SELECTIVE INSURANCE GROUP INC
Form 10-K
February 28, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K

(Mark one)

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

For the fiscal year ended December 31, 2007

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 0-8641

SELECTIVE INSURANCE GROUP, INC.

(Exact name of registrant as specified in its charter)

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

Registrant s telephone number, including area code: (973) 948-3000

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

Title of Each Class	Name of Each Exchange on Which Registered
7.5% Junior Subordinated Notes due September 27, 2066	New York Stock Exchange
Common Stock, par value $2 per share	NASDAQ Global Select Market

Preferred Share Purchase Rights

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

þ Yes o No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

o Yes þ No

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

þ Yes o No

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

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.

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 Act).

o Yes þ No

The aggregate market value of the voting Common stock held by non-affiliates of the registrant, based on the closing price on the NASDAQ Global Select Market, was $1,393,617,821 on June 30, 2007.

As of February 15, 2008, the registrant had outstanding 53,869,967 shares of Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive Proxy Statement for the 2008 Annual Meeting of Stockholders to be held on April 24, 2008 are incorporated by reference into Part III of this report.

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Exhibit 99.1

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PART I

Item 1. Business.

Overview

Selective Insurance Group, Inc., through its subsidiaries, (collectively known as Selective or the Company) offers property and casualty insurance products and diversified insurance services and products. Selective Insurance Group, Inc. was incorporated in New Jersey in 1977 and its main offices are located in Branchville, New Jersey. Selective Insurance Group, Inc. s Common Stock is publicly traded on the NASDAQ Global Select Market under the symbol, SIGI.

Selective classifies its business into three operating segments:

- Insurance Operations, which sells property and casualty insurance products and services primarily in 21 states in the Eastern and Midwestern United States;
- Investments; and
- Diversified Insurance Services, which provides human resource administration outsourcing products and services, and federal flood insurance administrative services.

Financial information about Selective s three operating segments is contained in this report in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, and Item 8. Financial Statements and Supplementary Data, Note 12 to the consolidated financial statements, Segment Information.

Description of Operating Segment Products and Markets

Insurance Operations Segment

Selective s Insurance Operations sell property and casualty insurance policies, which are contracts to cover losses for specified risks in exchange for premiums. Property insurance generally covers the financial consequences of accidental loss to the insured s property. Property claims are generally reported and settled in a relatively short period of time. Casualty insurance generally covers the financial consequences of bodily injury and/or property damage to a third party as a result of the insured s negligent acts, omissions, or legal liabilities. Casualty claims often take years to be reported and settled.

Selective s Insurance Operations segment writes its property and casualty insurance products through seven insurance subsidiaries (Insurance Subsidiaries), which are listed on the following table together with their respective pooled financial strength ratings by A.M. Best Company, Inc. (A.M. Best), and state of domicile by which each is primarily regulated:

Insurance Subsidiaries	A.M. Best Rating[1]	Domiciliary State
Selective Insurance Company of America (SICA)	A+ (Superior)	New Jersey
Selective Way Insurance Company (SWIC)	A+ (Superior)	New Jersey
Selective Insurance Company of South Carolina (SICSC)	A+ (Superior)	South Carolina
Selective Insurance Company of the Southeast (SICSE)	A+ (Superior)	North Carolina
Selective Insurance Company of New York (SICNY)	A+ (Superior)	New York
Selective Insurance Company of New England (SICNE)	A+ (Superior)	Maine
Selective Auto Insurance Company of New Jersey (SAICNJ)	A+ (Superior)	New Jersey

[1] With regard to an A+ rating, A.M. Best uses its highest Financial Strength Rating of Secure, and a descriptor of Superior, which

it defines as, Assigned to companies that have, in our opinion, a superior ability to meet their ongoing obligations to policyholders. Only 10% of commercial and personal insurance companies carry an A+ or better rating from A.M. Best.

In 2007, A.M. Best, in its list of Top Property/Casualty Writers, ranked Selective the 46th largest property and casualty group in the United States based on the combined net premiums written (NPW) for 2006.

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Insurance Operations

Selective s Insurance Operations segment derives substantially all of its revenues from insurance policy premiums. The Insurance Subsidiaries predominantly write annual policies, of which the associated premiums are defined as NPW. NPW is recognized as revenue as net premiums earned (NPE) ratably over the term of the insurance policy. Expenses fall into three categories: (i) losses associated with claims and various loss expenses incurred for adjusting claims; (ii) expenses related to the issuance of insurance policies, such as agent commissions, premium taxes, and other underwriting expenses, including employee compensation and benefits; and (iii) policyholder dividends.

Selective s Insurance Subsidiaries are regulated by each of the states in which they do business. Each Insurance Subsidiary is required to file financial statements with such states, prepared in accordance with accounting principles prescribed by, or permitted by, such Insurance Subsidiary s state of domicile (Statutory Accounting Principles or SAP). SAP have been promulgated by the National Association of Insurance Commissioners (NAIC) and adopted by the various states. Selective evaluates the performance of our Insurance Subsidiaries in accordance with SAP. Incentive-based compensation to independent agents and employees is based on SAP results and our rating agencies use SAP information to evaluate our performance and for industry comparative purposes.

The underwriting performance of insurance companies is measured under SAP by four different ratios:

1) Loss and loss expense ratio, which is calculated by dividing incurred loss and loss expenses by NPE;

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

3) Dividend ratio, which is calculated by dividing policyholder dividends by NPE; and

4) Combined ratio, which is the sum of the loss and loss expense ratio, the underwriting expense ratio, and the dividend ratio.

A statutory combined ratio under 100% generally indicates an underwriting profit and a statutory combined ratio over 100% generally indicates an underwriting loss. The statutory combined ratio does not reflect investment income, federal income taxes, or other non-operating income or expense.

SAP differs in several ways from generally accepted accounting principles in the United States of America (GAAP), under which Selective is required to report our financial results to the United States Securities and Exchange Commission (SEC). The most notable differences impacting our reported net income are as follows:

Under SAP, underwriting expenses are recognized when incurred; whereas under GAAP, underwriting expenses are deferred and amortized over the life of the policy;

Under SAP, the underwriting expense ratio is calculated using NPW as the denominator; whereas NPE is used as the denominator under GAAP; and

Under SAP, the results of Selective s flood line of business are included in the Insurance Operations segment, whereas under GAAP, these results are included within the Diversified Insurance Services segment.

Selective primarily uses SAP information to monitor and manage its results of operations. Selective believes that providing SAP financial information for the Insurance Operations segment helps its investors, agents, and customers better evaluate the underwriting success of Selective s insurance business.

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The following table shows the statutory results of the Insurance Operations segment for the last three completed fiscal years:

	Year Ended December 31,		
(in thousands)	**2007**	2006	2005
Insurance Operations Results			
NPW	$ **1,562,728**	1,540,901	1,462,914
NPE	$ **1,525,163**	1,504,632	1,421,439
Losses and loss expenses incurred	**997,230**	958,741	902,557
Net underwriting expenses incurred	**494,944**	482,657	449,569
Policyholders dividends	**7,202**	5,927	5,688
Underwriting profit	$ **25,787**	57,307	63,625
Ratios:			
Losses and loss expense ratio	**65.4**%	63.7	63.5
Underwriting expense ratio	**31.6**%	31.3	30.7
Policyholders dividends ratio	**0.5**%	0.4	0.4
Combined ratio	**97.5**%	95.4	94.6
GAAP Combined ratio [1]	**98.9** %	96.1	95.1

[1] The GAAP Combined ratio excludes the flood line of business, which is included in the Diversified Insurance Services segment on a GAAP basis. The total Statutory Combined ratio excluding flood was 98.2% in 2007, 96.1% in 2006, and 95.3% in 2005.

Historically, Selective has produced a lower statutory combined ratio than the property and casualty insurance industry, and outperformed the industry average for the past 10-year period by 2.3 points. The table below sets forth a comparison of certain Company and industry statutory ratios:

	Simple Average of All Periods Presented	**2007**	2006	2005	2004	2003	2002	2001	2000	1999	1998
Selective Ratios: (1)											
Loss and loss expense	69.5%	**65.4**	63.7	63.5	65.3	70.3	72.3	74.3	75.7	74.4	70.2
Underwriting expense	31.1	**31.6**	31.3	30.7	30.3	30.7	30.3	31.5	31.7	30.5	32.2
Policyholders dividends	0.6	**0.5**	0.4	0.4	0.3	0.5	0.6	0.9	0.9	0.8	0.7
Statutory combined ratio	101.2	**97.5**	95.4	94.6	95.9	101.5	103.2	106.7	108.2	105.7	103.2
Growth (decline) in net premiums written	8.2	**1.4**	5.3	6.9	12.0	15.7	13.8	10.5	3.6	8.1	4.4
Industry Ratios: (1) (2)											
Loss and loss expense	76.3	**67.7**	65.3	75.3	73.5	75.0	81.5	88.4	81.5	78.8	76.2
Underwriting expense	26.3	**27.2**	26.2	25.4	24.9	24.6	25.1	26.5	27.4	27.9	27.7
Policyholders dividends	0.9	**0.6**	0.9	0.5	0.5	0.5	0.6	0.8	1.4	1.3	1.7
Statutory combined ratio	103.5	**95.6**	92.4	101.2	98.9	100.1	107.3	115.7	110.4	108.1	105.6
Growth in net premiums written	4.9	**(1.2)**	3.9	0.0	4.4	9.7	15.1	8.5	4.7	1.9	1.8
Selective Favorable (Unfavorable) to Industry:											
Statutory combined ratio	2.3	**(1.9)**	(3.0)	6.6	3.0	(1.4)	4.1	9.0	2.2	2.4	2.4
Growth (decline) in net premiums written	33	**2.6**	1.4	6.9	7.6	6.0	(1.3)	2.0	(1.1)	6.2	2.6

1. The ratios and percentages are based upon SAP prescribed or permitted by state insurance departments in the states in which each company is domiciled. Effective January 1, 2001, Selective adopted a codified set of statutory accounting principles, as

required by the NAIC. These principles were not retroactively applied, but would not have had a material effect on the ratios presented above.

2. Source: A.M. Best. The industry ratios for 2007 have been estimated by A.M. Best.

Lines of Business and Products

Selective s Insurance Operations segment includes commercial lines (Commercial Lines), which markets primarily to businesses and represents approximately 87% of Selective s NPW; and personal lines (Personal Lines), which markets primarily to individuals and represents approximately 13% of NPW.

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Commercial Lines

Commercial Lines underwrites general liability, commercial automobile, workers compensation, commercial property, business owners policy, and bond risks through traditional insurance and alternative risk management products.

Personal Lines

Personal Lines underwrites and issues insurance policies for personal automobile, homeowners, and other various risks.

Regional Geographic Market Focus

Selective s Insurance Operations segment primarily focuses its marketing efforts and sells its products and services in the Eastern and Midwestern regions of the United States. Although still concentrated in coastal eastern states, this geographic diversification lessens Selective s exposure to regulatory, competitive and catastrophic risk. The Insurance Operations segment does not conduct any business outside of the United States. The following table shows the principal states in which Selective writes insurance business and the percentage of Selective s total NPW that such state represents for the last three fiscal years.

	Year Ended December 31,		
Net Premiums Written	**2007**	2006	2005
New Jersey	**30.0**%	32.6	33.9
Pennsylvania	**14.1**	14.3	14.4
New York	**10.8**	11.1	11.2
Maryland	**7.6**	7.5	7.2
Virginia	**6.0**	5.9	5.6
Illinois	**4.4**	3.9	3.8
North Carolina	**4.0**	3.8	3.8
Georgia	**3.5**	3.2	3.1
Indiana	**3.5**	3.1	2.8
South Carolina	**2.8**	2.5	2.5
Michigan	**2.0**	1.9	1.8
Ohio	**1.8**	1.6	1.5
Connecticut	**1.7**	1.4	1.3
Rhode Island	**1.3**	1.3	1.2
Delaware	**1.2**	1.3	1.4
Wisconsin	**1.2**	1.1	1.1
Minnesota	**1.0**	1.1	1.1
Other states[1]	**3.1**	2.4	2.3
Total	**100.0**%	100.0	100.0

[1] Other states include, among others, Florida, Iowa, Kentucky, Missouri and Washington D.C.

Independent Insurance Agent Distribution Model

According to a study done by the Independent Insurance Agents and Brokers of America, in 2005, independent insurance agents and brokers wrote approximately 80% of commercial property and casualty insurance and approximately 36% of the personal lines insurance business in the United States. Independent agents are a significant force in overall insurance industry premium production, in large part because they represent more than one insurance company and, therefore, can provide insureds with a wider choice of commercial and personal property and casualty insurance products. As a result, Selective is committed to the independent agency distribution channel and focuses its primary strategy on building relationships with well-established, independent insurance agents, including efforts to assist in the hiring and training of producers. In addition, Selective carefully monitors each agent s profitability, growth, financial stability, staff, and mix of business against plans that are developed annually with the agent. In developing annual plans with its independent insurance agents, Selective s field personnel and management spend considerable time meeting with agencies to: (i) advise them on Company developments; (ii) receive feedback on products and services; (iii) help agents increase market share; and (iv) consolidate more of their business utilizing Selective s technology advantages.

As of December 31, 2007, Selective s Insurance Subsidiaries had entered into agency agreements with approximately 880 independent insurance agents having approximately 1,800 storefronts pursuant to these agreements. The agents are authorized to sell policies written by the Insurance Subsidiaries and are paid commissions pursuant to calculations and specific percentages stated in the agency agreement. Under the agency agreement, other than as provided by law, agents are not permitted to receive compensation for the business they place with Selective from any insured or applicant for insurance other than Selective. The agency agreement provides for commissions to be paid based on a percentage of the premium written. Selective and its agents also negotiate other compensation arrangements, including supplemental commissions, based on the volume and underwriting results of the business the agent writes with Selective.

Technology and Field Model Business Strategy

Selective uses the service mark High Tech x High Touch = HT® to describe its business strategy for the Insurance Operations. High Tech signifies the advanced technology that Selective uses to make it easy for: (i) independent insurance agents to transact and process business with Selective; and (ii) customers to access real-time information, manage their accounts and pay their bills through an on-line customer portal that was established in September 2006. High Touch signifies the close relationships that Selective has with its independent insurance agents and customers as a result of its business model that places underwriters, claims representatives, technical or technology staff, and safety management representatives in the field near its agents and customers.

Technology

Selective seeks to transact as much of its business as possible through the use of technology and, in recent years, has made significant investments in state-of-the-art information technology platforms, integrated systems, Internet-based applications, and predictive modeling initiatives to: (i) provide its independent agents and customers with access to accurate business information; (ii) provide independent agents the ability to process business transactions from their offices and systems; and (iii) provide underwriters with targeted pricing tools to enhance profitability while growing the business. In 2007, Applied Systems Client Network presented Selective with the 2007 Commercial Lines Interface Carrier of the Year Award for promoting efficient communication between insurance carriers and independent agents. Applied Systems is a provider of automated solutions for property and casualty insurance agents. The award was given in recognition of Selective s excellent work to implement download and real-time interface technology with independent agents through its xSELerate® agency integration technology. Selective also received the 2007 Quantum Award from the AMS Users Group, another major provider of automated management solutions for agents, for creating technology that enables independent agents to make a quantum leap in productivity and profitability. This award was granted to Selective for increasing productivity and efficiency for its independent insurance agents through its xSELerate® agency integration technology. Additionally, Selective was recognized as a model carrier component by Celent, an IT consulting group, for its effective use of its xSELerate® technology.

Selective manages its information technology projects through a project management office (PMO). The PMO is staffed by certified individuals who apply methodologies to: (i) communicate project management standards; (ii) provide project management training and tools; (iii) review project status and cost; and (iv) provide non-technology project management consulting services to the rest of Selective. Selective s senior management meets monthly with the PMO to review all major projects and report on the status of other projects. Selective believes that the PMO is a factor in the success of its technology implementation and is a competitive advantage. Selective s technology operations are located in Branchville, New Jersey; Glastonbury, Connecticut; and Sarasota, Florida.

Field Strategy

To support its independent agents, Selective employs a field underwriting model and a field claims model that are supported by the home office in Branchville, New Jersey, and six regional branch offices (Region), which as of December 31, 2007 were as follows:

Region	Office Location
Great Lakes/Big River	Columbus, Ohio
Heartland	Carmel, Indiana
New Jersey	Hamilton, New Jersey
Northeast	Branchville, New Jersey
Mid-Atlantic	Allentown, Pennsylvania and Hunt Valley, Maryland
Southern	Charlotte, North Carolina

As of December 31, 2007, Selective s field force included:

98 Commercial Lines field underwriters, known as agency management specialists (AMSs). AMSs live and work in the geographic vicinity of Selective s appointed agents and generally work from offices in their homes. As a result of this close proximity and direct and regular interaction, AMSs are able to build strong relationships with agents.

11 Personal Lines territory managers that work with AMSs and independent agents to advance production. Territory managers build strong relationships with agents through direct and regular interaction, which better positions them to evaluate new business opportunities.

14 field technology employees. These employees work directly with agents, training and marketing Selective s technology systems like xSELerate® and SelectPLUS®. They also gather feedback from the agents to help improve Selective s technology to meet the needs of the agency force.

75 safety management specialists (SMSs). SMSs are located in the Regions and are responsible for surveying and assessing insured and prospective risks from a risk/safety standpoint, and for providing ongoing safety management services to certain insureds.

149 field claims adjusters, known as claim management specialists (CMSs). Like AMSs, CMSs live in the geographic vicinity of Selective s appointed agents and generally work from offices in their homes. CMSs, because of their geographic location, are able to conduct on-site inspections of losses and resolve claims faster, more accurately, and with higher levels of customer satisfaction. As a result, CMSs also obtain knowledge about potential exposures that they can share with AMSs.

Underwriting

Selective seeks to underwrite a variety of insurance risks and divides its markets into three segments:

Small business accounts with premiums less than $25,000 represent 52% of total direct premium written. During 2007, 30% of new small business was written through Selective s Internet-based One & Done® system s automated underwriting templates;

Middle market business accounts with premiums greater than $25,000 but less than $250,000 represent 42% of total direct premium written. This business, which cannot be written through the One & Done® system, is the primary focus of the AMSs; and,

Large business accounts with annual premiums of approximately $250,000 or greater represent 6% of Selective s total direct premium written and are underwritten by a specialized commercial lines unit, Selective Risk Managers (SRM). Approximately 24% of the of the SRM premium includes alternative risk transfer mechanisms such as retrospective rating plans, self-insured group retention programs, or individual self-insured accounts.

Selective s underwriting process requires communication and interaction among:

The independent agents and the AMSs, who identify product and market needs;

Selective s strategic business units (SBUs), located in the home office, which are organized by customer and product type, and develop Selective s pricing and underwriting guidelines in conjunction with regions;

The Regions, which work with the SBUs to establish annual premium and pricing goals; and

The Actuarial Department, located in the home office, which assists in the determination of rate and pricing levels while also monitoring pricing and profitability.

Selective also has an underwriting service center (USC) located in Richmond, Virginia. The USC assists Selective s agents by servicing small to mid-sized business customers. During 2006, the USC became available to personal lines business customers of our New Jersey agents, with a rollout to Selective s remaining states during 2007. At the USC, Selective employees, who are licensed agents, respond to customer inquiries about insurance coverage, billing transactions, and other matters. The agent, as consideration for these services, receives a commission that is lower than the standard commission by approximately two points. Selective has found that the USC also provides additional opportunities to increase direct premiums written, as larger agencies seek insurance companies that have service center capabilities. Currently, the USC is servicing commercial lines net premiums written of $70 million and personal lines net premiums written of $33 million. The total $103 million serviced represents 7% of total net premiums written.

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Selective believes that a distinct advantage of its field underwriting model is its ability to provide a wide range of front-line safety management services focused on improving the policyholder s safety and risk management programs, as expressed by its service mark Safety Management: Solutions for a safer workplace[SM] . Safety management services include: (i) risk evaluation and improvement surveys intended to evaluate potential exposures and provide solutions for mitigation; (ii) web-based safety management educational resources, including a large library of coverage-specific safety materials, videos and on-line courses, such as defensive driving and employee educational safety courses; (iii) thermographic infrared surveys aimed at identifying electrical hazards; and (iv) OSHA construction and general industry certification training. Risk improvement efforts for existing customers are designed to improve loss experience and policyholder retention through valuable ongoing consultative service. Selective s safety management goal is to partner with its policyholders to identify and eliminate potential loss exposures.

Selective analyzes its underwriting profitability by line of business, account, product, agency and other bases. Selective s goal is to continue to underwrite the risks that it understands well and that, in aggregate, are profitable.

Field Claims Management

Effective, fair, and timely claims management is one of the most important customer services that Selective provides and one of the critical factors in achieving underwriting profitability. Selective s claims practices emphasize the maintenance of timely and adequate claims reserves, and the cost-effective delivery of claims services by controlling losses and loss expenses. CMSs are primarily responsible for investigating and settling claims directly with policyholders and claimants. By promptly and personally investigating claims, CMSs are able to provide personal service and quickly resolve claims. CMSs also provide guidance on the handling of the claim until its final disposition. Selective also believes that by visiting the site of the claim, and meeting face-to-face with the insured or claimant, the settlement will be more accurate. In territories where there is insufficient claim volume to justify the placement of a CMS, or when a particular claim expertise is required, Selective uses independent adjusters to investigate and settle claims.

Selective has a centralized special investigations unit (SIU) that investigates potential insurance fraud and abuse, and supports efforts by regulatory bodies and trade associations to curtail the cost of fraud. The SIU adheres to uniform internal procedures to improve detection and takes action on potentially fraudulent claims. It is Selective s practice to notify the proper authorities of its findings. This practice sends a clear message that Selective will not tolerate fraudulent activity committed against it or its customers. The SIU also supervises anti-fraud training for CMSs and other employees, including AMSs.

