)
Less:						
Losses and loss expenses incurred	**239,049**	252,804	(5)	**491,243**	505,880	(3)
Net underwriting expenses incurred	**112,418**	121,937	(8)	**226,595**	249,914	(9)
Dividends to policyholders	**812**	1,579	(49)	**1,277**	2,114	(40)
Underwriting income	**$ 6,032**	934	546%	**3,069**	2,733	12%
GAAP Ratios:						
Loss and loss expense ratio	**66.7%**	67.0	(0.3)pts	**68.0%**	66.5	1.5pts
Underwriting expense ratio	**31.4%**	32.4	(1.0)	**31.4%**	32.8	(1.4)
Dividends to policyholders ratio	**0.2%**	0.4	(0.2)	**0.2%**	0.3	(0.1)
Combined ratio	**98.3%**	99.8	(1.5)	**99.6%**	99.6	
Statutory Ratios:						
Loss and loss expense ratio	**66.7%**	66.9	(0.2)	**68.0%**	66.4	1.6
Underwriting expense ratio	**31.9%**	31.4	0.5	**31.3%**	31.8	(0.5)
Dividends to policyholders ratio	**0.2%**	0.4	(0.2)	**0.2%**	0.3	(0.1)
Combined ratio	**98.8%**	98.7	0.1pts	**99.5%**	98.5	1.0pts

NPW decreased in both Second Quarter and Six Months 2009 compared to Second Quarter and Six Months 2008 due to the continued competitive insurance marketplace and the economic recession, which has led to reduced levels of exposure given the reduction in payroll consistent with the current unemployment level.

These factors are evidenced by the following:

- Reductions in endorsement and audit activity of $14.7 million, to a net return premium of $19.7 million, in Second Quarter 2009 and $29.1 million, to a net return premium of $37.2 million, in Six Months 2009; and
- Reductions in net renewals of $14.1 million, to $317.0 million, in Second Quarter 2009 and $18.7 million, to $642.1 million, in Six Months 2009 driven by the impact of unemployment on our workers compensation and general liability lines of business, the trend of which we expect to continue until the unemployment rate stabilizes. Commercial Lines retention decreased two points in Second Quarter 2009, to 76%, and one point, to 77%, in Six Months 2009.

Partially offsetting these items was an improvement in new business premium, which increased by $9.0 million, to $83.3 million, in Second Quarter 2009, and $16.2 million, to $165.2 million, for Six Months 2009, compared to the same periods last year.

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Although renewal premiums are down, renewal pure price increased by 0.6% for Second Quarter 2009, resulting in our first quarter of Commercial Lines pure price increases since the first quarter of 2005. Each month of the quarter contributed to this increase with April, May, and June coming in at 0.4%, 0.4%, and 1.1%, respectively. This increase is compared to a decrease in renewal pure price of 3.1% for Second Quarter 2008. For Six Months 2009, renewal pure price was down only 0.1% compared to 3.1% for Six Months 2008.

NPE decreases in Second Quarter 2009 and Six Month 2009 compared to the same periods last year, are consistent with the fluctuation in NPW for the twelve-month period ended June 30, 2009 as compared to the 12-month period ended June 30, 2008. This decrease was primarily driven by a decrease in exposure coupled with premiums written in 2008, which experienced a decrease in pure price of 3.1% in 2008, earning in over the course of 2009.

For Second Quarter 2009 compared to Second Quarter 2008, the GAAP loss and loss expense ratio decreased 0.3 points, reflecting: (i) property losses that were $5.3 million, or 0.7 points lower in Second Quarter 2009 at $46.9 million; and (ii) approximately $5 million, or 1.4 points in favorable casualty prior year development, primarily in our workers compensation line of business, compared to immaterial prior year development in Second Quarter 2008. This improvement was partially offset by casualty loss costs that have outpaced premiums in the current accident year.