Selective has a claims service center (CSC), co-located with the USC, in Richmond, Virginia. The CSC provides enhanced services to Selective s policyholders, including immediate claim review, 24 hours a day, seven days a week. The CSC is also designed to reduce the loss settlement time on first-party automobile claims and increase the usage of Selective s discounts at body shops, glass repair shops, and car rental agencies.

Net Loss and Loss Expense Reserves

Selective establishes loss and loss expense reserves that are estimates of amounts needed to pay claims and related expenses in the future for insured loss events that have already occurred. The process of estimating reserves involves a considerable degree of judgment by management and, as of any given date, is inherently uncertain. See Critical Accounting Policies and Estimates in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations in this Form 10-K for a full discussion regarding Selective s loss reserving process.

Selective s loss and loss expense reserve development over the proceeding 10 years is shown on the following table. Section I of the 10-year table shows the estimated liability that was recorded at the end of each of the indicated years for all current and prior accident year s unpaid loss and loss expenses. The liability represents the estimated amount of loss and loss expenses for claims that were unpaid at the balance sheet date, including incurred but not reported (IBNR) reserves. In accordance with GAAP, the liability for unpaid loss and loss expenses is recorded in the balance sheet gross of the effects of reinsurance with an estimate of reinsurance recoverables arising from reinsurance contracts reported separately as an asset. The net balance represents the estimated amount of unpaid loss and loss expenses outstanding as of the balance sheet date, reduced by estimates of amounts recoverable under reinsurance contracts.

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Section II shows the re-estimated amount of the previously recorded net liability as of the end of each succeeding year. Estimates of the liability for unpaid loss and loss expenses are increased or decreased as payments are made and more information regarding individual claims and trends, such as overall frequency and severity patterns, becomes known. Section III shows the cumulative amount of net loss and loss expenses paid relating to recorded liabilities as of the end of each succeeding year. Section IV shows the re-estimated gross liability and re-estimated reinsurance recoverables through December 31, 2007. Section V shows the cumulative net (deficiency)/redundancy representing the aggregate change in the liability from the original balance sheet dates and the re-estimated liability through December 31, 2007.

This table does not present accident or policy year development data. Conditions and trends that have affected development of the reserves in the past may not necessarily occur in the future. Accordingly, it may not be appropriate to extrapolate redundancies or deficiencies based on this table.

($ in millions)	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	**2007**
I. Gross reserves for unpaid losses and loss expenses at December 31	$ 1,161.2	1,193.3	1,273.8	1,272.7	1,298.3	1,403.4	1,587.8	1,835.2	2,084.0	2,288.8	**2,542.5**
Reinsurance recoverable on unpaid losses and loss expenses at December 31	$ (124.2)	(140.5)	(192.0)	(160.9)	(166.5)	(160.4)	(184.6)	(218.8)	(218.2)	(199.7)	**(227.8)**
Net reserves for unpaid losses and loss expenses at December 31	$ 1,037.0	1,052.8	1,081.8	1,111.8	1,131.8	1,243.1	1,403.2	1,616.4	1,865.8	2,089.0	**2,314.7**
II. Net Reserves estimated as of:											
One year later	$ 1,034.5	1,044.2	1,080.7	1,125.5	1,151.7	1,258.1	1,408.1	1,621.5	1,858.5	**2,070.2**	
Two years later	1,024.8	1,035.9	1,088.2	1,152.7	1,175.8	1,276.3	1,452.3	1,637.3	**1,845.1**		
Three years later	1,014.0	1,033.3	1,115.6	1,181.9	1,210.7	1,344.6	1,491.1	**1,643.7**			
Four years later	998.1	1,040.3	1,134.4	1,220.2	1,290.2	1,371.5	**1,522.9**				
Five years later	997.9	1,049.9	1,156.0	1,278.3	1,306.8	**1,413.8**					
Six years later	1,003.6	1,058.6	1,194.6	1,287.5	**1,349.6**						
Seven years later	1,011.6	1,090.0	1,203.2	**1,325.5**							
Eight years later	1,038.0	1,101.1	**1,238.2**								
Nine years later	1,045.2	**1,135.4**									
	1,078.3										

Ten years later										
Cumulative net redundancy (deficiency)	$ **(41.3)**	**(82.6)**	**(156.5)**	**(213.7)**	**(217.8)**	**(170.8)**	**(119.7)**	**(27.3)**	**20.7**	**18.8**
III. Cumulative amount of net reserves paid through:										
One year later	$ 313.7	328.1	348.2	399.2	377.1	384.0	414.5	422.4	468.6	**469.4**
Two years later	531.1	537.5	600.3	649.1	627.3	653.3	691.4	729.5	**775.0**	
Three years later	665.5	703.8	767.5	815.3	807.2	836.3	903.7	**942.4**		
Four years later	760.8	797.1	870.8	930.9	926.9	966.2	**1,033.5**			
Five years later	812.2	856.1	933.6	1,002.4	1,003.3	**1,044.6**				
Six years later	849.7	892.2	974.6	1,046.3	**1,053.8**					
Seven years later	875.9	919.2	1,001.1	**1,081.7**						
Eight years later	894.7	937.1	**1,029.0**							
Nine years later	908.5	**956.7**								
Ten years later	**922.5**									
IV. Re-estimated gross liability	$ 1,338.6	1,399.8	1,519.0	1,574.5	1,613.2	1,654.3	1,782.6	1,912.0	2,121.8	2,303.1
Re-estimated reinsurance recoverable	$ (260.3)	(264.4)	(280.8)	(249.0)	(263.6)	(240.4)	(259.6)	(268.3)	(276.7)	(232.9)
Re-estimated net liability	$ 1,078.3	1,135.4	1,238.2	1,325.5	1,349.6	1,413.8	1,522.9	1,643.7	1,845.1	2070.2
V. Cumulative gross deficiency	$ (177.4)	(206.5)	(245.2)	(301.8)	(314.8)	(250.8)	(194.8)	(76.8)	(37.8)	(14.4)
Cumulative net redundancy (deficiency)	$ (41.3)	(82.6)	(156.5)	(213.7)	(217.8)	(170.8)	(119.7)	(27.3)	20.7	18.8

Note: Some amounts may not foot due to rounding.

Selective experienced favorable prior year development in 2007 and 2006 of $18.8 million and $7.3 million, respectively. In 2005, prior year adverse development was $5.1 million. The following paragraphs provide information regarding the development in each of these calender years.

Selective experienced overall favorable development in its loss and loss expense reserves totaling $18.8 million in 2007, which was primarily driven as follows:

The commercial automobile line of business experienced favorable prior year loss and loss expense reserve development of approximately $19 million, which was primarily driven by lower than expected severity in accident years 2004 through 2006.

The personal automobile line of business experienced favorable prior year development of approximately $10 million, due to lower than expected loss emergence for accident years 2005 and prior partially offset by higher severity in accident year 2006.

The workers compensation line of business experienced favorable prior year development of approximately $4 million reflecting the implementation of a series of improvement strategies for this line in recent accident years partially offset by an increase in the tail factor related to medical inflation and general development trends.

The homeowners line of business experienced adverse prior year loss and loss expense reserve development of approximately $6 million driven by unfavorable trends in claims for groundwater contamination caused by the leakage of certain underground oil storage tanks.

The personal umbrella line of business experienced adverse prior year loss and loss expense reserve development of approximately $4 million in 2007, which was due to the impact of several significant losses on this small line.

The remaining lines of business, which collectively contributed approximately $4 million of adverse development, do not individually reflect any significant trends related to prior year development.

Selective s 2006 overall favorable loss and loss expense reserve development was driven by the following:

The commercial automobile line of business experienced favorable prior year loss and loss expense reserve development of approximately $15 million, which was primarily driven by lower than expected severity in accident years 2004 and 2005.

The workers compensation line of business experienced favorable prior year development of approximately $4 million, which was driven, in part, by savings realized from changing medical and pharmacy networks outside New Jersey and re-contracting our medical bill review services.

The personal automobile line of business experienced favorable prior year development of approximately $9 million, due to lower than expected frequency.

The general liability line of business experienced adverse prior year loss and loss expense reserve development of approximately $15 million in 2006, which was largely driven by our contractor completed operations business and an increase in reserves for legal expenses.

The remaining lines of business, which collectively contributed approximately $6 million of adverse development, do not individually reflect significant prior year development.

During the course of 2005, Selective had analyzed certain negative trends in the workers compensation line of business and certain positive trends in the commercial automobile line of business. In the fourth quarter of 2005, Selective had accumulated sufficient evidence to change management s best estimate of loss reserves for these lines.

Accordingly, Selective took the following actions:

- Workers compensation reserves were increased by approximately $42 million to reflect rising medical cost trends that impacted accident years 2001 and prior.

- Commercial automobile reserves were decreased by approximately $48 million, primarily due to ongoing favorable severity trends in the 2002 through 2004 accident years.

- The general liability reserves adversely developed by approximately $14 million over the course of the year, which was driven mainly by our contractor completed operations business impacting accident years 2001 and prior, but partially offset by positive development in accident years 2002 through 2004.

The adverse judicial ruling by the New Jersey Supreme Court in the second quarter of 2005 that eliminated the application of the serious life impact standard to personal automobile bodily injury liability cases under the verbal tort threshold of the New Jersey Automobile Insurance Cost Reduction Act (AICRA) led to an increase in personal automobile reserves of approximately $10 million, of which $6 million represents adverse development from prior years.

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The cumulative loss and loss expense reserve net deficiencies seen in the years 1998 through 2003 are generally reflective of the soft market pricing in the industry during that time frame, which hit the lowest levels in 1999. The property and casualty insurance industry, as a whole, underestimated reserves and loss trends leading to intense pricing competition. Additionally, during 1999, Selective significantly increased gross and ceded reserves by $37.5 million for prior accident years related to unlimited medical claims under personal injury protection provisions of personal automobile policies ceded to the Unsatisfied Claim and Judgment Fund in the State of New Jersey. Approximately 18% of the cumulative gross deficiency for years 1998 and prior stems from this increase.
The following table reconciles losses and loss expense reserves under SAP and GAAP at December 31, as follows:

(in thousands)	**2007**	2006
Statutory losses and loss expense reserves [(1)]	$ **2,312,086**	2,084,012
Provision for uncollectible reinsurance	**2,750**	2,700
Pension adjustment	**72**	2,619
Other	**(162)**	(299)
GAAP losses and loss expense reserve net	**2,314,746**	2,089,032
Reinsurance recoverable on unpaid losses and loss expenses	**227,801**	199,738
GAAP losses and loss expense reserves gross	$ **2,542,547**	2,288,770

(1) Statutory losses and loss expense reserves are presented net of reinsurance recoverable on unpaid losses and loss expenses.

Environmental Reserves

Reserves established for liability insurance include exposure to environmental claims, both asbestos and non-asbestos. Selective s exposure to environmental liability is primarily due to: (i) policies written prior to the introduction of the absolute pollutions endorsement in the mid-1980 s; and (ii) underground storage tank leaks, mostly from New Jersey homeowners policies in recent years. Selective s asbestos and non-asbestos environmental claims have arisen primarily from insured exposures in municipal government, small non-manufacturing commercial risks, and homeowners policies. The emergence of these claims is slow and highly unpredictable.

Asbestos claims are claims presented to Selective in which bodily injury is alleged to have occurred as a result of exposure to asbestos and/or asbestos-containing products. During the past two decades, the insurance industry has experienced the emergence and development of an increasing number of asbestos claims. At December 31, 2007, asbestos claims constituted 89% of Selective s 2,448 environmental claims compared with 88% of Selective s 2,575 outstanding environmental claims at December 31, 2006.

Non-asbestos claims are pollution and environmental claims alleging bodily injury or property damage presented, or expected to be presented to Selective, other than asbestos claims. These claims primarily include landfills and leaking underground storage tanks. In past years, landfill claims have accounted for a significant portion of Selective s environmental claim unit s litigation costs. Over the past few years, Selective has been experiencing adverse development in its homeowners line of business as a result of unfavorable trends in claims for groundwater contamination caused by leakage of certain underground heating oil storage tanks in New Jersey.

Selective refers all environmental claims to its centralized and specialized environmental claim unit. Environmental reserves are evaluated on a case-by-case basis. As cases progress, the ability to assess potential liability often improves. Reserves are then adjusted accordingly. In addition, each case is reviewed in light of other factors affecting liability, including judicial interpretation of coverage issues.

IBNR reserve estimation for environmental claims is difficult because, in addition to other factors, there are significant uncertainties associated with critical assumptions in the estimation process, such as average clean-up costs, third-party costs, potentially responsible party shares, allocation of damages, insurer litigation costs, insurer coverage defenses and potential changes to state and federal statutes. Moreover, normal historically-based actuarial approaches are difficult to apply because past environmental claims are not indicative of future potential environmental claims. In addition, while models can be applied, such models can produce significantly different results with small changes in assumptions. As a result, management does not calculate a specific environmental loss range. Historically, Selective s environmental claims have been significantly less volatile and uncertain than other competitors in the commercial lines industry. In part, this is due to the fact that Selective is the primary insurance carrier on the majority of its environmental exposures, thus providing more certainty in its reserve position compared to the insurance marketplace.

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Reinsurance

In the ordinary course of their business, the Insurance Subsidiaries reinsure a portion of the risks that they underwrite in order to control exposure to losses and protect capital resources. Reinsurance also permits the Insurance Subsidiaries additional underwriting capacity by permitting them to accept larger risks and underwrite a greater number of risks without a corresponding increase in capital or surplus. For a premium paid by the Insurance Subsidiaries, reinsurers assume a portion of the losses ceded by the Insurance Subsidiaries. Selective uses traditional forms of reinsurance and does not use finite risk reinsurance. Amounts not reinsured are known as retention. The Insurance Subsidiaries use two types of reinsurance to control exposure to losses:

Treaty reinsurance, in which certain types of policies are automatically reinsured without the need for approval by the reinsurer of the individual risks covered; and

Facultative reinsurance, in which an individual insurance policy or a specific risk is reinsured with the prior approval of the reinsurer. Facultative reinsurance is primarily used for policies with limits greater than the limits available under the reinsurance treaties.

In addition to treaty and facultative reinsurance, the Insurance Subsidiaries are partially protected by the Terrorism Risk Insurance Act of 2002, which was modified and extended through December 31, 2014 via the Terrorism Risk Insurance Program Reauthorization Act of 2007. For further information regarding this legislation, see Item 1A. Risk Factors of this Form 10-K.

Reinsurance does not legally discharge an insurer from its liability for the full-face amount of its policies, but it does make the reinsurer liable to the insurer to the extent of the reinsurance ceded. Reinsurance carries counterparty credit risk, which may be mitigated in certain cases by collateral such as letters of credit, trust funds, or funds withheld by the Insurance Subsidiaries. Selective attempts to mitigate the credit risk related to reinsurance by pursuing relationships with companies rated A- or higher in most circumstances and/or requiring collateral to secure reinsurance obligations. In addition, Selective employs procedures to continuously review the quality of reinsurance recoverables and reserve for uncollectible reinsurance. Selective also may take actions, such as commutations, in cases of potential reinsurer default. Some of the Insurance Subsidiaries reinsurance contracts include provisions that give Selective a contractual right to terminate and/or commute the reinsurers portion of the liabilities based on deterioration of the reinsurer s rating or financial condition.

Reinsurance recoverable balances tend to fluctuate based on the underlying losses incurred by the Insurance Subsidiaries. If a severe catastrophic event occurs, reinsurance recoverable balances may increase significantly. The reinsurance recoverable balances on paid and unpaid claims were 22% of stockholders equity at December 31, 2007 compared to 19% at December 31, 2006. These balances, net of available collateral, were 18% of stockholders equity at December 31, 2007 compared to 15% at December 31, 2006. Federal or state sponsored pools, which Selective believes to have minimal default risk, represented approximately 44% at December 31, 2007 and 50% at December 31, 2006 of the uncollateralized reinsurance recoverable on paid and unpaid balance. The following are the five largest individual uncollateralized reinsurance recoverables on paid and unpaid balances:

($ in thousands)	Ratings:	As of: 12/31/07		As of: 12/31/06	
Reinsurer Name	A.M. Best	Unsecured Recoverable on Paidand Unpaid	% of Total	Unsecured Recoverable on Paid and Unpaid	% of Total

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The table below summarizes the significant reinsurance treaties covering the Insurance Subsidiaries.

Treaty	Reinsurance Coverage	Terrorism Coverage
TRIA, Federal Statutory Program	See above for the description of TRIA. 85% of all TRIA certified losses above the retention. Selective s retention for 2008 is approximately $203 million. Current program covers both domestic and foreign terrorism. Terrorism acts related to the use of nuclear, biological, chemical or radioactive (NBCR) weapons are covered by TRIA provided that the Secretary of the Treasury certifies the event.	Current program is set to expire on December 31, 2014. For further information regarding this legislation and our risks concerning terrorism exposure, see Item 1A. Risk Factors of this Form 10-K.
Property Excess of Loss	$23 million above a $2 million retention in two layers. Losses other than TRIA certified losses are subject to the following reinstatements and annual aggregate limits: $8 million in excess of $2 million layer provides unlimited reinstatements, no annual aggregate limit; $15 million in excess of $10 million layer provides two reinstatements, $45 million in annual aggregate.	All NBCR losses are excluded regardless of whether or not they are certified under TRIA. For non-NBCR losses, the treaty distinguishes between acts certified under TRIA and those that are not. The treaty provides annual aggregate limits for TRIA certified (other than NBCR) acts of $24 million for the first layer and $22.5 million for the second layer. Non-certified terrorism losses (other than NBCR) are subject to the normal limits under the treaty.
Property Catastrophe Excess of Loss	95% of $310 million above $40 million retention in three layers: 95% of losses in excess of $40 million up to $100 million; 95% of losses in excess of $100 million up to $200 million; 95% of losses in excess of $200 million up to $350 million; and The treaty provides one reinstatement per layer, $589.0 million in annual aggregate limit, net of Selective s co-participation.	All nuclear, biological and chemical (NBC) losses are excluded regardless of whether or not they are certified under TRIA. TRIA losses related to foreign acts of terrorism are excluded from the treaty. Domestic terrorism is included regardless of whether it is certified under TRIA or not. Please see Item 1A. Risk Factors of this Form 10-K for further discussion regarding changes in TRIA.
Casualty Excess of Loss	Casualty Excess of Loss program is structured in two treaties: Workers compensation only working layer treaty and all inclusive Casualty treaty, which provides coverage for all casualty lines including Workers compensation. Workers compensation losses have per	All NBC losses are excluded. All other losses stemming from the acts of terrorism are subject to the following reinstatements and annual aggregate limits: Workers compensation only working

	occurrence coverage of $48 million in excess of $2 million retention and additional coverage of 75% of $40 million in excess of $50 million. All other casualty losses have per occurrence coverage of $45 million in excess of $5 million retention and additional coverage of 75% of $40 million in excess of $50 million. Losses other than TRIA certified losses are subject to the following reinstatements and annual aggregate limits: Workers compensation only working layer of $3 million in excess of $2 million layer provides five reinstatements, $18 million annual aggregate limit; Casualty treaty: $7 million in excess of $5 million layer provides three reinstatements, $28 million annual aggregate limit; $9 million in excess of $12 million layer provides two reinstatements, $27 million annual aggregate limit; $9 million in excess of $21 million layer provides one reinstatement, $18 million annual aggregate limit; and $20 million in excess of $30 million layer provides one reinstatement, $40 million annual aggregate limit. 75% of $40 million in excess of $50 million layer provides up to $30 million of coverage net of co-participation with one reinstatement, $60 million in net annual aggregate limit.	layer of $3 million in excess of $2 million layer provides two reinstatements for terrorism losses, $9 million annual aggregate limit; Casualty treaty: $7 million in excess of $5 million layer provides two reinstatements for terrorism losses, $21 million annual aggregate limit; $9 million in excess of $12 million layer provides two reinstatements for terrorism losses, $27 million annual aggregate limit; $9 million in excess of $21 million layer provides one reinstatement for terrorism losses, $18 million annual aggregate limit; $20 million in excess of $30 million layer provides one reinstatement for terrorism losses, $40 million annual aggregate limit; 75% of $40 million in excess of $50 million layer provides up to $30 million of coverage net of co-participation with one reinstatement for terrorism losses, $60 million in net annual aggregate limit; and
Flood	100% reinsurance by the federal government s National Flood Insurance Program Write Your Own program.	None.

Reinsurance Pooling Agreement

The Insurance Subsidiaries are parties to an inter-company reinsurance pooling agreement (Pooling Agreement). The purpose of the Pooling Agreement is to:

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

Prevent any Insurance Subsidiary from suffering undue loss;

Reduce administration expenses; and

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

Under the Pooling Agreement, all of the Insurance Subsidiaries mutually reinsure all insurance risks written by them pursuant to the respective percentage set forth opposite each Insurance Subsidiary s name on the table below:

Insurance Subsidiary	Respective Percentage
SICA	49.5%
SWIC	21.0%
SICSC	9.0%
SICSE	7.0%
SICNY	7.0%
SAICNJ	6.0%
SICNE	0.5%

Insurance Regulation

General

Insurance companies are subject to supervision and regulation in the states in which they are domiciled and transact business. Such supervision and regulation relates to a variety of aspects of an insurance company s business and financial condition. The primary public purpose of such supervision and regulation is to protect the insurer s policyholders, not the insurer s shareholders. The extent of regulation varies, and generally is derived from state statutes that delegate regulatory, supervisory, and administrative authority to state insurance departments. Although the insurance industry is primarily regulated by individual states, federal initiatives can have an impact on the industry, such as the federal government s enactment and extension of TRIA, the enforcement of economic and trade sanctions by the Office of Foreign Assets Control, and the proposal for an optional federal charter that would allow companies to choose between state regulation and national regulatory structure that would eliminate the need to comply with 51 sets of different regulations.

The Financial Services Modernization Act of 1999, also known as the Gramm-Leach-Bliley Act (GLB), and related regulations govern, among other things, the privacy of consumer financial information. GLB limits disclosure by financial institutions of nonpublic personal information about individuals who obtain financial products or services for personal, family, or household purposes. GLB generally applies to disclosures to non-affiliated third parties, but not to disclosures to affiliates. Many states in which Selective operates have adopted laws that are at least as restrictive as GLB. Privacy of consumer financial information is an evolving area of regulation requiring continued monitoring to ensure continued compliance with GLB.

Selective cannot quantify the financial impact it would incur to satisfy revised or additional regulatory requirements that may be imposed in the future.

State Regulation

The regulatory authority of state insurance departments extends to such matters as insurer solvency standards, insurer and agent licensing, investment restrictions, payment of dividends and distributions, provisions for current losses and future liabilities, deposit of securities for the benefit of policyholders, restrictions on policy terminations, unfair trade practices, and approval of premium rates and policy forms. State insurance departments also conduct periodic examinations of the financial and business affairs of insurers and require insurers to file annual and other periodic reports relating to their financial condition. Regulatory agencies require that premium rates not be excessive, inadequate, or unfairly discriminatory. The Insurance Subsidiaries, consequently, must file all rates for commercial and personal insurance with the insurance department of each state in which they operate.

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All states have enacted legislation that regulates insurance holding company systems. Each insurance company in a holding company system is required to register with certain insurance supervisory agencies and furnish information concerning the operations of companies within the holding company system that may materially affect the operations, management, or financial condition of the insurers. Pursuant to these laws, the respective departments may: (i) examine Selective and the Insurance Subsidiaries at any time; (ii) require disclosure or prior approval of material transactions of the Insurance Subsidiaries with any affiliate; and (iii) require prior approval or notice of certain transactions, such as dividends or distributions to Selective Insurance Group, Inc. (the Parent) from the Insurance Subsidiary domiciled in that state.

National Association of Insurance Commissioners (NAIC) Guidelines

The Insurance Subsidiaries are subject to statutory accounting principles and reporting formats established by the NAIC. The NAIC also promulgates model insurance laws and regulations relating to the financial and operational regulations of insurance companies, which includes the Insurance Regulatory Information System (IRIS). IRIS identifies 11 industry ratios and specifies usual values for each ratio. Departure from the usual values on four or more of the ratios can lead to inquiries from individual state insurance departments about certain aspects of the insurer s business. The Insurance Subsidiaries have consistently met the majority of the IRIS ratio tests.

NAIC model laws and regulations are not usually applicable unless enacted into law or promulgated into regulation by the individual states. The adoption of certain NAIC model laws and regulations is a key aspect of the NAIC Financial Regulations Standards and Accreditation Program, which also sets forth minimum staffing and resource levels for all state insurance departments. All of the Insurance Subsidiaries states of domicile, except New York, are accredited by the NAIC. Examinations conducted by, or along with, accredited states can be accepted by other states. The NAIC intends to create nationwide regulatory network of accredited states.

The NAIC model laws and regulations are also intended to enhance the regulation of insurer solvency. These model laws and regulations contain certain risk-based capital requirements for property and casualty insurance companies designed to assess capital adequacy and to raise the level of protection that statutory surplus provides for policyholders. Risk-based capital is measured by the four major areas of risk to which property and casualty insurers are exposed: (i) asset risk; (ii) credit risk; (iii) underwriting risk; and (iv) off-balance sheet risk. Insurers with total adjusted capital that is less than two times their Authorized Control Level, as calculated pursuant to the NAIC model laws and regulations, are subject to different levels of regulatory intervention and action. Based upon the unaudited 2007 statutory financial statements for the Insurance Subsidiaries, each Insurance Subsidiary s total adjusted capital substantially exceeded two times their Authorized Control Level.

Investments Segment

Selective s investment philosophy includes setting certain return and risk objectives for its equity and fixed maturity portfolios. The return objective of the equity portfolio is to meet or exceed a weighted-average benchmark of public equity indices. The primary return objective of the fixed maturity portfolio is to maximize after-tax investment yield and income while balancing certain risk objectives. The risk objectives for all portfolios are structured conservatively, focusing on: (i) asset diversification; (ii) investment quality; (iii) liquidity, particularly to meet the cash obligations of the insurance operations; (iv) consideration of taxes; and (v) preservation of capital. At December 31, 2007, Selective s investment portfolio consisted of $3,079.3 million (83%) of fixed maturity securities, $274.7 million (7%) of equity securities, $190.2 million (5%) of short-term investments, and $188.8 million (5%) of other investments.

Selective s fixed maturity portfolio is comprised primarily of highly rated securities, with almost 100% rated investment grade. The average rating of its fixed maturity securities is AA+ by Standard & Poor s (S&P), their second highest credit quality rating. Selective expects to continue to invest primarily in high quality, fixed maturity investments in order to reduce volatility of the portfolio and to maximize after-tax investment yield. For further information regarding Selective s interest rate sensitivity as well as other risks associated with its portfolio, see Item 7A. Quantitative and Qualitative Disclosures about Market Risk in this Form 10-K. The average duration of the fixed maturity portfolio, including short-term investments of $190.2 million at December 31, 2007 and $197.0 million at December 31, 2006, was 3.9 years at December 31, 2007 and 3.8 years at December 31, 2006.

Selective s Investments segment operations are based primarily in Parsippany, New Jersey, while certain segments of the portfolio are managed by external money managers. For additional information about investments, see the sections entitled, Investments, in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, and Item 8. Financial Statements and Supplementary Data, Note 4 to the consolidated financial statements.

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Diversified Insurance Services Segment

Selective s Diversified Insurance Services segment provides fee-based revenues that are expected to contribute to earnings, increase operating cash flow, and help mitigate potential volatility in insurance operating results. The Diversified Insurance Services segment is complementary to Selective s business model by sharing a common marketing or distribution system and creating new opportunities for independent agents to bring value-added services and products to their customers. In December 2005, Selective divested itself of its 100% ownership interest in CHN Solutions (Alta Services, LLC and Consumer Health Network Plus, LLC), which had historically been reported as part of the Managed Care component of the Diversified Insurance Services segment. For more information concerning the results of the Diversified Insurance Services segment for the last three fiscal years ended December 31, refer to Note 15, Discontinued Operations in Item 8. Financial Statements and Supplementary Data on this Form 10-K. The Diversified Insurance Services operation currently has two major components: (i) human resource administration outsourcing; and (ii) flood insurance.

Human Resource Administration Outsourcing

Human resource administration outsourcing (HR Outsourcing) products and services are sold by Selective HR Solutions, Inc. and its subsidiaries (Selective HR), which are headquartered in Sarasota, Florida. Selective HR s customers are small businesses who generally have existing relationships with independent insurance agents. Selective HR leverages these relationships by using independent insurance agents as its distribution channel for its products and services in the states where it operates. As a Professional Employer Organization (PEO), Selective HR enters into agreements with clients that establish a three-party relationship under which Selective HR and the client are co-employers of the employees who work at the client s location (worksite employees). As of December 31, 2007, Selective HR had approximately 25,111 worksite employees, 39% of which are from the state of Florida.

Flood Insurance

Selective is a servicing carrier in the Write-Your-Own (WYO) Program of the United States government s National Flood Insurance Program (NFIP). The WYO Program operates within the context of the NFIP, and is subject to its rules and regulations. The NFIP is administered by the Federal Emergency Management Agency (FEMA), which is part of the Department of Homeland Security. The WYO Program is a cooperative undertaking of the insurance industry and FEMA. The WYO Program allows participating property and casualty insurance companies to write and service the Standard Flood Insurance Policy in their own names, while ceding all of the premiums collected on these policies to the federal government. The companies receive an expense allowance, or servicing fee, for policies written and claims processed under the program, while the federal government retains responsibility for all underwriting losses. Selective is servicing approximately 299,000 flood policies under the NFIP through over 5,900 independent agents in 50 states and the District of Columbia.

Diversified Insurance Services Regulation

The companies within the Diversified Insurance Services segment are subject to certain laws and regulations. In particular, as a co-employer for some of its clients, Selective HR is subject to federal, state, and local laws and regulations relating to labor, tax, employment, employee benefits, and immigration matters. By contracting with its clients and creating a co-employer relationship with the worksite employees, Selective HR may be assuming certain contractual and legal obligations and responsibilities of an employer and could incur liability for violations of such laws and regulations, even if it was not actually responsible for the conduct giving rise to such liability. Some states in which Selective HR operates have already passed licensing or registration requirements for PEOs. These laws and regulations vary from state to state but generally provide for the monitoring of the fiscal responsibility of PEOs. Currently, many of these laws and regulations do not specifically address the obligations and responsibilities of co-employers. There can be no assurance that Selective HR will be able to satisfy new or revised laws and regulations.
The viability of the NFIP s reinsurance program under the WYO Program is an essential component of Selective s Diversified Insurance Services operations. In 2005, the destruction caused by the active hurricane season stressed the NFIP with excessive levels of flood losses. Selective continues to monitor developments with the NFIP regarding its ability to pay claims in the event of another large-scale disaster. Congress controls the federal agency s funding authority, which was exceeded after Hurricane Katrina, and is again nearing maximum capacity. Bills are pending in the House and Senate that could impact the NFIP. These bills contain substantial legislative changes and revisions to

the NFIP and WYO Program, some of which may be favorable and some of which may be unfavorable for Selective. For additional information regarding regulation of flood insurance see Item 1A. Risk Factors of this Form 10-K.

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Competition

Selective faces significant competition in both the Insurance Operations and Diversified Insurance Services segments. Property and casualty insurance is highly competitive on the basis of both price and service, and is extensively regulated by state insurance departments. In 2007, Selective was ranked as the 46th largest property and casualty group in the United States based on the 2006 NPW, by A.M. Best in its list, Top Property/Casualty Writers. The Insurance Operations compete with regional insurers, such as Cincinnati Financial and Harleysville, and national insurance companies, such as Travelers, The Hartford, and Zurich. Selective also competes against direct writers of insurance coverage, including insurance offered through competitors internet websites. These writers offer coverage primarily in personal lines, such as GEICO and Progressive. Many of these competitors have greater financial and operating resources than Selective. Many of them also have more customers, which provide them with more information regarding their risks and, with the use of statistical and computer models, may give them greater ability to make pricing and underwriting decisions. Purchasers of property and casualty insurance products do not always differentiate between insurance carriers and differences in coverage. The more significant competitive factors for most of Selective s insurance products are financial ratings, safety management, price, coverage terms, claims service, and technology. In addition, Selective also faces competition within each insurance agency that sells its insurance products as most of the agencies represent more than one insurance company.

With regard to the Diversified Insurance Services segment, according to the most recent published information, Selective HR was ranked as the 11th largest Professional Employer Organization in a Staffing Industry Report published by Staffing Industry Analysts, Inc., based on 2005 gross revenue. Based on 2006 information, Selective s Flood line of business is the 7th largest WYO carrier for the NFIP based on information obtained from Statutory Annual Statements.

Please refer to Item 1A. Risk Factors, of this Form 10-K for a discussion of the factors that could impact Selective s ability to compete.

Seasonality

Selective s insurance business experiences modest seasonality with regard to premiums written. Due to the general timing of commercial policy renewals, premiums written are usually highest in January and July and lowest during the fourth quarter of the year. Although the writing of insurance policies experiences modest seasonality, the premiums related to these policies are earned consistently over the period of coverage. Losses and loss expenses incurred tend to remain consistent throughout the year, unless a catastrophe occurs from man-made or weather-related events such as hail, tornadoes, windstorms, hurricanes, and nor easters.

Customers

No one customer or independent agency accounts for 10% or more of Selective s total revenue or the revenue of any one of its business segments.

Employees

At December 31, 2007, Selective had approximately 2,200 employees, of which 2,000 worked in the Insurance Operations and Investments segments and 200 worked in the Diversified Insurance Services segment.

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Executive Officers of the Registrant

The following table sets forth biographical information about Selective s Chief Executive Officer, Executive Officers, and senior management, as of February 28, 2008:

Name, Age, Title	Occupation And Background
Gregory E. Murphy, 52 Chairman, President, and Chief Executive Officer	Chairman, President, and Chief Executive Officer of Selective, present position since May 2000 President, Chief Executive Officer, and Director of Selective, May 1999 to May 2000 President, Chief Operating Officer, and Director of Selective, 1997 to May 1999 Other senior executive, management, and operational positions at Selective, since 1980 Director, Newton Memorial Hospital Foundation, Inc., since 1999 Director, Insurance Information Institute Trustee, the American Institute for CPCU (AICPCU) and the Insurance Institute of America (IIA), since June 2001 Graduate of Boston College (B.S. Accounting) Harvard University (Advanced Management Program) Certified Public Accountant (New Jersey) (Inactive)
Jamie Ochiltree III, 55 Senior Executive Vice President, Insurance Operations	Present position since February 2004 (scheduled retirement in March 2008) Variety of executive positions, Selective, 1994 February 2004 Miami University (B.A. Zoology) Wharton School (Advanced Management Program)
Richard F. Connell, 62 Senior Executive Vice President and Chief Administrative Officer	Present position since October 2007 Senior Executive Vice President and Chief Information Officer, August 2000 October 2007 Executive Vice President and Chief Information Officer, August 2000 January 2006 Central Connecticut State University (B.S. Marketing)
Kerry A. Guthrie, 50 Executive Vice President and Chief Investment Officer	Present position since February 2005 Senior Vice President and Chief Investment Officer, Selective, August 2002 February 2005 Variety of investment positions, Selective, 1987 2002 Chartered Financial Analyst Certified Public Accountant (New Jersey) (Inactive) Member, New York Society of Security Analysts Siena College (B.S. Accounting) Fairleigh Dickinson University (M.B.A. Finance)
Dale A. Thatcher, 46 Executive Vice President, Chief Financial Officer and Treasurer	Present position since February 2003 Senior Vice President, Chief Financial Officer and Treasurer, Selective, April 2000 February 2003 Certified Public Accountant (Ohio) (Inactive) Chartered Property and Casualty Underwriter

Chartered Life Underwriter
Member of the American Institute of Certified Public Accountants
Member of the Ohio Society of Certified Public Accountants
University of Cincinnati (B.B.A. Accounting; M.B.A., Finance)

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Name, Age, Title	**Occupation And Background**
Ronald J. Zaleski, 53 Executive Vice President and Chief Actuary	Present position since February 2003 Senior Vice President and Chief Actuary, Selective, February 2000 February 2003 Vice President and Chief Actuary, Selective, September 1999 February 2000 Fellow of Casualty Actuarial Society Member of the American Academy of Actuaries Loyola College (B.A. Mathematics)
Victor Daley, 64 Executive Vice President, Human Resources	Present position since September 2005 Executive Vice President, Chief Administrative, and Human Resources Officer for AmerUs Group, September 1995 October 2004 Providence College (B.S. Business Administration) Roosevelt University (M.P.A.) Harvard University (Advanced Management Program)
Sharon R. Cooper, 46 Senior Vice President, Chief Marketing and Communications Officer	Present position since October 2007. Vice President and Director of Communications, Selective, December 2000 October 2007 Director of Media Relations, Allstate Insurance, 1996 December 2000 Member, Society of Chartered Property and Casualty Underwriters University of Illinois (B.A. Broadcast Journalism) Seton Hall (M.A. Strategic Communications and Leadership)
Michael H. Lanza, 46 Executive Vice President, General Counsel, Corporate Secretary and Chief Compliance Officer	Present position since July 2004 Corporate advisor and legal consultant, April 2003 July 2004 Executive Vice President & Corporate Secretary, QuadraMed Corporation, a publicly-traded healthcare technology company, September 2000 March 2003 Member, Society of Corporate Secretaries and Corporate Governance Professionals University of Connecticut (B.A.) University of Connecticut School of Law (J.D.)
Mary T. Porter, 52 Executive Vice President, Chief Claims Officer	Present position since October 2007 Senior Vice President, Director of Corporate Claims, January 2007 - October 2007 Vice President, Group General Counsel, St. Paul Travelers, 1999 - 2006 Assistant Vice President, Group Counsel USF&G, St. Paul Companies, 1993 1999 Private law practice in Washington, D.C. and Maryland, 1980 1993 Long Island University, C.W. Post College, B.A, Political Science George Washington University, JD

Name, Age, Title	Occupation And Background
John J. Marchioni, 38 Executive Vice President, Chief Field Operations Officer	Present position since October 2007 Senior Vice President, Director of Personal Lines, August 2005 October 2007 Vice President, Mercantile & Service SBU, July 2004 August 2005 Vice President, Director of Government Affairs, August 2002 July 2004 Assistant Vice President, Government Affairs, August 2000 July 2002 Government Affairs Specialist, January 1998 July 2000 Chartered Property Casualty Underwriter (CPCU) Princeton University (B.A. History) Harvard University (Advanced Management Program)
Eduard J. Pulkstenis, 41 Executive Vice President, Chief Underwriting Officer	Present position since October 2007 Senior Vice President, Chief Commercial Lines Underwriting Officer, July 2004 October 2007 Vice President, Small Business, July 2003 July 2004 Vice President, Director of Actuarial Pricing, March 2000 July 2003 Managing Actuary, American International Group, October 1998 February 2000 Various Actuarial positions, Selective, June 1988 October 1998 Fellow of the Casualty Actuarial Society Member of the American Academy of Actuaries Member of the Society of Chartered Property Casualty Underwriters Messiah College (B.A. Mathematics)
Charles A. Musilli, III, 49 Senior Vice President, Northeast Region Manager and Agency Development	Present position since October 2007 Senior Vice President, Chief Field Operations and Marketing Officer, June 2004 October 2007 Senior Vice President, Selective Risk Managers, January 1997 June 2004 Other management and operational positions at Selective from 1981 1984 and 1989 1997 Member, Society of Chartered Property and Casualty Underwriters Rutgers University (B.A. Psychology)
Jeffrey F. Kamrowski, 43 Senior Vice President, Business Services	Present position since October 2007 Other management and operational positions at Selective, since 1988 Member, Society of Chartered Property and Casualty Underwriters Hartwick College (B.S. Computer Information Science)
Daniel Bravo, 44 Senior Vice President, Strategic Operations Group	Present position since October 2007 Senior Vice President of Knowledge Management (2005 October 2007) Vice President of Corporate Services Information Technology Services (2002 2005) Operations Manager, Liberty Mutual Insurance (2000 2002) Management Consultant for various consulting companies (1993 2000) Babson College, MBA

Harvard University Extension School, Special Studies in Management Certificate
University of the Basque Country (Spain), (B.S. Economics)

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Information regarding Selective s directors is included in the definitive Proxy Statement for the 2007 Annual Meeting of Stockholders to be held on April 24, 2008 in Information About Proposal 1, Election of Directors, and is also incorporated by reference into Part III of this Form 10-K.

Available Information

Selective files its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements, and other required information with the SEC. The public may read and copy any materials on file with the SEC at the SEC s Public Reference Room at 100 F Street N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site, www.sec.gov, that contains reports, proxy and information statements, and other information regarding issuers, including Selective, that file electronically with the SEC.

Selective has a website, www.selective.com, through which its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (Exchange Act) are available free of charge as soon as reasonably practicable after they are electronically filed with, or furnished to the SEC.

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Item 1A. Risk Factors

Certain risk factors exist that can have a significant impact on Selective s business, results of operations, and financial condition. The impact of these risk factors could also impact certain actions that Selective takes as part of its long-term capital strategy including, but not limited to, contributing capital to subsidiaries in its Insurance Operations and Diversified Insurance Services segments, issuing additional debt and/or equity securities, repurchasing shares of common stock (Common Stock), or increasing stockholders dividends. The following list of risk factors is not exhaustive and others may exist. Selective operates in a continually changing business environment, and new risk factors emerge from time to time. Consequently, Selective can neither predict such new risk factors nor assess the impact, if any, they might have on its business in the future.

Selective s reserves may not be adequate to cover actual losses and expenses.

Selective is required to maintain loss reserves for its estimated liability for losses and loss expenses associated with reported and unreported insurance claims for each accounting period. From time to time, Selective adjusts reserves and, if the reserves are inadequate, must increase its reserves. An increase in reserves: (i) reduces net income and stockholders equity for the period in which the deficiency in reserves is identified, and (ii) could have a material adverse effect on Selective s results of operations, liquidity, financial condition and financial strength, and debt ratings. Selective s estimates of reserve amounts are based on facts and circumstances of which it is aware, including its expectations of the ultimate settlement and claim administration expenses, predictions of future events, trends in claims severity and frequency, and other subjective factors. There is no method for precisely estimating the ultimate liability for settlement of claims. Selective regularly reviews its reserving techniques and its overall amount of reserves. For more information regarding reserves, see the section entitled Reserve for Losses and Loss Expenses in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-K. The Company also reviews:

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

Selective cannot be certain that the reserves it establishes are adequate or will be adequate in the future.

Selective is subject to a variety of operational risks which could have a material adverse impact on Selective s business results.

Selective relies on complex financial models which have been developed internally and by third parties to analyze historical loss costs and pricing, trends in claim severity and frequency, the occurrence of catastrophe losses, and investment performance. Flaws in these financial models and/or faulty assumptions used by these financial models could lead to increased losses and loss reserving. Examples of these various models are Risk Management Solutions, the ALGO risk tool, and predictive modeling.

Catastrophic events.

Results of property and casualty insurers are subject to weather and other conditions. While one year may be relatively free of major weather occurrences or other disasters, another year may have numerous such events, causing results to be materially worse than other years. Selective s Insurance Subsidiaries have experienced catastrophe losses and the Company expects them to experience such losses in the future.