The 1.5-point increase in the GAAP loss and loss expense ratio for Six Months 2009 compared to Six Months 2008 was primarily attributable to: (i) property losses that were $2.8 million, or 1.2 points higher in Six Months 2009 at $113.3 million; and (ii) casualty loss costs that have outpaced premiums in the current accident year. Partially offsetting this increase for Six Months 2009 was favorable casualty prior year development of approximately $15 million, or 2.1 points, in Six Months 2009 compared to approximately $3 million, or 0.4 points, in Six Months 2008 due to favorable results in our 2007 and prior accident years for our workers compensation line, partially offset by unfavorable prior year development in our 2008 accident year on this line.

Decreases in the GAAP underwriting expense ratio in Second Quarter and Six Months 2009, were primarily attributable to several expense initiatives implemented in 2008 and during the first quarter of 2009. These initiatives included, but were not limited to: (i) workforce reductions in 2008 that resulted in a $3.4 million charge in the first quarter of 2008; (ii) the re-domestication of two of the Insurance Subsidiaries to Indiana in June 2008; (iii) targeted changes to agency commissions that were implemented in most states in July 2008; (iv) the consolidation of our purchasing power with fewer vendors and their desire to lock up longer-term contracts; and (v) the elimination of retiree life insurance benefits for current employees amounting to a benefit of $4.2 million, pre-tax, in the first quarter of 2009.

Insurance Operations Outlook

In 2009, we continue to see a trend toward higher Commercial Lines pricing and fairly aggressive Personal Lines pricing in our Insurance Operations segment. As previously discussed, our Commercial Lines renewal pure pricing increased 0.6% for Second Quarter 2009, the first time in nearly four years during which our renewal pure pricing improved. Each month contributed to the positive quarter with renewal pure price increases of 0.4% in April, 0.4% in May and 1.1% in June. We believe these price increases, which were achieved while maintaining a delicate balance with retention, demonstrate the overall strength of the relationships that we have with our independent agents, even in difficult economic times. In the first quarter of 2009, our pure price decrease of 0.8% was relatively consistent with the 0.6% decrease indicated in the Commercial Lines Insurance Pricing Survey (CLIPS) first quarter report. As for our Personal Lines operations, we plan on implementing rate increases that are expected to generate approximately $9 million in additional premium in 2009, a portion of which have already been implemented.

Regardless of the encouraging trend in pricing, premium growth continues to be a challenge due to the current difficulties brought on by the current recession and its impact on payrolls, gross receipts, and property values. We continue to believe that the cycle management tools we have in place are performing as we intended in these market conditions. These tools protect us from writing business that we believe will ultimately be unprofitable and, over the long run as pricing and exposures improve, will better position us to return to targeted return on equity levels.

The overall outlook on the industry for 2009 from key rating agencies is as follows:

- *A.M. Best* A.M. Best is forecasting that the 2009 commercial lines industry combined ratio will be 105.1% and an overall industry combined ratio of 101.1%. In addition, in their report entitled 3-Month Financial Review, A.M. Best stated that they believe that pricing will begin to firm sometime in the later part of 2009.
- *Fitch Ratings (Fitch)* Fitch is projecting an industry-wide statutory combined ratio of 104.0% for 2009, reflecting their belief that underwriting results will not improve significantly as premiums are projected to grow by less than 1%. In addition, Fitch anticipates that underwriting results will be adversely impacted by higher expense ratios and less favorable reserve development, partially offset by a return to historical average catastrophe loss experience.
- *Standard & Poor s (S&P)* S&P recently released a mid-year update in which they stated that they are maintaining a negative outlook for the U.S. property and casualty insurance industry because of competitive pricing and investment losses that have significantly decreased surplus. S&P believes that rating downgrades will exceed upgrades for the industry during 2009.

Our Commercial Lines business reported a statutory combined ratio of 98.3% and 98.7% for the Second Quarter 2009 and Six Months 2009, respectively, while our Personal Lines business reported a statutory combined ratio of 102.1% and 104.5% for the same periods. In an effort to write profitable business in the current commercial and personal lines market conditions, we have implemented a clearly defined plan to improve risk selection and mitigate higher frequency and severity trends to complement our strong agency relationships and unique field-based model.