Various natural and man-made events can cause catastrophes, including, but not limited to, hurricanes, tornadoes, windstorms, earthquakes, hail, terrorism, explosions, severe winter weather, and fires, some of which may be related to climate changes. The frequency and severity of these catastrophes are inherently unpredictable. The extent of losses from a catastrophe is determined by the severity of the event and the total amount of insured exposures in the area affected by the event. Although catastrophes can cause losses in a variety of property and casualty lines, most of the catastrophe-related claims of Selective s Insurance Subsidiaries historically have been related to commercial property and homeowners coverages. Selective s property and casualty insurance business is concentrated geographically in the Eastern and Midwestern regions of the United States. New Jersey accounts for 30% of the Company s total net premiums written.

Selective s Insurance Subsidiaries seek to reduce their exposure to catastrophe losses through the purchase of catastrophe reinsurance. Reinsurance, however, may prove inadequate if:

The modeling software used to analyze the Insurance Subsidiaries risk proves inadequate;

A major catastrophic loss exceeds the reinsurance limit or the reinsurers financial capacity; or

The frequency of catastrophe losses result in the Insurance Subsidiaries exceeding their one reinstatement.

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The property and casualty insurance industry is cyclical.

Historically, the results of the property and casualty insurance industry have experienced significant fluctuations due to economic conditions, interest rates, and other factors, such as, competition. For example, the competitors pricing business below technical levels could force the Company to reduce its profit margin in order to protect its best business. Selective has experienced the following fluctuations in Commercial Lines premium pricing, excluding exposure (pure price), over the past several years:

- During 2007, pure price on Commercial Lines renewal business decreased 3.9%;
- During 2006, pure price on Commercial Lines renewal business decreased 1.7%;
- During 2005, pure price on Commercial Lines renewal business remained flat compared to 2004;
- From 2001 2004, pure price on Commercial Lines renewal business was increasing in a range from 4.3% to 12.6%; and
- For several years prior to 2001, Selective experienced decreases in pure price in our Commercial Lines operations.

As an example of pricing and loss trends on the combined ratio, taking a pure price decline of 1.4% and removing the expense that directly varies with premium volume yields an adverse combined ratio impact of approximately 1 point, in addition to a claims inflation increase of 3%, will cause the loss and loss adjustment expense ratio to increase approximately 2 points, all else remaining equal. The combination of claims inflation and price decreases could raise the combined ratio approximately 3 points in this example, absent any initiatives targeted to address these trends.

The industry s profitability also is affected by unpredictable developments, including:

- Natural and man-made disasters;
- Fluctuations in interest rates and other changes in the investment environment that affect investment returns;
- Inflationary pressures (medical and economic) that affect the size of losses;
- Judicial, regulatory, legislative, and legal decisions that affect insurers liabilities;
- Changes in the frequency and severity of losses;
- Pricing and availability of reinsurance in the marketplace; and
- Weather-related impacts due to the effects of climate changes.

Selective competes with regional and national property and casualty insurance companies, including public and mutual companies, some of which do not use independent agents and write directly with insureds. Many of these competitors are larger than Selective and have greater financial and operating resources, as well as greater information scale. The Internet has also emerged as a significant place of new competition, both from existing competitors and from new competitors. A new form of competition may enter the marketplace as reinsurers may attempt to diversify their insurance risk by writing business in the primary marketplace. Because Selective sells its coverages through independent insurance agents who also are agents of its competitors, the Company faces competition within each of its appointed independent insurance agencies.

Selective also faces competition, primarily in the commercial insurance market, from entities that self-insure their own risks. Many of Selective s customers and potential customers are examining the benefits and risks of self-insuring as an alternative to traditional insurance.

New competition from these developments could cause the supply or demand for insurance to change, which could adversely affect Selective s results of operations and financial condition.

General economic conditions can adversely affect Selective s business results and prospects.

Changes in general economic conditions can impact Selective s business. For example, Selective s contractor business represents 45% of its insurance operations segment and is significantly impacted by changes in general economic conditions, including the downturn in the U.S. housing market. Other economic conditions impacting Selective s business include, but, are not limited to, recessions; increases in corporate, municipal and/or consumer bankruptcies; changes in interest rate levels; a continued downturn in the U.S. housing market; changes in domestic and international laws, including tax laws and bankruptcy laws; intervention by governments in financial markets, including the imposition of limits on the ability of mortgagees to foreclose on defaulted mortgage loans; wars; and terrorist acts could adversely affect the performance of the Company s insured and investment portfolios, possibly leading to increases in losses and loss reserves in the insured portfolio and decreases in the value of the investment portfolio and, therefore, the Company s financial strength.

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Acts of terrorism not covered by, or exceeding, reinsurance limits.

On November 26, 2002, the Terrorism Risk Insurance Act of 2002 legislation was signed into law. This legislation was amended in December 2005 and extended through December 31, 2007 through the Terrorism Risk Insurance Extension Act of 2005 (collectively, these two acts will be referred to as TRIA). On December 18, 2007, TRIA was extended for seven more years until December 31, 2014. This revised legislation ends the distinction between foreign and domestic acts of terrorism without increasing the level of damages necessary to trigger the program ($100 million). This seven year period will provide the market with much-needed stability. TRIA requires sharing the risk of future losses from terrorism between private insurers and the federal government, and is applicable to almost all commercial lines of insurance. Insurance companies with direct commercial insurance exposure in the United States are required to participate in this program. TRIA rescinded all previously approved exclusions for terrorism. Policyholders for non-workers compensation policies have the option to accept or decline the terrorism coverage Selective offers in its policies, or negotiate other terms. In 2007, approximately 90% of Selective s commercial non-workers compensation policyholders purchased terrorism coverage. The terrorism coverage is mandatory for all workers compensation primary policies. In addition, 48%, or ten of the twenty-one primary states in which Selective writes commercial property coverage mandate the coverage of fire following an act of terrorism. These provisions apply to new policies written after enactment of TRIA. A terrorism act must be certified by the Secretary of Treasury in order to be covered by TRIA. Each participating insurance company will be responsible for paying out a certain amount in claims (a deductible) before federal assistance becomes available. This deductible, which is equal to approximately $200 million in 2008, is based on a percentage of commercial lines direct earned premiums for lines subject to TRIA from the prior calendar year. For losses above an insurer s deductible, the federal government will cover 85%, while the insurer contributes 15%. Although the provisions of TRIA will serve to mitigate Selective s exposure in the event of a large-scale terrorist attack, the Company s deductible is substantial.

Selective s investments support its operations and provide a significant portion of its revenues and earnings.

Like many other property and casualty insurance companies, Selective depends on income from its investment portfolio for a significant portion of its revenues and earnings. Any significant decline in the Company s investment income as a result of falling interest rates, decreased dividend payment rates, reduced returns in the Company s other investment portfolio, primarily from alternative investments, or general market conditions would have an adverse effect on its results. Fluctuations in interest rates cause inverse fluctuations in the market value of the Company s debt portfolio. In addition, issuers of debt which the Company holds in its investment portfolio may default in its financial obligations as a result of insolvency, lack of liquidity, operational failure or other reasons. Any significant decline in the market value of its investments, excluding its held-to-maturity investments, would reduce the Company s stockholders equity. A significant decline in the market value of its equity and other investments would also reduce its policyholders surplus, which could impact the Company s ability to write additional premiums. In addition, Selective s notes payable are subject to certain debt-to-capitalization restrictions, which could also be impacted by a significant decline in investment values. For more information see Item 7A. Quantitative and Qualitative Disclosures About Market Risk in this Form 10-K.

Changes in tax laws impacting marginal tax rates and/or the preferred tax treatment of municipal obligations could adversely impact Selective s business.

Tax legislation which imposes a flat tax or otherwise changes the tax preference of municipal obligations under current law could adversely affect the market value of municipal obligations. Forty-one percent of the Company s investment portfolio is invested in tax-exempt municipal obligations; as such, the value of the investment portfolio could be adversely affected by any such legislation. Additionally, any such changes in tax law could reduce the difference between tax-exempt interest rates and taxable rates.

Selective may be adversely impacted by a change in its ratings.

Insurance companies are subject to financial strength ratings produced by external rating agencies, based upon factors relevant to policyholders. Ratings are not recommendations to buy, hold, or sell any of Selective s securities. Higher ratings generally indicate financial stability and a strong ability to pay claims. A significant downgrade in ratings, from A.M. Best in particular, could: (i) affect Selective s ability to write new business with customers, some of whom are required (under various third party agreements) to maintain insurance with a carrier that maintains a specified minimum rating; (ii) be an event of default under Selective s line of credit; or (iii) make it more expensive for Selective to access capital markets.

Selective is a holding company, and its subsidiaries may have a limited ability to declare dividends, and thus may not have access to the cash that is needed to meet its cash needs.

Substantially all of Selective s operations are conducted through its subsidiaries. Restrictions on the ability of the Company s subsidiaries, particularly the Insurance Subsidiaries, to pay dividends or make other cash payments to the Parent may materially affect its ability to pay principal and interest on its indebtedness and dividends on its Common Stock.

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Under the terms of Selective s debt agreements and financial solvency laws affecting insurers, the Company s subsidiaries are permitted to incur indebtedness up to certain levels that may restrict or prohibit the making of distributions, the payment of dividends, or the making of loans by the subsidiaries to the Parent. The Company cannot assure that the agreements governing the current and future indebtedness of its subsidiaries will permit such subsidiaries to provide the Parent with sufficient dividends, distributions, or loans to fund its cash needs. Sources of funds for the Insurance Subsidiaries primarily consist of premiums, investment income, and proceeds from sales and redemption of investments. Such funds are applied primarily to payment of claims, insurance operating expenses, income taxes and the purchase of investments, as well as dividends and other payments.

The Insurance Subsidiaries may declare and pay dividends to the Parent only if they are permitted to do so under the insurance regulations of their respective state of domicile. All of the states in which the Insurance Subsidiaries are domiciled regulate the payment of dividends. Some states, including New Jersey, North Carolina, and South Carolina, require that Selective give notice to the relevant state insurance commissioner prior to its Insurance Subsidiary domiciled in that respective state declaring any dividends and distributions payable to the Parent. During the notice period, the state insurance commissioner may disallow all or part of the proposed dividend upon determination that: (i) the insurer s surplus is not reasonable in relation to its liabilities and adequate to its financial needs and those of the policyholders, or (ii) in the case of New Jersey, the insurer is otherwise in a hazardous financial condition. In addition, insurance regulators may block dividends or other payments to affiliates that would otherwise be permitted without prior approval upon determination that, because of the financial condition of the insurance subsidiary or otherwise, payment of a dividend or any other payment to an affiliate would be detrimental to an insurance subsidiary s policyholders or creditors. Selective s Selective HR subsidiary may also declare and pay dividends, which are restricted by the operating needs of this entity as well as a professional employer organization licensing requirements to maintain a current ratio of at least 1:1.

Selective depends on independent insurance agents and other third party service providers.

Selective markets and sells its insurance products through independent, non-exclusive insurance agencies and brokers. Agents and brokers are not obligated to promote Selective s insurance products, and they may also sell the insurance products of the Company s competitors. As a result, Selective s business depends in part on the marketing and sales efforts of these agencies and brokers. As Selective diversifies and expands its business geographically, it may need to expand its network of agencies and brokers to successfully market its products. If these agencies and brokers fail to market Selective s products successfully, its business may be adversely impacted. Also, independent agents may decide to sell their businesses to banks, other insurance agencies, or other businesses. Agents with a Selective appointment may decide to buy other agents. Changes in ownership of agencies or expansion of agencies through acquisition could adversely affect an agency s ability to control growth and profitability, thereby adversely affecting Selective s business.

In addition to independent insurance agents, Selective also relies on third party service providers to conduct a portion of its premium audits, safety management services, and claims adjusting services. Selective s HR Outsourcing business relies on third party service providers for products such as health coverage, flexible spending accounts, and 401(k) savings plans. If these third-party service providers fail to perform their respective services and/or fail to provide their products successfully and/or accurately, Selective s business may be adversely impacted.

Selective is heavily regulated in the states in which it operates.

Selective is subject to extensive supervision and regulation in the states in which the Insurance Subsidiaries transact insurance business. The primary purpose of insurance regulation is to protect individual policyholders and not shareholders or other investors. Selective s business can be adversely affected by regulations affecting property and casualty insurance companies. For example, laws and regulations can lead to mandated reductions in rates to levels that Selective does not believe are adequate for the risks it insures. Other laws and regulations limit the Company s ability to cancel or refuse to renew certain policies and require Selective to offer coverage to all consumers. Changes in laws and regulations, or their interpretations, pertaining to insurance may also have an impact on Selective s business. Selective s concentration of business may expose the Company to increased risks of regulatory matters in the states in which the Insurance Subsidiaries write insurance that could be greater than the risks the Company could be exposed to by transacting business in a greater number of geographic markets.

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Although the insurance industry is primarily regulated by individual states, federal initiatives, such as, the National Flood Insurance Program, the optional federal charter, and the Office of Foreign Assets Control, can also impact the insurance industry. Proposals intended to control the cost and availability of healthcare services have been debated in the U.S. Congress and state legislatures. Although Selective neither writes health insurance nor assumes any healthcare risk, rules affecting healthcare services can affect workers compensation, commercial and personal automobile, liability, and other insurance that it does write. Selective cannot determine whether, or in what form, healthcare reform legislation may be adopted by the U.S. Congress or any state legislature. Selective also cannot determine the nature and effect, if any, that the adoption of healthcare legislation or regulations, or changing interpretations, at the federal or state level would have on it.

Examples of insurance regulatory risks include:

Automobile Insurance Regulation

In 1998, New Jersey instituted an Urban Enterprise Zone (UEZ) Program, which requires New Jersey auto insurers to have a market share in certain urban territories that is in proportion to their statewide market share. Due to mandated urban rate caps, the premiums on these UEZ policies are typically insufficient to cover losses. Although the law that imposed these urban rate caps was repealed in 1998, the caps continue to be enforced by the New Jersey Department of Banking and Insurance (NJDOBI).

From time to time, legislative proposals are passed and judicial decisions are rendered related to automobile insurance regulation that could adversely affect Selective s results of operations. For example, in 2005 a New Jersey Supreme Court decision eliminated the application of the serious life impact standard to personal automobile bodily injury liability cases under the verbal tort threshold of New Jersey s Automobile Insurance Cost Reduction Act (AICRA). This decision allows claimants to file lawsuits for non-economic damages without proving that the injuries sustained had a serious impact on their lives.

Workers Compensation Insurance Regulation

Because Selective voluntarily writes workers compensation insurance, it is required by state law to support the involuntary market. Insurance companies that underwrite voluntary workers compensation insurance can either directly write involuntary coverage, which is assigned by state regulatory authorities, or participate in a sharing arrangement, where the business is written by a servicing carrier and the profits or losses of that serviced business are shared among the participating insurers. Selective currently participates through a sharing arrangement in all states, except New Jersey, where it currently writes involuntary coverage directly. Historically, workers compensation business has been unprofitable whether written directly or handled through a sharing arrangement. Additionally, Selective is required to provide workers compensation benefits for losses arising from acts of terrorism under its workers compensation policies. The impact of any terrorist act is unpredictable, and the ultimate impact on Selective will depend upon the nature, extent, location, and timing of such an act. Any such impact on Selective could be material.

Homeowners Insurance Regulation

Selective is subject to regulatory provisions that are designed to address potential availability and/or affordability problems in the homeowners property insurance marketplace. Involuntary market mechanisms, such as the New Jersey Insurance Underwriting Association (New Jersey FAIR Plan), generally result in assessments against the Insurance Subsidiaries. The New Jersey FAIR Plan writes fire and extended coverage on homeowners for those individuals unable to secure insurance elsewhere. Insurance companies who voluntarily write homeowners insurance in New Jersey are assessed a portion of any deficit from the New Jersey FAIR Plan based on their share of the voluntary market. Similar involuntary plans exist in most other states where Selective operates.

Certain coastal states have instituted, or are considering adopting, legislation or regulation to maintain or increase the availability of property insurance, particularly homeowners insurance, in those states. For example, in 2002 Florida combined its two high-risk insurance pools, the Windstorm and Joint Underwriting Association, to create Florida Citizens Property Insurance Corporation (CPIC). CPIC is a state-regulated association and historically has provided property insurance to policyholders unable to obtain coverage in the private insurance market. However, CPIC has evolved from market of last resort to become the state s largest property insurer. In May 2007, a new insurance law passed in Florida expanding the role of CPIC and making its rates more competitive with the private market. Florida homeowners can now purchase coverage from CPIC if the rates for a policy from a private insurer are more than 15% higher than from a similar CPIC policy. CPIC can now also offer high-risk policyholders homeowners insurance as well as wind-only coverage in other parts of the state, which is driving homeowners rates down in the private market. In addition, effective January 1, 2008, an insurer writing homeowners insurance in another state, but not in Florida, may not continue to write private passenger automobile insurance in Florida unless such insurer is affiliated with an insurer writing homeowners insurance in Florida. At this time, none of Selective s Insurance Subsidiaries write private passenger automobile insurance in Florida.

Certain other coastal states, including certain states in which Selective s Insurance Subsidiaries transact homeowners insurance business, are considering legislation requiring that insurers that write homeowners insurance in any geographic area of a state must write homeowners insurance in all geographic areas of that state. Selective cannot predict whether any such legislation or regulation will be enacted, and the ultimate impact on Selective will depend upon the specifics of the legislation or regulation and the state or states that adopt any such legislation or regulation.

Credit Scoring Regulation

Selective uses certain aspects of credit scores when evaluating individual risks. In June 2007 the United States Supreme Court interpreted the Fair Credit Reporting Act (FCRA) concerning the meaning of the term adverse action as it relates to an insurance carrier s use of credit scoring when it quotes premium for a personal lines applicant or raises premium for an existing personal lines insured. This interpretation requires insurance carriers to notify policyholders and applicants when their credit reports are the basis for adverse action, such as a rate increase. An adverse action notification, according to the interpretation, would be required if a quoted rate is higher than it would have been in a credit neutral comparison, which compares the credit score-based rate against a credit score neutral rate. The interpretation does not require an insurance carrier to inform all policyholders that their credit reports have been reviewed in the underwriting process or that the rate they have received is higher than the best possible rate of the carrier.

In 2007, 31 states introduced 83 bills seeking to limit or completely restrict the use of credit scores on individuals. In addition, the Federal Trade Commission produced a report in late 2007 stating the use of credit scores is an accurate predictor of risk and is not prejudicial to minority groups. Congress is expected to continue investigating this issue and many state legislatures and agencies will continue to monitor the impact credit scoring has on the insurance marketplace.

Changes to regulation regarding the use of credit scores may impact the way in which the Company prices business and/or notifies policyholders or applicants of adverse actions resulting from the use of these score.

Flood Insurance Regulation

The federal government s NFIP program currently covers flooding caused by storm surge where water is pushed toward the shore by the force of the winds swirling around a storm. If this federal program is modified in an unfavorable manner, whereby flooding related to storm surge is no longer covered or is required to be covered by homeowners policies, such modification could have a material adverse effect on Selective s Flood and/or Homeowners results. Legislation exists that may force policies to cover claims related to windstorm damage and could lower the fee paid by the NFIP to the servicing carrier. The current repayment of claims by the NFIP could also be restricted, with the current authorization expected to last only to 2009.

Regulation and Legislation of Agent Compensation

Selective s Insurance Subsidiaries sell insurance products and services primarily through appointed independent insurance agents. Accordingly, Selective seeks to compensate its agents consistent with market practices and pay commissions and other consideration for business agents place with Selective s Insurance Subsidiaries. Selective discloses its compensation practices in notices to all policyholders and on Selective s public website, while referring all specific questions about agent compensation to the agent that placed the business with Selective.

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Because Selective s agents also generally represent several of Selective s competitors, Selective s primary marketing strategy is to:

Develop close relationships with each agent by: (i) soliciting their feedback on products and services, (ii) advising them concerning company developments, and (iii) investing significant time with them professionally and socially; and,

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

At present, Selective believes its agent compensation practices and disclosures meet current legal and regulatory requirements. Over the last two years, however, certain state attorneys general have investigated, and continue to investigate, various alleged anticompetitive practices engaged in by several insurance brokers and national insurance companies that compete with Selective. Some of these investigations, mainly related to insureds that are much larger than Selective s target customers, have resulted in consent orders under which brokers and several of Selective s competitors have left uncontested the attorneys general s allegations that some of their compensation arrangements may have caused certain brokers to clandestinely steer clients to specific insurers without sufficient disclosure to the client. The consent orders also have, to one degree or another, banned the use of such compensation arrangements by the offending brokers and insurers in several, but not all, lines of business.

Given the regulatory scrutiny of compensation arrangements with brokers to date, it is possible that compensation arrangements between insurers and independent agents will come under further review and will be the subject of public policy debate and possible legislative reform. Selective monitors these developments but cannot determine the nature or effect, if any, that such a public policy debate or possible legislative reform will have on its agent compensation practices or business.

Reinsurance Regulation

Florida, a state in which Selective does not write homeowners insurance, recently passed legislation (i) changing the funding and operation of the Florida state-sponsored insurer of last resort, Citizens Property Insurance Corporation, and the Florida Hurricane Catastrophe Fund (FHCF), which is the Florida state-sponsored reinsurance facility, and (ii) prohibiting residential property insurers from including in rate calculations the additional costs of private reinsurance or loss exposure that duplicates FHCF coverage. In the short-term, such legislative action may increase overall private property reinsurance availability and reduce its costs outside of Florida. Should other states in which Selective writes business enact similar legislation, it is possible that Selective may not be able to include the costs of reinsurance that it deems appropriate in its rates. In such an event, Selective may be forced, if permitted under applicable law, to exit certain markets. If not permitted to exit such markets, Selective may face unfair competitive situations, where state-sponsored insurers implement rate freezes or decreases.

Selective s ability to reduce its exposure to risks depends on the availability and cost of reinsurance.

Selective transfers its risk exposure to other insurance and reinsurance companies through reinsurance arrangements. Through these arrangements, another insurer assumes a specified portion of the Company s losses and loss adjustment expenses in exchange for a specified portion of the insurance policy premiums. The availability, amount, and cost of reinsurance depend on market conditions, which may vary significantly. Any decrease in the amount of Selective s reinsurance will increase its risk of loss.

Selective also faces credit risk with respect to reinsurance. In addition, reinsurers which the Company has contracted with may default in their financial obligations as a result of insolvency, lack of liquidity, operational failure or other reasons. The inability of any of the Company s reinsurers to meet their financial obligations could materially and adversely affect Selective s operations, as the Company remains primarily liable to its customers under the policies that it has reinsured.

Class action litigation could affect Selective s business practices and financial results.

Selective s industries have been the target of class action litigation in areas including the following:

After-market crash parts;

Urban homeowner underwriting practices;

Credit scoring and predictive modeling pricing;

Investment disclosure;

Health maintenance organization practices;

Discounting and payment of personal injury protection claims; and

Shareholder class action suits.

A change in Selective s market share in New Jersey could adversely impact the results of its private passenger automobile business.

New Jersey insurance regulations require New Jersey auto insurers to involuntarily write private passenger automobile insurance for individuals who are unable to obtain insurance in the voluntary market. These policies are priced according to a separate rating scheme that is established by the assigned risk plan and subject to approval by NJDOBI. The amount of involuntary insurance an insurer must write in New Jersey depends on the insurer s statewide market share the greater the market share, the more involuntary coverage the insurer is required to write. The underwriting of involuntary personal automobile insurance in New Jersey has been historically unprofitable. In addition to the assigned risk plan in New Jersey, there are ongoing attempts to address rate disparities between different geographic regions in the state, as well as judicial attempts to address limitations of lawsuits.

Selective depends on key personnel.

To a large extent, the success of Selective s businesses is dependent on its ability to attract and retain key employees, in particular its senior officers, key management, sales, information systems, underwriting, claims, HR Outsourcing, and corporate personnel. Competition to attract and retain key personnel is intense. While Selective has employment agreements with a number of key managers, the Company generally does not have employment contracts with its employees and cannot ensure that it will be able to attract and retain key personnel. In addition, Selective s workforce is older, with an average age of 47. Approximately 25% of Selective s workforce is retirement eligible under Selective s retirement and benefit plans.

Selective faces risks from technology-related failures.

Selective s businesses are increasingly dependent on computer and Internet-enabled technology. The Company s inability to anticipate or manage problems with technology associated with scalability, security, functionality, or reliability could adversely affect its ability to write business and service accounts, and could adversely impact its results of operations and financial condition.

Selective faces risks as a servicing carrier in the Write-Your-Own (WYO) Program of the United States government s National Flood Insurance Program (NFIP).

Flood insurance is offered through the NFIP, which is managed by the Mitigation Division of FEMA under the U.S. Department of Homeland Security. In 2005, the destruction caused by the active hurricane season stressed the NFIP with flood losses currently estimated by FEMA to be in excess of $20 billion. Selective continues to monitor developments with the NFIP regarding its ability to pay claims in the event of another large-scale disaster. Congress controls the federal agency s funding authority and future limitations in this funding could occur.

Effective October 1, 2006, the fee paid to Selective by the NFIP decreased 0.6 points to 30.2% of premiums written. This fee structure is still in place as of December 31, 2007. However, during 2008, the NFIP is expected to further decrease the fee 0.5 points to 29.7%. Further reductions in this rate could occur through legislative activity.

The current program is also being reevaluated to include a cap on claim fees paid by the NFIP. While the final outcome of this legislation is unknown, this cap could impact the ultimate claim fee the Company could receive in the event that there is a large catastrophe in an area in which Selective is geographically concentrated.

Selective faces risks in the HR Outsourcing business.

Selective HR s operations are affected by numerous federal and state laws and regulations relating to employment matters, benefits plans, and taxes. In performing services for its clients, Selective HR assumes some obligations of an employer under these laws and regulations. Regulation in the HR Outsourcing business is constantly evolving, which could result in the modification of laws and regulations from time to time. Selective cannot predict what additional government initiatives, if any, affecting Selective HR s business may be promulgated in the future. Consequently, the Company also cannot predict whether Selective HR will be able to adapt to new or modified regulatory requirements or obtain necessary licenses and government approvals.

Selective is subject to the compliance requirements of the federal securities laws.

Selective is subject to extensive regulation under the federal securities laws as a registrant under the Securities Exchange Act of 1934, as amended. In the event Selective was unable to comply with the federal securities laws, the Company would likely be unable to access the public capital markets, which would make it more difficult to raise necessary capital and/or increase the cost of capital. If Selective cannot obtain adequate capital on favorable terms or at all, the business, operating results and financial condition would be adversely affected.

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Selective employs anti-takeover measures that may discourage potential acquirers and could adversely affect the value of its Common Stock.

Selective owns all of the shares of stock of its Insurance Subsidiaries domiciled in the states of New Jersey, New York, North Carolina, South Carolina, and Maine. State insurance laws require prior approval by state insurance departments of any acquisition or control of a domestic insurance company or of any company that controls a domestic insurance company. Any purchase of 10% or more of Selective s outstanding Common Stock would require prior action by all or some of the insurance commissioners of these states.

Other factors also may discourage, delay, or prevent a change of control of Selective, including, among others, provisions in the Company s certificate of incorporation (as amended), relating to:

- Supermajority voting and fair price to Selective s business combinations;
- Staggered terms for Selective s directors;
- Supermajority voting requirements to amend the foregoing provisions;
- Selective s stockholders rights plan; and
- The ability of Selective s board of directors to issue blank check preferred stock.

The New Jersey Shareholders Protection Act provides that Selective, as a New Jersey corporation, may not engage in business combinations specified in the statute with a shareholder having indirect or direct beneficial ownership of 10% or more of the voting power of Selective s outstanding stock (an interested shareholder) for a period of five years following the date on which the shareholder became an interested shareholder, unless the business combination is approved by the board of directors of the corporation before the date the shareholder became an interested shareholder. In addition, Selective may not engage at any time in any business combination with any interested shareholder other than: (i) a business combination approved by Selective s board of directors prior to the shareholder becoming an interested shareholder; (ii) a business combination approved by two-thirds of Selective s shareholders (other than the interested shareholder); or (iii) a business combination that satisfies certain price criteria. These provisions also could have the effect of depriving Selective stockholders of an opportunity to receive a premium over the prevailing market price if a hostile takeover were attempted and may adversely affect the value of Selective s Common Stock.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties.

Selective s main office is located in Branchville, New Jersey, on a site owned by a subsidiary with approximately 114 acres and 315,000 square feet of operational space. Selective leases all of its other facilities. The principal office locations related to Selective s three business segments are described in the Field Strategy, Investments Segment, and Human Resource Administration Outsourcing sections of Item 1. Business. Selective believes its facilities provide adequate space for its present needs and that additional space, if needed, would be available on reasonable terms.

Item 3. Legal Proceedings.

In the ordinary course of conducting business, Selective and its subsidiaries are named as defendants in various legal proceedings. Most of these proceedings are claims litigation involving the Insurance Subsidiaries as either: (a) liability insurers defending or providing indemnity for third-party claims brought against insureds or (b) insurers defending first-party coverage claims brought against them. Selective accounts for such activity through the establishment of unpaid loss and loss adjustment expense reserves. Selective s management expects 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 Selective s consolidated financial condition, results of operations, or cash flows.

From time-to-time, the Insurance Subsidiaries are also involved 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. The Insurance Subsidiaries are also from time-to-time involved 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. Selective believes that it has valid defenses to these cases. Selective s management expects that the ultimate liability, if any, with respect to such lawsuits, after consideration of provisions made for estimated losses, will not be material to Selective s 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 Selective s consolidated results of operations or cash flows in particular quarterly or annual periods.

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

No matters were submitted to a vote of security holders, through the solicitation of proxies or otherwise, during the fourth quarter of 2007.

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PART II

Item 5. Market For Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

(a) Market Information

Selective s Common Stock is traded on the NASDAQ Global Select Market under the symbol SIGI. The following table sets forth the high and low sales prices, as reported on the NASDAQ Global Select Market, for Selective s Common Stock for each full quarterly period within the two most recent fiscal years:

		2007		2006	
		High	**Low**	High	Low
First Quarter	$	**29.07**	**23.25**	29.18	26.10
Second Quarter		**27.87**	**25.27**	28.23	25.38
Third Quarter		**27.33**	**19.04**	28.02	24.89
Fourth Quarter		**25.41**	**20.84**	29.10	25.95

On February 22, 2008, the closing price of Selective as reported on the NASDAQ Global Select Market was $24.40.

(b) Holders

As of February 15, 2008, there were approximately 2,651 holders of record of Selective s Common Stock, including beneficial holders whose securities were held in the name of the registered clearing agency or its nominee.

(c) Dividends

Dividends on shares of Selective s Common Stock are declared and paid at the discretion of the Board of Directors based on Selective s operating results, financial condition, capital requirements, contractual restrictions, and other relevant factors. The following table provides information on the dividends declared for each quarterly period within Selective s two most recent fiscal years:

Dividend per share		**2007**		2006
First Quarter	$	**0.12**	**$**	0.11
Second Quarter		**0.12**		0.11
Third Quarter		**0.12**		0.11
Fourth Quarter		**0.13**		0.11

Selective s ability to declare dividends is restricted by covenants contained in senior notes that it issued on May 4, 2000 (2000 Senior Notes). See Note 9 to the consolidated financial statements entitled, Indebtedness. All such covenants were met during 2007 and 2006. At December 31, 2007, the amount available for dividends to holders of Selective s common shares under such restrictions was $336.0 million for the 2000 Senior Notes.

Selective s ability to receive dividends, loans, or advances from its Insurance Subsidiaries is subject to the approval and/or review of the insurance regulators in the respective domiciliary states of the Insurance Subsidiaries. Such approval and review is made under the respective domiciliary states insurance holding company acts, which generally require that any transaction between related companies be fair and equitable to the insurance company and its policyholders. Selective does not believe that such restrictions materially limit the ability of the Insurance Subsidiaries to pay dividends to Selective now or in the foreseeable future. Selective currently expects to continue to pay quarterly cash dividends on shares of its Common Stock in the future.

(d) Securities Authorized for Issuance Under Equity Compensation Plans

The following table provides information about Selective s Common Stock authorized for issuance under equity compensation plans as of December 31, 2007:

	(a)	**(b)**	**(c)**
	Number of		**Number of securities remaining available for**

Plan Category	**securities to be issued upon exercise of outstanding options, warrants and rights**	**Weighted-average exercise price of outstanding options, warrants and rights**	**future issuance under equity compensation plans (excluding securities reflected in column (a))**
Equity compensation plans approved by security holders	1,241,153	$ 16.69	5,448,923(1)

(1) Includes 251,434 shares available for issuance under Selective s Employee Stock Purchase Savings Plan, 2,418,754 shares available for issuance under Selective s 2005 Omnibus Stock Plan, which can be issued, among other things, as stock options or restricted stock awards, and 2,778,735 shares available for issuance under Selective s Stock Purchase Plan for Independent Insurance Agencies.

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(e) Performance Graph

The following chart, produced by Research Data Group, Inc., depicts Selective s performance for the period beginning December 31, 2002 and ending December 31, 2007, as measured by total stockholder return on the Company s Common Stock compared with the total return of the NASDAQ Composite Index and a select group of peer companies.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

Among Selective Insurance Group Inc., The NASDAQ Composite Index

And A Peer Group

* $100 invested on 12/31/02 in stock or index-including reinvestment of dividents. Fiscal year ending December 31.

Notwithstanding anything to the contrary set forth in any of Selective s previous filings under the Securities Act of 1933 or the Exchange Act that might incorporate future filings made by Selective under those statutes, the preceding performance graph will not be incorporated by reference into any of those prior filings, nor will such graph be incorporated by reference into any future filings made by Selective under those statutes.

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

The following table provides information regarding Selective s purchase of its own Common Stock in the fourth quarter of 2007:

Period	Total Number of Shares Purchased[1]	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs[2]	Maximum Number of Shares that May Yet Be Purchased Under the Announced Plans or Programs[2]
October 1-31, 2007	163,505	$ 24.27		3,519,300
November 1-30, 2007	4,017	22.75		3,519,300
December 1-31, 2007	10,619	24.07		3,519,300
Total	178,141	$ 24.22		

1 During the fourth quarter of 2007, 174,047 shares were purchased from employees in connection with the vesting of restricted stock and 4,094 shares

were purchased from employees in connection with stock option exercises. These repurchases were made in connection with satisfying tax withholding obligations with respect to those employees. These shares were not purchased as part of the publicly announced program. The shares were purchased at the current market prices of Selective s Common Stock on the dates of the purchases.

2 On July 24, 2007, the Board of Directors authorized a new share repurchase program for up to 4 million shares, which expires on July 26, 2009. During the fourth quarter of 2007, no shares were repurchased, leaving 3,519,300 shares remaining to be purchased under

the authorized
program.

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Item 6. Selected Financial Data.

Eleven-Year Financial Highlights[1]

(All presentations are in accordance with GAAP unless noted otherwise, number of weighted average shares and dollars in thousands, except per share amounts)	**2007**	2006	2005	2004	2003
Net premiums written	**$ 1,554,867**	1,535,961	1,459,474	1,365,148	1,219,159
Net premiums earned	**1,517,306**	1,499,664	1,418,013	1,318,390	1,133,070
Net investment income earned	**174,144**	156,802	135,950	120,540	114,748
Net realized gains (losses)	**33,354**	35,479	14,464	24,587	12,842
Diversified Insurance Services revenue from continuing operations[2,3]	**115,566**	110,526	98,711	86,484	70,780
Total revenues	**1,846,228**	1,807,867	1,671,012	1,553,624	1,335,056
Underwriting profit (loss)	**15,957**	57,978	69,728	40,768	(25,252)
Diversified Insurance Services income (loss) from continuing operations[2,3]	**18,623**	17,808	14,793	11,921	6,194
Net income from continuing operations[3]	**146,498**	163,574	147,452	127,177	64,375
Total discontinued operations, net of tax[3]			546	1,462	1,969
Cumulative effect of change in account principle, net of tax			495		
Net income	**146,498**	163,574	148,493	128,639	66,344
Comprehensive income	**131,940**	159,802	112,078	134,723	99,362
Total assets	**5,001,992**	4,767,705	4,375,625	3,912,411	3,423,925
Notes payable and debentures[6]	**295,067**	362,602	339,409	264,350	238,621
Stockholders equity	**1,076,043**	1,077,227	981,124	882,018	749,784
Statutory premiums to surplus ratio[4]	**1.5**	1.5	1.6	1.7	1.8
Statutory combined ratio[2,5]	**97.5**	95.4	94.6	95.9	101.5
Combined ratio[2,5]	**98.9**	96.1	95.1	96.9	102.2
Yield on investment, before-tax	**4.8**	4.6	4.6	4.7	5.1
Debt to capitalization	**21.5**	25.2	25.7	23.1	24.1
Return on average equity	**13.6**	15.9	15.9	15.8	9.5
Per share data:					
Net income from continuing operations[3]:					
Basic	**$ 2.80**	2.98	2.72	2.38	1.23
Diluted	**2.59**	2.65	2.33	2.01	1.07
Net income:					
Basic	**$ 2.80**	2.98	2.74	2.41	1.27
Diluted	**2.59**	2.65	2.35	2.04	1.10
Dividends to stockholders	**$ 0.49**	0.44	0.40	0.35	0.31
Stockholders equity	**$ 19.81**	18.81	17.34	15.79	13.74
Price range of Common Stock:					
High	**$ 29.07**	29.18	29.64	22.98	16.50

Low	**19.04**	24.89	20.88	15.86	10.91
Close	**22.99**	28.65	26.55	22.12	16.18
Number of weighted average shares:					
Basic	**52,382**	54,986	54,342	53,462	52,262
Diluted	**57,165**	62,542	64,708	64,756	63,206

1. See the Glossary of Terms attached to this Form 10-K as Exhibit 99.1.

2. Flood business is included in statutory underwriting results in accordance with prescribed statutory accounting practices. On a GAAP basis only, flood servicing revenue and expense has been reclassified from underwriting results to Diversified Insurance Services.

3. See Item 8. Financial Statements and Supplementary Data, Note 15 to the consolidated financial statements and Item 7. Management s Discussion and Analysis of Financial Condition and Results of

Operations, the section entitled Diversified Insurance Services Segment for a discussion of discontinued operations and Item 8. Financial Statements and Supplementary Data, Note 12 to the consolidated financial statements for the components of income.

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2002	2001	2000	1999	1998	1997
1,053,487	925,420	843,604	811,677	748,873	717,618
988,268	883,048	821,265	799,065	722,992	676,268
103,067	96,767	99,495	96,531	99,196	100,530
3,294	6,816	4,191	29,377	(2,139)	6,021
59,399	51,783	43,463	22,554	8,562	7,060
1,157,553	1,041,177	972,153	950,669	831,791	793,007
(38,743)	(60,638)	(65,122)	(54,147)	(24,986)	(3,022)
3,103	(3,819)	2,112	4,257	1,765	646
40,310	24,112	24,487	53,483	53,277	69,531
1,659	1,581	2,048	234	293	77
41,969	25,693	26,535	53,717	53,570	69,608
59,366	24,405	49,166	16,088	78,842	105,931
3,016,335	2,673,721	2,590,903	2,507,545	2,432,168	2,306,191
262,768	156,433	163,634	81,585	88,791	96,559
652,102	591,160	577,797	569,964	607,583	565,316
1.9	1.8	1.7	1.6	1.5	1.5
103.2	106.7	108.2	105.7	103.2	100.1
103.9	106.9	107.9	106.8	103.6	100.3
5.4	5.4	5.8	5.6	5.7	6.0
28.7	21.0	22.1	12.5	13.2	14.6
6.8	4.4	4.6	9.1	9.1	13.4
0.80	0.50	0.50	0.99	0.94	1.21
0.74	0.46	0.47	0.93	0.87	1.14
0.83	0.53	0.54	0.99	0.94	1.21
0.77	0.49	0.51	0.94	0.87	1.14
0.30	0.30	0.30	0.30	0.28	0.28
12.26	11.58	11.46	10.73	10.65	9.66
15.74	14.11	12.94	11.25	14.63	14.19
9.68	9.97	7.32	8.25	8.35	9.16
12.59	10.87	12.13	8.60	10.07	13.50
50,602	49,166	49,814	54,162	56,960	57,818
55,990	52,848	53,144	57,754	60,824	61,850

4. Regulatory and rating agencies use the statutory premiums to surplus ratio as

a measure of solvency, viewing an increase in the ratio as a possible increase in solvency risk. Management and analysts also view this ratio as a measure of the effective use of capital because, as the ratio increases, revenue per dollar of capital increases, indicating the possibility of increased returns or increased losses due to the effects of leverage.

5. Changes in both the GAAP and statutory combined ratios are viewed by management and analysts as indicative of changes in the profitability of underwriting operations. A ratio over 100% is indicative of an underwriting loss, and a ratio below 100% is indicative of an underwriting profit.

6.

See Item 8. Financial Statements and Supplementary Data, Note 9 to the consolidated financial statements for a discussion of notes payable and debentures.

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

Forward-looking Statements

Certain statements in this report, including information incorporated by reference, are forward-looking statements as that term is defined in the Private Securities Litigation Reform Act of 1995 (PSLRA). The PSLRA provides a safe harbor under the Securities Act of 1933 and the Securities Exchange Act of 1934 for forward-looking statements. These statements relate to Selective s intentions, beliefs, projections, estimations or forecasts of future events or future financial performance and involve known and unknown risks, uncertainties and other factors that may cause Selective s or the industry s actual results, levels of activity, or performance to be materially different from those expressed or implied by the forward-looking statements. In some cases, forward-looking statements may be identified by use of words such as may, will, could, would, should, expect, plan, anticipate, target, project, estimate, predict, potential, pro forma, seek, likely or continue or other comparable terminology. These sta only predictions, and Selective can give no assurance that such expectations will prove to be correct. Selective undertakes no obligation, other than as may be required under the federal securities laws, to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Factors that could cause Selective s actual results to differ materially from those Selective has projected, forecasted or estimated in forward-looking statements are discussed in further detail in Item 1A. Risk Factors. These risk factors may not be exhaustive. Selective operates in a continually changing business environment, and new risk factors emerge from time-to-time. Selective can neither predict such new risk factors nor can Selective assess the impact, if any, of such new risk factors on Selective s 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.

Introduction

Selective Insurance Group, Inc., (Selective, the Company, we, or our) offers property and casualty insurance produ and diversified insurance services through its various subsidiaries. Selective classifies its businesses into three operating segments: (i) Insurance Operations; (ii) Investments; and (iii) Diversified Insurance Services.

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. For convenience and reading ease, we have written the remainder of the MD&A in the first person plural.

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

- Critical Accounting Policies and Estimates;
- Financial Highlights of Results for years ended December 31, 2007, 2006, and 2005;
- Results of Operations and Related Information by Segment;
- Financial Condition, Liquidity, and Capital Resources;
- Off-Balance Sheet Arrangements;
- Contractual Obligations and Contingent Liabilities and Commitments;
- Federal Income Taxes; and
- Adoption of Accounting Pronouncements.

Critical Accounting Policies and Estimates

We have identified the policies and estimates described below as critical to our business operations and the understanding of the results of our operations. Our preparation of the Consolidated Financial Statements requires us to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of our Consolidated Financial Statements, and the reported amounts of revenue and expenses during the reporting period. There can be no assurance that actual results will not differ from those estimates. Those estimates that were most critical to the preparation of the financial statements involved the following: (i) reserve for losses and loss expenses; (ii) deferred policy acquisition costs; (iii) pension and postretirement benefit plan actuarial assumptions; and (iv) other-than-temporary investment impairments.