Our focus for 2009 continues to include the following:

- Deploying updated Commercial Lines predictive modeling tools to improve individual account underwriting and pricing.

- Personal Lines rating increases that are expected to generate approximately $9 million in additional premium in 2009, including approximately 20 anticipated rate increases of 3% or more, of which 14 were implemented in Six Months 2009.

- Claims Strategic Initiative program underway with a focus on enhancing areas of: (i) workers compensation best practices and targeted case management; (ii) litigation management; (iii) enhanced potential fraud and recovery recognition through use of advanced systems analytics; (iv) advanced claims automation; and (v) enhanced vendor management.

- Sales management efforts, including our market planning tools and leads program. Our market planning tools allow us to identify and strategically appoint additional independent agencies and hire or redeploy agency management specialists (AMS) in underpenetrated territories. We have continued to expand our independent agency count, which now stands at approximately 960 agencies across our footprint. These independent insurance agencies are serviced by approximately 100 field-based AMSs who make hands-on underwriting decisions on a daily basis. In addition, we use our predictive modeling and business analytics tools to help agents identify potential new customers.

- Expense management initiatives over the past year, which include the elimination of retiree life insurance benefits for current employees and ongoing controlled hiring practices, along with several initiatives taken in 2008, such as our workforce reduction initiatives, changes to agent commission programs, and the re-domestication of two of the Insurance Subsidiaries to Indiana. These expense management initiatives serve to benefit our expense ratio this year, and the ongoing impact of these initiatives will continue to benefit expenses going forward.

- Technology that allows agents and our field teams to input business seamlessly into our systems, including our One & Done® small business system and our xSELerate® straight-through processing system. Premiums of approximately $320,000 per workday were processed through our One & Done® small business system during Second Quarter 2009, up 16% from the same period last year.

Strategically expanding our business in our footprint states, including Tennessee, in which we began operations in June 2008. In the first 13 months of operations in this state, we wrote premium of approximately $12 million.

Given the improved profitability we have seen year to date, we are positively revising our combined ratio guidance to below 101.5% on both a GAAP and statutory basis for the full year 2009. This guidance includes our assumptions for catastrophe losses of 1.4 points for 2009 and does not assume any reserve development, favorable or unfavorable.

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Review of Underwriting Results by Line of Business

Commercial Lines Results

Commercial Lines	**Unaudited Quarter ended June 30,**		**Change % or**	**Unaudited Six Months ended June 30,**		**Change % or**
($ in thousands)	**2009**	**2008**	**Points**	**2009**	**2008**	**Points**
GAAP Insurance Operations Results:						
NPW	**$ 306,630**	333,203	(8)%	**632,071**	675,403	(6)%
NPE	**305,245**	325,197	(6)	**616,790**	657,288	(6)
Less:						
Losses and loss expenses incurred	**199,821**	216,133	(8)	**411,566**	429,322	(4)
Net underwriting expenses incurred	**96,426**	106,367	(9)	**195,933**	219,172	(11)
Dividends to policyholders	**812**	1,579	(49)	**1,277**	2,114	(40)
Underwriting income	**$ 8,186**	1,118	632%	**8,014**	6,680	20%
GAAP Ratios:						
Loss and loss expense ratio	**65.5%**	66.5	(1.0)pts	**66.7%**	65.3	1.4pts
Underwriting expense ratio	**31.5%**	32.7	(1.2)	**31.8%**	33.4	(1.6)
Dividends to policyholders ratio	**0.3%**	0.5	(0.2)	**0.2%**	0.3	(0.1)
Combined ratio	**97.3%**	99.7	(2.4)	**98.7%**	99.0	(0.3)
Statutory Ratios:						
Loss and loss expense ratio	**65.5%**	66.5	(1.0)	**66.7%**	65.3	1.4
Underwriting expense ratio	**32.5%**	31.8	0.7	**31.8%**	32.2	(0.4)
Dividends to policyholders ratio	**0.3%**	0.5	(0.2)	**0.2%**	0.3	(0.1)
Combined ratio	**98.3%**	98.8	(0.5)pts	**98.7%**	97.8	0.9pts