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Reserves for Losses and Loss Expenses

Significant periods of time can elapse between the occurrence of an insured loss, the reporting of the loss to the insurer, and the insurer s payment of that loss. To recognize liabilities for unpaid losses and loss expenses, insurers establish reserves as balance sheet liabilities representing estimates of amounts needed to pay reported and unreported net losses and loss expenses. As of December 31, 2007, we had accrued $2.5 billion of gross loss and loss expense reserves compared to $2.3 billion at December 31, 2006.

How reserves are established

When a claim is reported to an insurance subsidiary, claims personnel establish a case reserve for the estimated amount of the ultimate payment. The amount of the reserve is primarily based upon a case-by-case evaluation of the type of claim involved, the circumstances surrounding each claim, and the policy provisions relating to the type of losses. The estimate reflects the informed judgment of such personnel based on their knowledge, experience, and general insurance reserving practices. Until the claim is resolved, these estimates are revised as deemed appropriate by the responsible claims personnel based on subsequent developments and periodic reviews of the case.

In addition to case reserves, we maintain estimates of reserves for losses and loss expenses incurred but not yet reported (IBNR). Using generally accepted actuarial reserving techniques, we project our estimate of ultimate losses and loss expenses at each reporting date. The difference between: (i) projected ultimate loss and loss expense reserves and (ii) case loss reserves and loss expense reserves thereon are carried as the IBNR reserve. The actuarial techniques used are part of a comprehensive reserving process that includes two primary components. The first component is a detailed quarterly reserve analysis performed by our internal actuarial staff, which is managed independently from the operating units. In completing this analysis, the actuaries are required to make numerous assumptions, including, for example, the selection of loss development factors and the weight to be applied to each individual actuarial indication. These indications include paid and incurred versions for the following actuarial methodologies: loss development, Bornhuetter-Ferguson, Berquist-Sherman, and frequency/severity. Additionally, the actuaries must gather substantially similar data in sufficient volume to ensure the statistical credibility of the data. The second component of the analysis is the projection of the expected ultimate loss ratio for each line of business for the current accident year. This projection is part of our planning process wherein we review and update expected loss ratios each quarter. This review includes actual versus expected pricing changes, loss trend assumptions, and updated prior period loss ratios from the most recent quarterly reserve analysis.

In addition to the most recent loss trends, a range of possible IBNR reserves is determined annually and continually considered, among other factors, in establishing IBNR for each reporting period. Loss trends include, but are not limited to, large loss activity, environmental claim activity, large case reserve additions or reductions for prior accident years, and reinsurance recoverable issues. We also consider factors such as: (i) per claim information; (ii) company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the imposition of damages, and changes in political attitudes; and (iv) trends in general economic conditions, including the effects of inflation. Based on the consideration of the range of possible IBNR reserves, recent loss trends, uncertainty associated with actuarial assumptions and other factors, IBNR is established and the ultimate net liability for losses and loss expenses is determined. Such an assessment requires considerable judgment given that it is frequently not possible to determine whether a change in the data is an anomaly until some time after the event. Even if a change is determined to be permanent, it is not always possible to reliably determine the extent of the change until some time later. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of reserves because the eventual deficiency or redundancy is affected by many factors. The changes in these estimates, resulting from the continuous review process and the differences between estimates and ultimate payments, are reflected in the consolidated statements of income for the period in which such estimates are changed. Any changes in the liability estimate may be material to the results of operations in future periods.

Major trends by line of business creating additional loss and loss expense reserve uncertainty

The Insurance Subsidiaries are multi-state, multi-line property and casualty insurance companies and, as such, are subject to reserve uncertainty stemming from a variety of sources. These uncertainties are considered at each step in the process of establishing loss and loss expense reserves. However, as market conditions change, certain trends are identified that management believes create an additional amount of uncertainty. A discussion of recent trends, by line of business, that have been recognized by management follows:

Workers Compensation
With $832 million, or 36% of our total recorded reserves, net of reinsurance at December 31, 2007, workers compensation is our largest reserved line of business. In addition to the uncertainties associated with actuarial assumptions and methodologies described above, workers compensation is the line of business most susceptible to unexpected changes in medical services costs due to the length of time over which medical services are provided and the unpredictability of medical cost inflation. From 2005 through 2007, we experienced an unusual amount of volatility associated with our workers compensation medical costs. In 2005, we had sufficient evidence of greater than expected increases in our workers compensation medical costs and raised our reserves in this line of business by $42 million for accident years 2001 and prior. From 2006 to 2007, our workers compensation medical development returned to a more normal level and as a result our reserves for prior accident years were reduced by the relatively moderate amount of $4 million in 2006 and $4 million in 2007. Even though medical cost development returned to a more customary level in 2007, the unusual amount of volatility over the past few years does create additional uncertainty. If the higher than historical increases in medical costs in 2005 were a just an anomaly, then our historical patterns are an appropriate basis for our future reserve projections. If higher trends return and continue on a longer term, our historical patterns will be less meaningful in predicting future loss costs and could result in significant adverse reserve development.
General Liability
At December 31, 2007, our general liability line of business had recorded reserves, net of reinsurance of $815 million, which represented 35% of our total net reserves. This line of business includes umbrella policies which provide additional limits above underlying automobile and general liability coverages. While favorable development in 2007 for prior years was minimal, two recent changes in our book of business relating to umbrella coverage could create additional volatility in our results: (i) we have grown the number of our commercial umbrella policies at a greater rate than the rest of our commercial lines of business; and (ii) we have raised the net retention of our reinsurance covering these policies. Both of these changes raise the average limits of losses that we retain on a net basis. While management has not identified any specific trends relating to additional reserve uncertainty, our increase in average net retention does create the potential for additional volatility in our reserves.
Commercial Automobile
At December 31, 2007, our commercial automobile line of business had recorded reserves, net of reinsurance, of $330 million, which represented 14% of our total net reserves. This line of business has experienced favorable loss development in recent years driven by a downward trend in large claims. The number of large claims has a high degree of volatility from year-to-year and, therefore, requires a longer period before true trends are recognized and can be acted upon. We have experienced lower than expected severity in accident years 2002 through 2006, which resulted in favorable development in 2006 and 2007 of $15 million and $19 million, respectively. This result is driven by trends that are positively affecting the commercial auto insurance market in general, as well as by Selective specific initiatives such as: (i) the increase in lower hazard auto business as a percentage of our overall commercial auto book of business; (ii) a re-underwriting of our newest operating region; and (iii) a more proactive approach to loss prevention. At this time, the lower trend in large claims has leveled off and management has not identified any other recent trends that would create significant reserve uncertainty for this line of business.
Personal Automobile
At December 31, 2007, our personal automobile line of business had recorded reserves, net of reinsurance, of $171 million, which represented 7% of our total net reserves. The majority of this business is written in New Jersey, where the judicial and regulatory environment has been subject to significant changes over the past few decades. The most recent change occurred in June 2005, when the New Jersey Supreme Court ruled that the serious life impact standard does not apply to the Automobile Insurance Cost Reduction Act (AICRA) limitation on lawsuit threshold. As a result of this decision, we increased reserves for this line of business by a net amount of $10 million, the majority of which was reflected in 2005 results. This recent judicial decision has increased the uncertainty surrounding our personal automobile reserves, particularly for accident years 2006 and 2007, since much of the historical information used to make assumptions has been rendered less effective as a basis for projecting future results.
Other Lines of Business

At December 31, 2007, no other individual line of business had recorded reserves of more than $60 million, net of reinsurance. Management has not identified any recent trends that would create additional significant reserve uncertainty for these other lines of business.

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The following tables provide case and IBNR reserves for losses, reserves for loss expenses, and reinsurance recoverable on unpaid losses and loss expenses as of December 31, 2007 and 2006:

As of December 31, 2007

($ in thousands)	Loss Reserves Case Reserves	Loss Reserves IBNR Reserves	Total	Loss Expense Reserves	Reinsurance Recoverable on Unpaid Losses and Loss Expenses	Net Reserves
Commercial automobile	$ 117,299	188,294	305,593	36,236	12,255	329,574
Workers compensation	382,364	424,528	806,892	102,315	76,747	832,460
General liability	198,636	500,806	699,442	162,098	46,434	815,106
Commercial property	44,520	2,030	46,550	3,572	5,895	44,227
Business owners policy	23,469	30,967	54,436	8,604	5,281	57,759
Bonds	4,008	3,509	7,517	2,217	296	9,438
Other	907	1,601	2,508		863	1,645
Total commercial lines	771,203	1,151,735	1,922,938	315,042	147,771	2,090,209
Personal automobile	127,646	70,989	198,635	38,221	65,541	171,315
Homeowners	17,889	21,227	39,116	4,511	944	42,683
Other	7,479	14,404	21,883	2,201	13,545	10,539
Total personal lines	153,014	106,620	259,634	44,933	80,030	224,537
Total	$ 924,217	1,258,355	2,182,572	359,975	227,801	2,314,746

As of December 31, 2006

($ in thousands)	Loss Reserves Case Reserves	Loss Reserves IBNR Reserves	Total	Loss Expense Reserves	Reinsurance Recoverable on Unpaid Losses and Loss Expenses	Net Reserves
Commercial automobile	$ 104,490	180,937	285,427	$ 33,817	5,802	313,442
Workers compensation	351,511	386,796	738,307	93,095	68,018	763,384
General liability	154,807	448,474	603,281	139,714	34,882	708,113
Commercial property	19,076	1,321	20,397	3,622	347	23,672
Business owners policy	22,273	25,707	47,980	7,584	5,166	50,398
Bonds	1,106	4,139	5,245	2,391	339	7,297
Other	477	1,704	2,181		448	1,733
Total commercial lines	653,740	1,049,078	1,702,818	280,223	115,002	1,868,039
Personal automobile	127,051	81,663	208,714	42,849	68,196	183,367

Homeowners	13,895	13,953	27,848	3,969	1,080	30,737
Other	7,727	12,378	20,105	2,244	15,460	6,889
Total personal lines	148,673	107,994	256,667	49,062	84,736	220,993
Total	$ 802,413	1,157,072	1,959,485	$ 329,285	199,738	2,089,032

Range of reasonable reserves

We established a range of reasonably possible reserves for net claims of approximately $2,180 million to $2,414 million at December 31, 2007 and of $1,977 million to $2,174 million at December 31, 2006. A low and high reasonable reserve selection was derived primarily by considering the range of indications calculated using generally accepted actuarial techniques. Such techniques assume that past experience, adjusted for the effects of current developments and anticipated trends, are an appropriate basis for predicting future events. Although this range reflects likely scenarios, it is possible that the final outcomes may fall above or below these amounts. Based on internal stochastic modeling, management feels that a reasonable estimate of the likelihood that the final outcome falls within the current range is approximately 70%. This range does not include a provision for potential increases or decreases associated with environmental reserves. Management s best estimate is consistent with the actuarial best estimate. We do not discount to present value that portion of its loss reserves expected to be paid in future periods; however, the loss reserves take into account anticipated recoveries for salvage and subrogation claims.

Sensitivity Analysis: Potential impact on reserve volatility due to changes in key assumptions

Our process to establish reserves includes a variety of key assumptions, including, but not limited to, the following:

- The selection of loss development factors;
- The weight to be applied to each individual actuarial indication;
- Projected future loss trend; and
- Expected ultimate loss ratios for the current accident year.

The importance of any single assumption depends on several considerations, such as the line of business and the accident year. If the actual experience emerges differently than the assumptions used in the process to establish reserves, changes in our reserve estimate are possible and may be material to the results of operations in future periods. Set forth below is a discussion of the potential impact of using certain key assumptions that differ from those used in our latest reserve analysis. It is important to note that the following discussion considers each assumption individually, without any consideration of correlation between lines of business and accident years, and therefore, does not constitute an actuarial range. While the following discussion represents possible volatility from variations in key assumptions as identified by management, there is no assurance that the future emergence of our loss experience will be consistent with either our current or alternative set of assumptions. By the very nature of the insurance business, loss development patterns have a certain amount of normal volatility.

Workers Compensation

In addition to the normal amount of volatility, medical loss development factors for workers compensation are particularly sensitive to assumptions relating to medical inflation. Actual medical loss development factors could be significantly different than those which are selected from historical loss experience if actual medical inflation is materially different than what was observed in the past. In addition, workers compensation has been the focus of a multi-faceted underwriting strategy designed to significantly reduce the loss ratio over time. The combination of the sensitivity of workers compensation results to medical inflation and changes in underwriting could lead to actual experience emerging differently than the assumptions used in the process to establish reserves. In our judgment, it is possible that actual medical loss development factors could range from 6% below to 8% above those selected in our latest reserve analysis and expected loss ratios could range from 5% below to 3% above those selected in our latest reserve analysis. The combination of reducing the assumptions for medical loss development by 6% and the expected loss ratio by 5% could decrease our indicated workers compensation reserves by approximately $55 million for accident years 2006 and prior. Alternatively, the combination of increasing the medical loss development factors by 8% and the expected loss ratio by 3% could increase our indicated workers compensation reserves by approximately $70 million.

General Liability

In addition to the normal amount of volatility, general liability loss development factors have greater uncertainty due to the complexity of the coverages and the possibly significant periods of time that can elapse between the occurrence of an insured loss, the reporting of the loss to the insurer, and the insurer s payment of that loss. In our judgment, it is possible that general liability loss development factors could be +/- 6% from those actually selected in our latest reserve analysis. If the loss development assumptions were changed by +/- 6%, that would increase/decrease our indicated general liability reserves by approximately $80 million for accident years 2006 and prior.

Commercial Automobile

In addition to the normal amount of volatility, our commercial automobile line of business has experienced significant favorable development in recent years. This favorable development has been driven in large part by a reduction in our bodily injury large loss experience. The actual number of large claims has a high degree of volatility from year-to-year and, therefore, requires a longer period of time before we would respond to this type of information. Under these circumstances, the difference between a traditional loss development method and the expected ultimate loss ratio is larger than usually expected. For this reason, the weight to be applied to each individual actuarial indication in this situation is another key assumption. If the impact of changing the weights to be applied to each actuarial indication is combined with the impact of possible changes to selected loss development factors of +/- 6%, it is our judgment that the possible impact to overall reserves could range from approximately $65 million reduction to approximately $40 million increase for accident years 2006 and prior.

Personal Automobile

In addition to the normal amount of volatility, the uncertainty of personal automobile loss development factors is greater than usual due to the number of judicial and regulatory changes in the New Jersey personal automobile market over the years. In our judgment, it is possible that personal auto bodily injury loss development factors could range from 5% below those actually selected in our latest reserve analysis to 4% above those selected in our latest reserve analysis. If the loss development assumptions were reduced by 5%, that would decrease our indicated personal automobile reserves by approximately $35 million for accident years 2006 and prior. Alternatively, if the loss development factors were increased by 4%, that would increase our indicated personal automobile reserves by approximately $30 million.

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Current Accident Year

For the 2007 accident year, the expected ultimate loss ratio by line of business is a key assumption. This assumption is based upon a large number of inputs that are assessed periodically, such as historical loss ratios, projected future loss trend, and planned pricing amounts. In our judgment, it is possible that the actual ultimate loss ratio for the 2007 accident year could be +/-7% from the one selected in our latest reserve analysis for each of our four major long tailed lines of business. The table below summarizes the possible impact on our reserves of varying our expected loss ratio assumption by +/-7% by line of business for the 2007 accident year.

Reserve Impact of Changing Current Year Expected Ultimate Loss Ratio Assumption

($ in millions)	If Assumption Was Reduced by 7%	If Assumption Was Raised by 7%
Workers Compensation	(22)	22
General Liability	(29)	29
Commercial Automobile Liability	(17)	17
Personal Automobile Liability	(7)	7

Prior year reserve development

In light of the many uncertainties associated with establishing the estimates and making the assumptions necessary to establish reserve levels, we review our reserve estimates on a regular basis as described above and make adjustments in the period that the need for such adjustment is determined. These reviews could result in the identification of information and trends that would require us to increase some reserves and/or decrease other reserves for prior periods and could also lead to additional increases in loss and loss adjustment expense reserves, which could materially adversely affect our results of operations, equity, business, insurer financial strength, and debt ratings. In 2007, we experienced favorable loss development in accident years 2002 through 2006 of $61.7 million partially offset by unfavorable loss development in accident years 2001 and prior of $42.9 million, netting to total favorable prior year development of $18.8 million. In 2006, we experienced net favorable prior year development of $7.3 million, and in 2005, we experienced net adverse prior year development of $5.1 million. For further discussion on the prior year development in loss and loss expense reserves, see the discussion on Net Loss and Loss Expense Reserves in Item 1. Business and Note 8 of Item 8. Financial Statements and Supplementary Data in this Form 10-K.

Asbestos and Environmental Reserves

Included in our loss and loss expense reserves are amounts for environmental claims, both asbestos and non-asbestos. Carried net loss and loss expense reserves for environmental claims were $51.4 million as of December 31, 2007 and $46.5 million as of December 31, 2006. Our exposure to environmental liability is primarily due to policies written prior to the introduction of the absolute pollution exclusion endorsement in the mid-1980 s and underground storage tank leaks, mostly from New Jersey homeowners policies in recent years. Our asbestos and non-asbestos environmental claims have arisen primarily from insured exposures in municipal government, small commercial risks, and homeowners policies. The emergence of these claims is slow and highly unpredictable. Over the past few years, we also experienced adverse development in its homeowners line of business as a result of unfavorable trends in claims for groundwater contamination caused by leakage of certain underground heating oil storage tanks in New Jersey. In addition, certain landfill sites are included on the National Priorities List (NPL) by the United States Environmental Protection Agency (USEPA). Once on the NPL the USEPA determines an appropriate remediation plan for these sites. A landfill can remain on the NPL for many years until final approval for the removal of the site is granted from the USEPA. The USEPA also has the authority to re-open previously closed sites and return them to the NPL. We currently have reserves for several claims related to sites on the NPL.

IBNR reserve estimation for environmental claims is often difficult because, in addition to other factors, there are significant uncertainties associated with critical assumptions in the estimation process, such as average clean-up costs, third-party costs, potentially responsible party shares, allocation of damages, insurer litigation costs, insurer coverage defenses, and potential changes to state and federal statutes.

However, management is not aware of any emerging trends that could result in future reserve adjustments. Moreover, normal historically-based actuarial approaches are difficult to apply because relevant history is not available. While models can be applied, such models can produce significantly different results with small changes in assumptions. As a result, management does not calculate a specific environmental loss range, as it believes it would not be meaningful.

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The table below summarizes the number of asbestos and non-asbestos claims outstanding at December 31, 2007, 2006, and 2005. For additional information about our environmental reserves, see Item 1. Business, and Item 8. Financial Statements and Supplementary Data, Note 8 to the Consolidated Financial Statements.

Environmental Claims Activity

		2007	2006	2005
Asbestos Related Claims (1)				
Claims at beginning of year		**2,273**	2,089	3,025
Claims received during year		**114**	358	276
Claims closed during year (2)		**(210)**	(174)	(1,212)
Claims at end of year		**2,177**	2,273	2,089
Average gross loss settlement on closed claims	$	**81**	914	527
Gross amount paid to administer closed claims	$	**51,868**	66,710	230,340
Net survival ratio (3)		**16**	20	16
Non-Asbestos Related Claims (1)				
Claims at beginning of year		**302**	293	285
Claims received during year		**108**	111	154
Claims closed during year (2)		**(139)**	(102)	(146)
Claims at end of year		**271**	302	293
Average gross loss settlement on closed claims	$	**4,149**	555	65,204
Gross amount paid to administer closed claims	$	**62,874**	26,321	1,717,746
Net survival ratio (3)		**14**	9	7

(1) The number of environmental claims includes all multiple claimants who are associated with the same site or incident.

(2) Includes claims dismissed, settled, or otherwise resolved.

(3) The net survival ratio was calculated using a three-year average for net losses and expenses paid.

Deferred Policy Acquisition Costs

Policy acquisition costs, which include commissions, premium taxes, fees, and certain other costs of underwriting policies, are deferred and amortized over the same period in which the related premiums are earned. Deferred policy acquisition costs are limited to the estimated amounts recoverable after providing for losses and loss expenses that are expected to be incurred, based upon historical and current experience. Anticipated investment income is considered in determining whether a premium deficiency exists. The methods of making such estimates and establishing the deferred costs are continually reviewed, and any adjustments are made in the accounting period in which the adjustment arose. We measure the recoverability of deferred policy acquisition costs at the operating segment level. We had deferred policy acquisition costs of $226.4 million at December 31, 2007 compared to $218.1 million at December 31, 2006.

Pension and Postretirement Benefit Plan Actuarial Assumptions

Our pension benefit and postretirement life benefit obligations and related costs are calculated using actuarial concepts, within the framework of Statement of Financial Accounting Standards No. 87, *Employers Accounting for Pensions* (SFAS 87); and Statement of Financial Accounting Standards No. 106, *Employers Accounting for Postretirement Benefits Other than* Pension (SFAS 106), respectively. Two key assumptions, the discount rate and the expected return on plan assets, are important elements of expense and/or liability measurement. We evaluate these key assumptions annually. Other assumptions involve demographic factors such as retirement age, mortality, turnover, and rate of compensation increases.

The discount rate enables us to state expected future cash flow as a present value on the measurement date. The guideline for setting this rate is a high-quality long-term corporate bond rate. A higher discount rate decreases the present value of benefit obligations and decreases pension expense. We increased our discount rate to 6.50% for 2007, from 5.90% for 2006 to reflect market interest rate conditions. To determine the expected long-term rate of return on the plan assets, we consider the current and expected asset allocation, as well as historical and expected returns on each plan asset class. A lower expected rate of return on pension plan assets would increase pension expense. Our long-term expected return on plan assets was 8.00% in 2007 and 2006. Changes in the related pension and postretirement benefit expense may occur in the future due to changes in these assumptions.

For additional information regarding our pension and postretirement benefit plan obligations, see Item 8. Financial Statements and Supplementary Data, Note 16(d) to the Consolidated Financial Statements.