NPW decreased in Second Quarter and Six Months 2009 compared to the same periods last year due to the continued competitive insurance marketplace and the economic recession, which has led to reduced levels of exposure given the reduction in payroll consistent with the current unemployment level. These factors are evidenced by the following:

- Endorsement and audit activity decreased by $14.2 million, to a net return premium of $19.7 million in Second Quarter 2009 and $28.1 million, to a net return premium of $36.9 million in Six Months 2009 driven by the impact of unemployment on our workers compensation and general liability lines of business, the trend of which we expect to continue until the unemployment rate stabilizes; and
- Net renewals decreased $15.7 million in Second Quarter 2009, which includes a two-point decrease in retention, to 76%, partially offset by renewal pure price increases of 0.6% in Second Quarter 2009 compared to renewal pure price decreases of 3.1% in Second Quarter 2008. As previously discussed, Second Quarter 2009 is the first quarter since the first quarter of 2005 that pure pricing has increased, with each month of the quarter reflecting pure price increases. Net renewals decreased $22.1 million in Six Months 2009, including a one-point decrease in retention, to 77%, partially offset by renewal pure price decreases of 0.1% compared to renewal pure price decreases of 3.1% in Six Months 2008.

Partially offsetting these items was an improvement in new business, which has increased 12%, to $69.9 million, in Second Quarter 2009 compared to Second Quarter 2008 and 12%, to $141.3 million, in Six Months 2009 compared to Six Months 2008.

NPE decreased in Second Quarter and Six Months 2009, consistent with the fluctuation in NPW for the twelve-month period ended June 30, 2009 as compared to the twelve-month period ended June 30, 2008.

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The 1.0-point decrease in the GAAP loss and loss expense ratio in Second Quarter 2009 compared to Second Quarter 2008 was primarily attributable to: (i) a decrease in property losses of $6.3 million, or 1.3 points; and (ii) $6 million, or 2.0 points, of favorable casualty prior year development primarily in our workers compensation line of business in accident years 2004 through 2007, partially offset by unfavorable prior year development for the 2008 accident year, compared to immaterial development in Second Quarter 2008. These items are partially offset by an increase in casualty loss costs that have outpaced premium in the current accident year.

The 1.4-point increase in the GAAP loss and loss expense ratio in Six Months 2009 compared to Six Months 2008 was primarily attributable to: (i) a 0.4-point increase in property losses; and (ii) an increase in casualty loss costs that have outpaced premium in the current accident year. Partially offsetting these items are favorable casualty prior year development primarily in our workers compensation line of business of approximately $13 million, or 2.1 points, in Six Months 2009 from the 2007 and prior accident years, partially offset by unfavorable prior year development in the 2008 accident year, compared to approximately $3 million, or 0.5 points, in Six Months 2008.

Improvements in the GAAP underwriting expense ratio in Second Quarter and Six Months 2009 compared to the same periods last year were primarily attributable to the expense initiatives that we implemented in 2008 and 2009 as mentioned above, including a $2.5 million benefit related to the elimination of retiree life insurance benefits recognized in the first quarter of 2009 that, when combined with the $2.9 million restructuring charge in the first quarter of 2008, contributed to the year over year improvement in the underwriting ratio.