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Other-Than-Temporary Investment Impairments

An investment in a fixed maturity or equity security, that is available for sale and reported at fair value, 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 value. If we believe that a decline in the value of a particular investment is temporary, we record the decline as an unrealized loss in accumulated other comprehensive income. If we believe the decline is other-than-temporary, we write down the carrying value of the investment and record a realized loss in our Consolidated Statements of Income. Management s assessment of a decline in value includes 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 write-down provided that management has the ability and intent to hold such a security to maturity.

Our evaluation for other-than-temporary impairment of a fixed maturity security, 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 an 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;
- Buy/hold/sell recommendations published by outside investment advisors and analysts;
- Relevant rating history, analysis and guidance provided by rating agencies and analysts;
- The length of time and the extent to which the fair value has been less than carrying value; and
- Our ability and intent to hold a security to maturity given interest rate fluctuations.

Our evaluation for other-than-temporary impairment of an equity security, other investment, 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 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;
- 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 carrying value.

In 2007, we recorded an impairment charge of $4.9 million for two investments that we concluded were impaired for other than temporary declines in fair value. We had no impairment charges during 2006. We recorded an impairment charge of $1.2 million in 2005 for one investment that we concluded was impaired for an other-than-temporary decline in value. For further information regarding the impairment charges, see the section entitled Investments in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations. of this Form 10-K.

Goodwill

Goodwill results from business acquisitions where the cost of assets acquired exceeds the fair value of those assets. We test goodwill for impairment annually, or more frequently if events or changes in circumstances indicate that goodwill may be impaired. Goodwill is allocated to the reporting units for the purposes of the impairment test. We did not record any impairments during 2007, 2006 or 2005.

Reinsurance

Reinsurance recoverable on paid and unpaid losses and loss expenses represent estimates of the portion of such liabilities that will be recovered from reinsurers. Each reinsurance contract is analyzed to ensure that the transfer of risk exists to properly record the transactions in the financial statements. Amounts recoverable from reinsurers are recognized as assets at the same time and in a manner consistent with the paid and unpaid losses associated with the reinsurance policies. An allowance for estimated uncollectible reinsurance is recorded based on an evaluation of balances due from reinsurers and other available information. This allowance totaled $2.8 million at December 31, 2007.

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Financial Highlights of Results for Years Ended December 31, 2007, 2006, and 2005 [1]

($ in thousands, except per share amounts)	**2007**	2006	**2007 vs 2006**	2005	2006 vs 2005
Revenues	**$ 1,846,228**	1,807,867	**2%**	1,671,012	8%
Net income before cumulative effect of change in accounting principle	**146,498**	163,574	**(10)**	147,998	11
Net income	**146,498**	163,574	**(10)**	148,493	10
Diluted net income before cumulative effect of change in accounting principle per share	**2.59**	2.65	**(2)**	2.34	13
Diluted net income per share	**2.59**	2.65	**(2)**	2.35	13
Diluted weighted-average outstanding shares	**57,165**	62,542	**(9)**	64,708	(3)
GAAP combined ratio	**98.9%**	96.1	**2.8** pts	95.1	1.0 pts
Statutory combined ratio	**97.5%**	95.4	**2.1**	94.6	0.8
Return on average equity	**13.6%**	15.9	**(2.3)**	15.9	

[1] Refer to the Glossary of Terms attached to this Form 10-K as Exhibit 99.1 for definitions of terms used in this financial review, which exhibit is incorporated by reference.

Revenues

Revenues increased in 2007 compared to 2006 and 2005 primarily due to growth in net premiums earned (NPE) and net investment income earned.

NPE growth contributed $17.6 million of the $38.4 million in revenue growth in 2007 compared to 2006 and $81.7 million to the $136.9 million in revenue growth in 2006 compared to 2005. The following factors contributed to the growth of NPE:

- Direct new business written, excluding flood, of $352.3 million in 2007 compared to $310.0 million in 2006 and $300.5 million in 2005.

- Commercial lines renewal prices, including exposure, which decreased by 0.3% in 2007 and increased in 2006 and 2005 by 2.2% and 3.5%, respectively.

The above items were partially offset by (i) a slight reduction in commercial lines retention in 2007 compared to 2006 and 2005; (ii) a $17.9 million reduction in audit and endorsement premium activity in 2007 compared to 2006 and a $7.6 million reduction in 2006 compared to 2005 as a result of economic changes, especially in the construction industry; and (iii) decreases in NPE on our New Jersey personal automobile book of business attributable to the loss of a portion of our book that was repriced at higher pricing levels through our MATRIX® pricing system and subsequently did not renew. Our New Jersey personal automobile book of business experienced an 8% reduction in the number of cars insured at December 31, 2007 compared to December 31, 2006 and a 12% reduction in the number of cars from December 31, 2006 compared to December 31, 2005. Overall personal lines NPE was down 5% to

$203.3 million in 2007 compared to $213.8 million in 2006. These premiums increased 2% in 2006 from $209.3 million in 2005.

Net investment income earned increased 11% in 2007 compared to 2006 and contributed $17.3 million to the $38.4 million revenue growth in 2007. In 2006, net investment income earned increased 15% compared to 2005 and contributed $20.9 million to the $136.9 million revenue growth in 2006. These increases are primarily attributable to a higher invested asset base, coupled with higher interest rates and strong returns from our other investment portfolio. The increase in our invested asset base is the result of operating cash flows of $386.3 million in 2007 and $393.1 million in 2006, as well as net proceeds of $96.8 million from our $100.0 million junior subordinated notes offering in the third quarter of 2006. These increases were partially offset by: (i) stock repurchases under our authorized stock repurchase program of 5.7 million shares during 2007 at a total cost of $143.3 million and 4.1 million shares during 2006 at a total cost of $110.1 million; and (ii) net share settlements of principal for $37.5 million in 2007 on our Senior convertible notes.

Net Income

Net income decreased in 2007 compared to 2006 due to increases in our GAAP combined ratio, resulting from lower pricing and higher claim severity, particularly in property losses, partially offset by profitability improvements in our workers compensation line of business and increases in net favorable prior year loss and loss expense development within our casualty lines of business. The reduction in our underwriting profit was partially offset by: (i) net investment income earned increases in 2007 as noted above; and (ii) decreases in federal income tax expense in 2007 compared to 2006, primarily attributable to lower underwriting income in our Insurance Operations segment, as explained above.

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Net income increased in 2006 compared to 2005 due to growth in NPE, net investment income earned, and net realized gains as discussed above, partially offset by the reduction in our underwriting profit, resulting from increased property losses, including catastrophe losses, and increased underwriting expenses.

Results of Operations and Related Information by Segment

Insurance Operations

Our Insurance Operations segment writes property and casualty insurance business in 21 states in the Eastern and Midwestern United States through seven insurance subsidiaries (the Insurance Subsidiaries). These Insurance Subsidiaries write business through approximately 880 independent insurance agencies. Our Insurance Operations segment consists of two components: (i) commercial lines (Commercial Lines), which markets primarily to businesses, and represents approximately 87% of net premiums written (NPW), and (ii) personal lines (Personal Lines), which markets primarily to individuals and represents approximately 13% of NPW.

Summary of Insurance Operations

All Lines

($ in thousands)	**2007**	2006	**2007 vs. 2006**	2005	2006 vs. 2005
GAAP Insurance Operations Results:					
NPW	$ **1,554,867**	1,535,961	**1**%	1,459,474	5%
NPE	**1,517,306**	1,499,664	**1**	1,418,013	6
Less:					
Losses and loss expenses incurred	**999,206**	959,983	**4**	905,730	6
Net underwriting expenses incurred	**494,941**	475,776	**4**	436,867	9
Dividends to policyholders	**7,202**	5,927	**22**	5,688	4
Underwriting income	$ **15,957**	57,978	(**72**)%	69,728	(17)%
GAAP Ratios:					
Loss and loss expense ratio	**65.9%**	64.0	**1.9** pts	63.9	0.1 pts
Underwriting expense ratio	**32.5**	31.7	**0.8**	30.8	0.9
Dividends to policyholders ratio	**0.5**	0.4	**0.1**	0.4	
Combined ratio	**98.9**	96.1	**2.8**	95.1	1.0
Statutory Ratios[1]:					
Loss and loss expense ratio	**65.4**	63.7	**1.7**	63.5	0.2
Underwriting expense ratio	**31.6**	31.3	**0.3**	30.7	0.6
Dividends to policyholders ratio	**0.5**	0.4	**0.1**	0.4	
Combined ratio[1]	**97.5%**	95.4	**2.1** pts	94.6	0.8 pts

1 The statutory ratios include Selective s flood line of business, which is included in the Diversified

Insurance Services Segment on a GAAP basis and therefore excluded from the GAAP ratios. The total Statutory Combined ratio excluding flood was 98.2% for 2007, 96.1% for 2006, and 95.3% for 2005.

NPW increased in 2007 compared to 2006 and in 2006 compared to 2005. Premium growth in 2007 compared to 2006 is attributable to increases in direct new business written, excluding flood, of 14% to $352.3 million for 2007 compared to 2006 partially offset by (i) commercial lines renewal pricing, including exposure, which decreased by 0.3% in 2007; (ii) a slight reduction in commercial lines retention in 2007 compared to 2006 and 2005; (iii) an $17.9 million reduction in audit and endorsement premium activity in 2007 compared to 2006 and a $7.6 million reduction in 2006 compared to 2005 as a result of economic changes, especially in the construction industry; and, (iv) a decline in NPW for our New Jersey personal automobile business of $12.6 million to $80.1 million for 2007 compared to 2006 driven by a reduction in the number of New Jersey personal automobiles that we insure, primarily as a result of repricing at higher levels through our MATRIX® pricing system.

Premium growth in 2006 compared to 2005 is attributable to increases in direct new business written, excluding flood, of 3% to $310.0 million for 2006 compared to 2005 coupled with Commercial Lines renewal pricing increases, including exposure, of 2.2% in 2006. Partially offsetting these items is a decline in NPW for our New Jersey personal automobile business of $14.6 million to $92.7 million for 2006 compared to 2005 as a result of the highly competitive marketplace.

NPE increased slightly in 2007 compared to 2006 and increased in 2006 compared to 2005 reflecting increases in NPW discussed above.

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The 1.9 point increase in the GAAP loss and loss expense ratio in 2007 compared to 2006 was primarily attributable to lower pricing on our Commercial and Personal Lines business, as well as increases in property losses and overall higher loss costs in 2007 compared to 2006. The increases in property losses were driven by higher non-catastrophe losses for 2007 compared to 2006. These increases to the GAAP loss and loss expense ratio were partially offset by (i) improved profitability in our workers compensation line of business, and (ii) net favorable prior year loss and loss expense development within our casualty lines of business of approximately $19 million in 2007, compared to approximately $7 million in 2006. The GAAP loss and loss expense ratio in 2006 remained comparable with the 2005 ratio.

The increases in the GAAP underwriting expense ratio in 2007 compared to 2006 and 2005 was primarily attributable to increases in underwriting expenses that outpaced premium growth in the comparable periods. Increased labor expenses drove the increase in expense dollars for 2007 and 2006. For additional information regarding our initiatives in the management of the underwriting expense ratio, see the outlook section below and Note 22, Subsequent Events in Item 8. Financial Statements and Supplementary Data of this Form 10-K.

Insurance Operations Outlook

Historically, the results of the property and casualty insurance industry have experienced significant fluctuations due to high levels of competition, economic conditions, interest rates, loss cost trends, and other factors. During 2007, the industry experienced low levels of catastrophe losses and a softening market characterized by accelerated competition, leading to pricing deterioration in the primary insurance market that was worse than originally anticipated. We expect this trend to continue into 2008. The average forecast, according to the U.S. Property/Casualty Review & Preview from A.M. Best (the Forecast) dated January 28, 2008, calls for negative growth in NPW of 0.6% in 2008. This is in addition to the estimated negative growth in NPW of 1.2% for 2007 discussed in the Forecast and results from an across-the-board softening in the personal and commercial lines pricing environments, a weakening economy, leakage of premium to government operated reinsurers and strong interest in alternative forms of risk transfer, including various forms of self insurance, captives, and catastrophe bonds. The 2008 NPW forecast, if accurate, would represent the first decline in total industry annual premiums since 1943. As a result, we may need to reduce our pricing, which could lead to a decrease in margins in order to retain our best business. Accelerated competition in the marketplace, coupled with low premium growth rates, has also led to an increased interest in merger and acquisition activity within the industry. The Forecast also indicates an increase in the expected statutory combined ratio in 2008 compared to the 2007 expectation, indicating that underwriting performance in the industry, although still profitable, is deteriorating. We believe that future profitability may be impacted by higher loss trends, which are characterized by changes in frequency, severity, and pricing deterioration. When renewal pure price increases are declining and loss costs trend higher, a market cycle shift occurs. General inflation and, notably, medical inflation, can drive up loss costs and lead to higher industry-wide statutory combined ratios. We believe it is critical to have a clearly defined plan to improve risk selection and mitigate higher frequency and severity trends during market cycles. Some of the tools we use to lower frequency and severity are knowledge management, predictive modeling, safety management, managed care, and enhanced claims review. Although it is uncertain at this time whether our initiatives will offset macro pricing and loss trends, we have outperformed the industry s loss and loss adjustment expense ratio by 6.8 points, on average, over the past 10 years.

Considering the current environment, in the upcoming year, we anticipate pricing discipline and expense management to be key factors in the generation of strong underwriting results. As part of our expense management initiative, in February 2008, we announced a reduction in our workforce of approximately 80 positions, including the immediate displacement of 60 employees and the elimination of 20 open positions. We anticipate these changes to have a related one-time pre-tax cost of approximately $4 million in the first quarter of 2008 and annualized pre-tax savings of approximately $8 million. In addition, we are implementing targeted changes to agency commissions that will maintain highly competitive awards for agents who produce the strongest results for us, while reducing commissions where our historically higher payments have not generated an appropriate level of profitable growth. The changes will bring our program more in line with the competition; however, commissions on 87% of our direct premiums written will not be affected, and the supplemental commission program that rewards our most profitable growth agencies does not change. We feel the changes will bring our program more in line with the competition. These commission revisions are expected to generate annualized pre-tax savings of approximately $8.0 million, and are targeted for rollout in most states in July 2008.

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Even in this competitive market, we believe that the strategies we have implemented will allow us to continue to profitably grow our business based on strong agency relationships and our unique field-based model. To this end, we have developed market-planning tools that are allowing us to strategically appoint additional independent agencies as well as agency management specialists (AMSs) in under-penetrated territories, with classes of business that we know historically have been profitable. Through the end of 2007, the Insurance Subsidiaries total agency count increased to approximately 880, up from 770 at last year-end, serviced by approximately 100 field-based AMSs who make hands-on underwriting decisions in agents offices on a daily basis.

We back the high touch component of our business model with technology that allows agents and the Insurance Subsidiaries field teams to input business seamlessly into our systems, while also allowing them to select and price accounts at optimal levels through predictive modeling. Technology that allows for the seamless placement of business into our systems includes our One & Done® small business system and our xSELerate® straight-through processing system. Premiums of $250,000 per workday were processed through our One & Done® small business system in 2007, up 42% from 2006. We have set a multi-year small business growth target of $350,000 in One & Done® business per work day, and in 2008 our efforts will be centered on: (i) better managing price points and scale; (ii) implementing a more comprehensive marketing and branding strategy; and (iii) updating the distribution model to address multiple agent and customer needs.

We also continue to pursue our organic growth strategy. Effective July 1, 2007, we entered our 21st primary state, Massachusetts, for Commercial Lines only and wrote approximately $3.8 million of new business in 2007. In 2008, we have plans to expand our footprint to Tennessee. We also have expanded Personal Lines into Rhode Island, Minnesota, and Iowa, states that are already within our existing Commercial Lines footprint. In addition to our organic growth strategy, we are taking note of opportunities that marketplace competition may be creating and would not rule out making an opportunistic acquisition.

Based on our expense management programs along with technology investments, ongoing underwriting improvements, our assessment of current loss cost and pricing trends, and other areas of strategic focus, we are providing 2008 earnings guidance in the range of $2.20 to $2.40 per diluted share. Our guidance is based on the following assumptions: (i) a statutory combined ratio of 98% and a GAAP combined ratio of 100%; (ii) after-tax catastrophe losses of $14.4 million; (iii) growth in after-tax investment income of 3%, including a 10% pre-tax yield on alternative investments, included in Other investments on the Consolidated Balance Sheets; (iv) Diversified Insurance Services revenue growth of 5% with a return on revenue of 10%; and (v) diluted weighted average shares of 52.5 million, which includes the expectation of repurchasing 3.5 million shares over the course of the year.

Review of Underwriting Results by Line of Business

Commercial Lines

Commercial Lines

($ in thousands)	**2007**	2006	**2007 vs. 2006**	2005	2006 vs. 2005
GAAP Insurance Operations Results:					
NPW	$ **1,350,798**	1,318,873	**2%**	1,258,632	**5%**
NPE	**1,314,002**	1,285,876	**2**	1,208,666	**6**
Less:					
Losses and loss expenses incurred	**838,577**	811,326	**3**	748,548	**8**
Net underwriting expenses incurred	**426,118**	405,141	**5**	378,759	**7**
Dividends to policyholders	**7,202**	5,927	**22**	5,688	**4**
Underwriting income	$ **42,105**	63,482	**(34)**	75,671	**(16)**

GAAP Ratios:

Loss and loss expense ratio	**63.8%**	63.1	**0.7**	61.9	**1.2**
Underwriting expense ratio	**32.5%**	31.5	**1.0**	31.3	**0.2**
Dividends to policyholders ratio	**0.5%**	0.5		0.5	
Combined ratio	**96.8%**	95.1	**1.7**	93.7	**1.4**
Statutory Ratios:					
Loss and loss expense ratio	**63.4%**	62.9	**0.5** pts	61.8	**1.1** pts
Underwriting expense ratio	**32.0%**	31.6	**0.4**	31.3	**0.3**
Dividends to policyholders ratio	**0.5%**	0.5		0.5	
Combined ratio	**95.9%**	95.0	**0.9**	93.6	**1.4**

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NPW increased in 2007 compared to 2006 and 2005. Premium growth in 2007 was attributable to increases in direct new business written of $36.4 million to $313.3 million for 2007 compared to 2006 partially offset by: (i) a slight reduction in retention for 2007 compared to 2006 and 2005; (ii) decreases in audit and endorsement premium activity of $11.5 million and $6.3 million, respectively; and, (iii) renewal price decreases, including exposure of 0.3% in 2007 reflecting the competitive pressure on our renewal book of business.

Premium growth in 2006 as compared to 2005 was attributable to increases in direct new business of $14.1 million to $276.9 million coupled with renewal price increases, including exposure, of 2.2% in 2006.

NPE increased reflecting increases in NPW as discussed above.

The GAAP loss and loss expense ratio increased 0.7 points in 2007 compared to 2006 and 1.2 points in 2006 compared to 2005, primarily due to: (i) lower pricing on our commercial book of business; and, (ii) increases in property losses. Included in total property losses were catastrophe losses that decreased $3.6 million, or 0.3 points, to $12.0 million in 2007 compared to 2006 and increased $11.8 million or 0.9 points to $15.6 million in 2006 compared to 2005. The GAAP loss and loss expense ratio increases were partially offset by: (i) underwriting improvements related to the implementation of our long-term strategies; and, (ii) favorable prior year loss and loss expense development within our workers compensation and commercial auto lines of business.

For 2007, net favorable prior year loss and loss expense development within our casualty lines of business amounted to approximately $20 million, or 1.5 points, compared to approximately $2 million in 2006, or 0.1 points, and minimal prior year loss and loss expense development in 2005.

The increase in the GAAP underwriting expense ratio in 2007 compared to 2006 and 2005 was attributable to increases in underwriting expenses that outpaced premium growth. These underwriting expense increases were driven by higher labor costs. For additional information regarding our initiatives in the management of the underwriting expense ratio, see the outlook section below and Note 22, Subsequent Events in Item 8. Financial Statements and Supplementary Data of this Form 10-K.

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

Commercial Automobile

($ in thousands)	2007	2006	2007 vs. 2006	2005	2006 vs. 2005
Statutory NPW	$ **319,176**	319,710	**%**	325,048	(2)%
Statutory NPE	**315,259**	319,921	**(1)**	320,080	
Statutory combined ratio	**88.1%**	88.1	pts	74.4	13.7 pts
% of total statutory commercial NPW	**23%**	24		26	

Our continued strong performance in this line is the result of underwriting and pricing improvements over the last several years. We have implemented targeted rate decreases on the best accounts to grow this profitable line of business. The policy count on this line of business increased 8% in 2007 compared to 2006 driven by new policy count increases of 18%. In 2006, as compared to 2005, policy counts increased 6% driven by new policy count increases of 4%. However, renewal prices, including exposure, decreased 2.9% in 2007 compared to a decrease of 1.1% in 2006 and an increase of 0.4% in 2005, which has put pressure on NPW and NPE. Lower severity trends have resulted in favorable prior year statutory loss and loss expense development of approximately $19 million in 2007 compared to $15 million in 2006 and $48 million in 2005.

General Liability

($ in thousands)	2007	2006	2007 vs. 2006	2005	2006 vs. 2005
Statutory NPW	$ **420,388**	413,381	**2%**	382,172	8%
Statutory NPE	**410,024**	402,745	**2**	363,713	11
Statutory combined ratio	**98.8%**	96.5	**2.3** pts	97.5	(1.0) pts
% of total statutory commercial NPW	**31%**	31		30	

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Total policy counts in this line of business increased 9% in 2007 compared to 2006 and 7% in 2006 compared to 2005. New business premiums in this line of business increased 14% for 2007 compared to 2006 and 1% for 2006 compared to 2005. Evidence of the softening market is illustrated in our renewal pricing for this line which, including exposure, decreased 1.1% in 2007 compared to increases of 1.5% in 2006 and 3.0% in 2005. Continuing evidence of the softening market is illustrated by retention that decreased slightly to 75% in 2007 compared to 77% in 2006 and 76% in 2005.