The following is a discussion of our most significant commercial lines of business:

General Liability

($ in thousands)	Unaudited Quarter ended June 30, 2009	2008	Change % or Points	Unaudited Six Months ended June 30, 2009	2008	Change % or Points
Statutory NPW	**$ 92,429**	105,042	(12)%	**192,233**	216,325	(11)%
Statutory NPE	**91,853**	99,932	(8)	**186,077**	203,201	(8)
Statutory combined ratio	**103.7%**	103.3	0.4pts	**104.0%**	100.2	3.8pts
% of total statutory commercial NPW	**30%**	32		**30%**	32	

NPW for this line of business decreased in the Second Quarter and Six Months 2009 compared to the same periods last year, primarily driven by: (i) a $6.6 million, or 7%, decrease in net renewals for the Second Quarter 2009, and a $10.5 million, or 6%, decrease in Six Months 2009; and (ii) a $4.6 million decrease in endorsement and audit activity, to a net return premium of $6.6 million for the Second Quarter 2009 and a $11.3 million decrease, to a return premium of $13.0 million in Six Months 2009. These decreases are primarily driven by the competitive nature of the insurance marketplace and the current economic recession. As of June 30, 2009, approximately 59% of our premium is subject to audit, whereby actual exposure units (usually sales or payroll) are compared to estimates and a return premium, or additional premium, transaction occurs. Retention decreased two-points for Second Quarter and Six Months 2009 to 74% while total policy counts increased more than 1% for the Second Quarter and Six Months 2009 compared to the Second Quarter and Six Months 2008.

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We continue to experience competition in our middle market and large account business. However, there have been indications of rate stabilization in the general liability line of business, which experienced renewal pure price increases of 1.6% in Second Quarter 2009 compared to decreases of 1.7% in Second Quarter 2008 and pure price increases of 0.6% in Six Months 2009 compared to decreases of 2.1% in Six Months 2008. We continue to concentrate on our long-term strategies of improving profitability, focusing on diversifying our mix of business by writing more non-contractor classes of business, which typically experience lower volatility during economic cycles. While the Second Quarter 2009 profitability results remained in line with the prior year period, there are offsetting drivers of the results. These drivers are: (i) increased loss costs in the current accident year that have outpaced premiums, leading to an increase in the combined ratio; and (ii) an increase in the expense ratio caused by premium declines that have outpaced expense reductions resulting from our various expense initiatives. These items were partially offset by favorable prior year development of approximately $1 million, or 1.5 points, in Second Quarter 2009 compared to unfavorable prior year development of approximately $3 million, or 3.0 points, in Second Quarter 2008. The Six Months 2009 statutory combined ratio increased 3.8 points compared to Six Months 2008 primarily due to an increase in loss costs that have outpaced premium growth in the current accident year. This increase was partially offset by a reduction in unfavorable prior year development to approximately $2 million, or 0.9 points, in Six Months 2009 from approximately $4 million, or 2.0 points, in Six Months 2008.

Workers Compensation

($ in thousands)	Unaudited Quarter ended June 30, 2009	2008	Change % or Points	Unaudited Six Months ended June 30, 2009	2008	Change % or Points
Statutory NPW	**$ 64,696**	78,753	(18)%	**136,872**	159,053	(14)%
Statutory NPE	**66,590**	77,501	(14)	**136,967**	155,968	(12)
Statutory combined ratio	**100.9%**	98.6	2.3pts	**96.6%**	96.5	0.1pts
% of total statutory commercial NPW	**21%**	24		**22%**	24	

In Second Quarter and Six Months 2009, NPW on this line decreased compared to the same period last year, despite a 4% increase in Second Quarter 2009 and a 3% increase in Six Months 2009 in total policy counts, due primarily to: (i) competitive pressure from monoline carriers willing to write workers compensation policies mainly on the upper end of our middle market business and our large account business; (ii) a two-point decrease in retention, to 77%, in Second Quarter 2009 compared to Second Quarter 2008 and a two-point decrease in retention, to 76%, in Six Months 2009 compared to Six Months 2008, due to initiatives that have allowed us to target price increases for our worst performing business, thereby improving the quality of our retained business; and (iii) an $8.1 million decrease in endorsement and audit activity, to a return premium of $12.0 million, in Second Quarter 2009, and a $13.9 million decrease in endorsement and audit activity, to a returned premium of $20.6 million, in Six Months 2009 compared to the prior year periods. This decrease was partially offset by: (i) a 0.2% increase in renewal pure price in Second Quarter 2009 compared to a 2.5% decrease in Second Quarter 2008 and a 0.4% decrease in Six Months 2009 compared to a 1.7% decrease in Six Months 2008; and (ii) an increase in new business of $4.1 million, to $18.3 million, in Second Quarter 2009 compared to Second Quarter 2008, and an increase of $7.4 million, to $36.9 million, in Six Months 2009 compared to the prior year.

The increase in the statutory combined ratio of this line in Second Quarter and Six Months 2009 compared to the same periods last year reflects the shortfall in written premiums that increased the expense ratio despite a decline in underwriting expenses of 9% in Second Quarter and 12% in Six Months 2009 compared to the same periods last year. Partially offsetting this increase was overall favorable prior year statutory development of approximately $4 million, or 6.0 points, in Second Quarter and approximately $11 million, or 8.0 points, in Six Months 2009 for the 2007 and prior accident years partially offset by unfavorable development in the 2008 accident year. In Second Quarter 2008, favorable development was approximately $3 million, or 3.9 points, and approximately $7 million, or 4.5 points, in

Six Months 2008.

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Commercial Automobile

($ in thousands)	Unaudited Quarter ended June 30, 2009	2008	Change % or Points	Unaudited Six Months ended June 30, 2009	2008	Change % or Points
Statutory NPW	**$ 76,187**	78,483	(3)%	**156,046**	158,682	(2)%
Statutory NPE	**75,339**	77,758	(3)	**151,185**	156,982	(4)
Statutory combined ratio	**99.0%**	96.2	2.8pts	**97.6%**	98.2	(0.6)pts
% of total statutory commercial NPW	**25%**	24		**25%**	23	

NPW for this line of business decreased slightly in Second Quarter and Six Months 2009 compared to Second Quarter and Six Months 2008, while total policy counts increased 4% for both comparable periods. This decrease was driven by: (i) net renewal premiums, which were down $3.0 million for the Second Quarter 2009 and $4.6 million for Six Months 2009; and (ii) endorsement premiums, which were down $0.8 million in the Second Quarter 2009 and $1.8 million in Six Months 2009; largely offset by new business premiums, which were up $1.6 million, or 13%, in Second Quarter 2009 and $3.9 million, or 16%, in Six Months 2009. Renewal pure price increased 0.8% in Second Quarter 2009 and 0.2% in Six Months 2009 compared to a decrease of 5.2% in Second Quarter and Six Months 2008. The increase in the statutory combined ratio for Second Quarter 2009, compared to Second Quarter 2008, was driven by increased loss costs that have outpaced premium. The decrease in the statutory combined ratio for Six Months 2009, compared to Six Months 2008, included favorable casualty prior year development of approximately $5 million, or 3.0 points, due to favorable emergence in accident years 2005 through 2007, compared to no favorable prior year development in Six Months 2008 and physical damage losses that were $3.5 million, or approximately 1.8 points, lower in Six Months 2009 compared to the same period last year. These items were partially offset by increased loss costs.

Commercial Property

($ in thousands)	Unaudited Quarter ended June 30, 2009	2008	Change % or Points	Unaudited Six Months ended June 30, 2009	2008	Change % or Points
Statutory NPW	**$ 50,217**	48,986	3%	**100,451**	97,230	3%
Statutory NPE	**48,970**	48,575	1	**97,855**	98,511	(1)
Statutory combined ratio	**78.6%**	94.4	(15.8)pts	**89.8%**	95.5	(5.7)pts
% of total statutory commercial NPW	**16%**	15		**16%**	14	

NPW for this line of business increased in Second Quarter 2009 and Six Months 2009 compared to Second Quarter 2008 and Six Months 2008 due to: (i) new business premium increases of 6%, to $11.4 mill