Pricing pressure, coupled with higher loss costs, continues to put pressure on profitability in this line of business. However, we continue to concentrate on our long-term strategy to improve profitability, which focuses on: (i) contractor growth in business segments with lower completed operations exposures; and (ii) contractor and subcontractor underwriting guidelines to minimize losses.

Workers Compensation

($ in thousands)	**2007**	2006	**2007 vs. 2006**	2005	2006 vs. 2005
Statutory NPW	$ **336,189**	325,008	**3%**	309,584	5%
Statutory NPE	**325,657**	314,221	**4**	293,311	7
Statutory combined ratio	**101.6%**	108.4	**(6.8) pts**	124.1	(15.7) pts
% of total statutory commercial NPW	**25%**	25		25	

Our multi-faceted workers compensation strategy, which incorporates our knowledge management and predictive modeling initiatives, has enabled us to retain and write more of the best accounts, leading to 2007 increases in total policy counts of 9% compared to 2006 and 6% in 2006 compared to 2005. Direct new voluntary policy premiums increased 28% for 2007 compared to 2006 and 30% for 2006 compared to 2005. At the same time, these initiatives have allowed us to target price increases for our worst performing business, which contributed to the decrease in our retention in 2007 to 79% from 80% in 2006 and 81% in 2005, thereby improving the profitability of our retained business.

The improvement in the statutory combined ratio of this line of 6.8 points in 2007 compared to 2006 and 15.7 points in 2006 compared to 2005 reflects not only the ongoing progress resulting from the execution of our workers compensation strategies, but also favorable prior year statutory development of $3 million attributable to these strategies, partially offset by an increase in the tail factor related to medical inflation and general development trends. Favorable prior year statutory development of approximately $2 million in 2006 was driven, in part, by savings realized from changing medical and pharmacy networks outside of New Jersey and re-contracting our medical bill review services. Adverse prior year statutory development of $40 million in 2005 was primarily the result of adverse loss trends, specifically in medical costs in the 2001 and prior accident years, which warranted an increase in management s best estimates within the loss range.

Commercial Property

($ in thousands)	**2007**	2006	**2007 vs. 2006**	2005	2006 vs. 2005
Statutory NPW	$ **198,903**	188,839	**5%**	176,764	7%
Statutory NPE	**190,681**	182,351	**5**	168,281	8
Statutory combined ratio	**92.7%**	82.1	**10.6 pts**	69.5	12.6 pts
% of total statutory commercial NPW	**15%**	14		14	

Net premiums written for this line of business increased in 2007 compared to 2006 and 2005 due to increases in total policy counts of 11% in 2007 compared to 2006 and 9% in 2006 compared to 2005. Stable retention of approximately 81% over the past three years has also led to an increase in net premiums written. NPW growth was partially offset by renewal prices, including exposure, which decreased 0.4% in 2007 compared to increases of 2.1% in 2006 and 2.8% in 2005.

Although still profitable, the higher statutory combined ratio for commercial property reflects lower pricing and increased property losses especially in comparison to the unusually low experience in 2006. The increase in property losses appears to be part of the normal variability in this line and was primarily the result of an increase in the severity of losses, mainly attributable to flood events and electrical fires. For 2007, catastrophe losses decreased $2.5 million to $10.7 million compared to 2006, however, for 2006, catastrophe losses increased $10.4 million to $13.2 million compared to 2005.

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Personal Lines

Personal Lines

($ in thousands)	2007	2006	2007 vs. 2006	2005	2006 vs. 2005
GAAP Insurance Operations Results:					
NPW	$ **204,069**	217,088	**(6)%**	200,842	8%
NPE	**203,304**	213,788	**(5)**	209,347	2
Less:					
Losses and loss expenses incurred	**160,629**	148,657	**8%**	157,182	(5)%
Net underwriting expenses incurred	**68,823**	70,635	**(3)**	58,108	22
Underwriting loss	$ **(26,148)**	(5,504)	**(375)**	(5,943)	7
GAAP Ratios:					
Loss and loss expense ratio	**79.0%**	69.5	**9.5 pts**	75.1	(5.6) pts
Underwriting expense ratio	**33.9%**	33.1	**0.8**	27.8	5.3
Combined ratio	**112.9%**	102.6	**10.3**	102.9	(0.3)
Statutory Ratios[1]:					
Loss and loss expense ratio	**78.2%**	68.5	**9.7 pts**	73.4	(4.9) pts
Underwriting expense ratio	**29.7%**	29.7		27.2	2.5
Combined ratio	**107.9%**	98.2	**9.7**	100.6	(2.4)

1 The statutory ratios include Selective s flood line of business, which is included in the Diversified Insurance Services Segment on a GAAP basis and therefore excluded from the GAAP ratios. The total Statutory Combined ratio excluding flood was 113.0% for 2007, 102.9% for 2006, and

105.0 % for
2005.

NPW decreased in 2007 compared to 2006 after increasing in 2006 compared to 2005. Excluding the impact from the cancellation of the New Jersey Homeowners Quota Share Treaty (Quota Share Treaty), which increased 2006 NPW by $11.3 million, NPW decreased 1% in 2007 compared to 2006 and increased 2% in 2006 compared to 2005.

The remaining decrease in NPW in 2007 compared to 2006 was primarily driven by a decline in NPW for our New Jersey personal automobile business of $12.6 million to $80.1 million in 2007. This resulted from a reduction in the number of New Jersey personal automobiles that we insure, primarily driven by repricing at higher levels through our MATRIX® pricing system. Partially offsetting this decrease were increases in our personal automobile business outside of New Jersey of $5.4 million to $50.0 million coupled with increases in our homeowners business of $4.5 million to $65.4 million in 2007.

The New Jersey personal automobile market has been impacted by the introduction of new companies writing business in the state with rating plans that allow them to price accounts competitively without the legacy issue of repricing existing accounts through filed rate increases. Our new Personal Lines rating plan was approved by the New Jersey Department of Banking and Insurance (NJDOBI) and was implemented in August 2006. Our new plan allows us to better evaluate and price risks, which will help us to profitably compete for new business in our agencies. We have moved our entire existing renewal inventory into our new pricing and tiering structure in New Jersey, which has caused a dislocation in this book of business due to the repricing of certain business at higher levels, some of which did not renew. As annual increases or decreases are capped at 20% by the NJDOBI, we expect improvements to materialize over a three-year period. We continue to focus on increasing new business production within and outside of New Jersey through this advanced pricing methodology. In our continuing efforts to improve our existing book of automobile business, we have implemented average renewal rate increases of 13.1% in Pennsylvania effective August 1, 2007, and 8.5% in Maryland effective September 1, 2007. These changes applied to business written prior to the implementation of our MATRIX® program. In 2008, we are taking steps to continue to improve our automobile business by filing further rate increases of 7% in New Jersey, which is targeted for May, 7% in Pennsylvania, targeted for July, and 6% in Maryland, targeted for August. The New Jersey change applies to all business, and the other changes apply to business originally written prior to the implementation of our MATRIX® program. Such rate increases were necessary, as these states have regulatory restrictions on moving the renewal book into our new pricing methodology and the previous rates did not yield sufficient profitability.

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Excluding the impact of the one-time benefit received from the cancellation of the Quota Share Treaty, NPW increased 2% in 2006 compared to 2005. This increase reflects the retention of homeowners business that had previously been ceded under the treaty coupled with an increase in direct homeowners premiums written of 6% in 2006 compared to 2005, partially offset by a decrease in our personal automobile business of $16.6 million to $137.4 million. NPW on our personal automobile line of business decreased in 2006 as a result of the ongoing competition in the New Jersey personal automobile marketplace coupled with our rating plans that were not competitive through the first half of the year due to a historically restrictive rating environment.

The fluctuations in NPE reflect the fluctuations in NPW as discussed above.

The deterioration in the GAAP loss and loss expense ratio in 2007 compared to 2006 was primarily driven by decreased pricing in our New Jersey personal automobile line of business coupled with the following:

An increase of $6.7 million in non-catastrophe property losses in 2007 compared to 2006.

Unfavorable prior year development in our casualty lines of $1 million in 2007 compared to favorable prior year development of $6 million in 2006. The unfavorable development in 2007 reflects (i) higher severity in accident year 2006 for our personal automobile line of business; (ii) adverse prior year development due to unfavorable trends in claims for groundwater contamination caused by the leakage of certain underground oil storage tanks in our homeowners line of business; and, (iii) several significant losses in our personal umbrella line of business, partially offset by lower than expected loss emergence for accident years prior to 2006. In 2006, the favorable prior year development primarily related to lower than expected frequency in personal automobile claims.

This deterioration in the loss and loss expense ratio was partially offset by a reduction in catastrophe losses of $2.2 million, to $2.9 million in 2007.

The improvement in the 2006 GAAP loss and loss expense ratio was driven by the reserving actions taken in 2005 in light of a New Jersey Supreme Court decision that eliminated the application of the serious life impact standard to personal automobile cases under the verbal tort threshold of New Jersey s Automobile Insurance Cost Reduction Act (AICRA) and resulted in an increase to our reserves of $13.0 million in the second quarter of 2005. The implementation of AICRA, and our rating and tiering actions had enabled us to achieve profitability in the New Jersey personal automobile line of business over the two years prior to the ruling. However, factoring higher expected claim costs into our New Jersey personal automobile excess profits calculation eliminated $5.5 million of excess profits reserves in the second quarter of 2005.

The deterioration in the GAAP underwriting expense ratio in 2007 compared to 2006 and 2005 was primarily attributable to overhead costs that have outpaced premiums earned. In addition, costs associated with the reorganization of the Personal Lines department in May of 2007, which reduced the staffing level by 31 employees, added 0.6 points to the underwriting expense ratio in 2007.

We have also implemented a three-part profit improvement plan that will focus on returning Personal Lines to profitability by the end of 2009. To decrease costs associated with writing policies and servicing claims, we plan to: (i) utilize the full capability of our MATRIX® pricing system, along with widening the One & Done® pipeline to maximize the cost savings that are associated with these policies; (ii) roll out our knowledge management initiatives to the Personal Lines operation in May 2008; and, (iii) move additional claims to our centrally located claims department to cut down on costs incurred for claims handling.

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Reinsurance

We have reinsurance contracts that cover both property and casualty business. We use traditional forms of reinsurance and do not utilize finite risk reinsurance. Our contracts can be segregated into the following key categories:

- *Property Reinsurance* includes our Property Excess of Loss treaty purchased for protection against large individual property losses and our Property Catastrophe treaty purchased to provide protection for the overall property portfolio against severe catastrophic events. Facultative reinsurance is also used for property risks that are in excess of our treaty capacity.
- *Casualty Reinsurance* purchased to provide protection for both individual large casualty losses and catastrophic casualty losses involving multiple claimants or insureds. Facultative reinsurance is also used for casualty risks that are in excess of our treaty capacity.
- *Other Reinsurance* includes smaller treaties, such as our Surety and Fidelity Excess of Loss treaties, which do not fall within the categories above.

Additional information regarding the terms and related coverage associated with each of our categories of reinsurance can be found in Item 1. Business of this Form 10-K.

We regularly reevaluate our overall reinsurance program and try to develop the most effective ways to manage our risk. Our analysis is based on a comprehensive process that includes periodic analysis of modeling results, aggregation of exposures, exposure growth, diversification of risks, limits written, projected reinsurance costs, financial strength of reinsurers and projected impact on earnings and statutory surplus. We strive to balance sometime opposing considerations of reinsurer credit quality, price, terms, and our appetite for retaining a certain level of risk.

Terrorism Reinsurance

In addition to treaty and facultative reinsurance, the Insurance Subsidiaries are partially protected by the Terrorism Risk Insurance Act of 2002, which was modified and extended through December 31, 2014 via the Terrorism Risk Insurance Program Reauthorization Act of 2007. For further information regarding this legislation, see Item 1A. Risk Factors of this Form 10-K.

Property Reinsurance

The Property Catastrophe treaty renewed effective January 1, 2008 with a 15% reduction in premium. The current treaty provides per occurrence coverage for 95% of $310.0 million in excess of $40.0 million retention compared to 95% of $335.0 million in excess of $40.0 million retention under the expiring treaty. The annual aggregate limit net of our co-participation is $589.0 million compared to $636.5 million for the expiring treaty. We continue to assess our property catastrophe exposure aggregations, modeled results and effects of growth on our property portfolio and strive to manage our exposure to individual large events balanced against the cost of reinsurance protection.

The following table presents Risk Management Solutions, Inc. s (RMS) v.7.0 modeled hurricane losses based on the Insurance Subsidiaries property book of business as of June 30, 2007:

($ in thousands)	Historic Basis			Stochastic Basis		
Occurrence Exceedence Probability	**Gross Losses RMS v.7.0**	**Net Losses[1]**	**Net Losses as a Percent of 12/31/07 Equity**	**Gross Losses RMS v.7.0**	**Net Losses[1]**	**Net Losses as a Percent of 12/31/07 Equity**
4.00% (1 in 25 year event)	$ 49,277	26,874	2 %	$ 69,947	28,823	3%
2.00% (1 in 50 year event)	100,670	31,702	3	134,532	34,057	3
1.00% (1 in 100 year event)	190,897	37,977	4	244,445	41,015	4
0.40% (1 in 250 year event)	400,631	79,637	7	485,837	135,021	13

1

Losses are after tax and include applicable reinstatement premium.

RMS v.7.0 allows modeling based on the long term averages (historic view) and modeling based on a five year projection that includes an assumption of elevated hurricane activity in the Atlantic Basin in the short to medium term (stochastic view). Results of both models are provided above for select probabilities. Our current catastrophe program provides protection for a 1 in 209 year event, or an event with 0.5 % probability according to the RMS v.7.0 historic model, and for a 1 in 159 year event, or an event with 0.6% probability according to RMS v.7.0 stochastic model.

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The retention and limit under our Property Excess of Loss treaty renewed July 1, 2007, remained the same at $23.0 million in excess of $2.0 million. Consistent with prior year contract, all nuclear, biological, chemical and radioactive reaction (NBCR) losses are excluded from the Property Excess of Loss treaty. Terrorism (excluding NBCR) and per occurrence aggregate limits remain at $46.5 million.

Casualty Reinsurance

The Casualty Excess of Loss program was renewed effective July 1, 2007, with no changes to the expiring structure. The total program currently provides the following coverage:

- Workers compensation only treaty, covering up to $3.0 million in excess of $2.0 million per occurrence;
- All Casualty Lines Excess of Loss treaty (Casualty Treaty) covering all casualty business, including workers compensation, up to $45.0 million, in excess of $5.0 million per occurrence; and
- Additional layer to the Casualty Treaty covering all casualty business, including workers compensation, up to 75% of $40.0 million in excess of $50 million.

The total coverage for workers compensation claims continues to be $78.0 million per occurrence and $75.0 million per occurrence for casualty claims other than workers compensation, net of our co-participation in the $40.0 million in excess of $50.0 million layer.

Other Reinsurance

Our Surety and Fidelity Excess of Loss treaty was renewed effective January 1, 2008, with essentially no changes in coverage and a 2.5% increase in estimated ceded premium due to an increase in projected subject premium offset by a decrease in the rate.

Effective January 1, 2008, we entered into a new treaty which covers our participation in the involuntary National Council on Compensation Insurance (NCCI) pool, a residual workers compensation market. The treaty provides 100% Quota Share coverage, including terrorism coverage, for the 2008 underwriting year business assumed from NCCI and has an aggregate combined ratio limit of approximately 142%. The treaty is placed with two carriers both rated A+ by A. M. Best and we expect to cede $6.0 million in premium in 2008. We believe that the protection provided within this treaty for residual market business will be especially beneficial given current market conditions and the expected deterioration in the experience of the NCCI pool.

Investments

Our investment portfolio consists primarily of fixed maturity investments (83%), but also contains equity securities (7%), short-term investments (5%), and other investments (5%). Our investment philosophy includes setting certain return and risk objectives for our fixed maturity and equity portfolios. The primary return objective of our fixed maturity portfolio is to maximize after-tax investment yield and income while balancing certain risk objectives. The return objective of the equity portfolio is to meet or exceed a weighted-average benchmark of public equity indices. The risk objective for our entire portfolio is to ensure that our investments are structured conservatively, focusing on: (i) asset diversification; (ii) investment quality; (iii) liquidity, particularly to meet the cash obligations of the insurance operations; (iv) consideration of taxes; and (v) preservation of capital.

Our investment returns for the last three years are as follows:

($ in thousands)	**2007**	2006	**2007 vs. 2006**	2005	2006 vs. 2005
Net investment income before tax	$ **174,144**	156,802	**11%**	135,950	15%
Net investment income after tax	$ **133,669**	121,460	**10%**	104,840	16%
Total invested assets	**3,733,029**	3,596,102	**4%**	3,245,545	11%
Effective tax rate	**23.2 %**	22.5	**0.7**pts	22.9	(0.4) pts
Annual after-tax yield on investment portfolio	**3.6 %**	3.6	pts	3.5	0.1 pts

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The increase in net investment income, before tax, of $17.3 million for 2007 compared to 2006 was primarily the result of increased fixed maturity income due to higher invested assets and increased income of approximately $7.0 million from certain alternative investments within our Other investments category. Growth in net investment income, before tax, of $20.9 million for 2006 compared to 2005 was primarily attributable to the increase in our investment portfolio as well as increased income of $4.0 million in alternative investment income and $1.0 million in dividend income. Our investment portfolio totaled $3.7 billion at December 31, 2007, an increase of 4% compared to $3.6 billion at December 31, 2006. The increase in invested assets was due to substantial cash flows from operations of $386.3 million in 2007, $393.1 million in 2006 and $406.8 million in 2005. Cash flows from operations in 2007 were partially offset by cash outflows of: (i) $143.3 million related to treasury stock repurchases under our authorized program; (ii) $37.5 million related to principal payments on our senior convertible notes; and (iii) $18.3 million related to principal payments on our 8.87% and 8.63 senior notes. Debt offerings in September 2006 and November 2005 added approximately $96.8 million and $98.4 million in assets, respectively, in 2006 and 2005.

We continue to maintain a conservative, diversified investment portfolio, with fixed maturity investments representing 83% of invested assets. Sixty-nine percent (69%) of our fixed maturities portfolio is rated AAA while the portfolio has an average rating of AA+, S&P s second highest credit quality rating. High credit quality continues to be a cornerstone of our investment strategy, as evidenced by the fact that almost 100% of the fixed maturities are investment grade. At December 31, 2007 and 2006, non-investment grade securities (below BBB-) represented less than 1%, or approximately $10 million, of our fixed maturity portfolio. Our mortgage backed securities portfolio totaled $697.9 million at December 31, 2007, with an average credit rating of AA+. Selective has no significant sub-prime mortgage exposure. Prior to investing in mortgage-backed securities, we analyze, among other credit factors, each transaction s FICO credit score and loan to value ratio. For additional information regarding our fixed investment income portfolio, see Exhibit 99.1 of Form 8-K dated January 23, 2008 and Exhibit 99.2 of Form 8-K dated February 12, 2008. For additional information regarding market risk related to our investment portfolio, see Item 7A. Quantitative and Qualitative Disclosures About Market Risk of this Form 10-K.

The following table presents the Moody s and S&P ratings of our fixed maturities portfolio:

Rating	**2007**	2006
Aaa/AAA	**69%**	73%
Aa/AA	**16%**	17%
A/A	**9%**	7%
Baa/BBB	**6%**	3%
Ba/BB or below	**<1%**	<1%
Total	**100%**	100%

Our fixed maturity investment strategy is to make security purchases that are attractively priced in relation to perceived credit risks. We manage the interest rate risk associated with holding fixed maturity investments by monitoring and maintaining the average duration of the portfolio with a view toward achieving an adequate after-tax return without subjecting the portfolio to an unreasonable level of interest rate risk. We invest our fixed maturities portfolio primarily in intermediate-term securities to limit the overall interest rate risk of fixed maturity investments. Generally, the Insurance Subsidiaries have a duration mismatch between assets and liabilities. The duration of the fixed maturity portfolio, including short-term investments, is 3.9 years while the Insurance Subsidiaries liabilities have a duration of 3.4 years. The current duration of our fixed maturities is within our historical range and is monitored and managed to maximize yield and limit interest rate risk. The duration mismatch is managed with a laddered maturity structure and an appropriate level of short-term investments that avoids liquidation of available-for-sale fixed maturities in the ordinary course of business. Liquidity is always a consideration when buying or selling securities, but because of the high quality and active market for the majority of securities in our investment portfolio, the securities sold have not diminished the overall liquidity of our portfolio. Our normal liquidity requirements have historically been met by operating cash flow from our Insurance Operations and Diversified Insurance Services segments. We expect our liquidity requirements in the future to be met by these sources of funds or, if necessary, the issuance of debt and equity securities, as well as borrowings from our credit facility. Managing investment risk by adhering to these strategies is intended to protect the interests of our stockholders and the policyholders of our Insurance Subsidiaries, while enhancing our financial strength and underwriting capacity.

Realized Gains and Losses

Realized gains and losses are determined on the basis of the cost of specific investments sold, and are credited or charged to income. Also included in realized gains and losses are write-downs for other than temporary impairment charges. Our Investments segment included net realized gains before tax of $33.4 million in 2007, compared to $35.5 million in 2006, and $14.5 million in 2005. The realized gains were principally from the sale of equity securities. Net realized gains in 2007 and 2006 reflect the sale of several equity positions which resulted in re-weighting various sector exposures. Realized gains were partially offset by realized losses, of which the most significant losses are discussed below. We maintain a high quality and liquid investment portfolio and the sale of the securities that resulted in realized gains did not change the overall liquidity of the investment portfolio. Our philosophy for sales of securities generally is to reduce our exposure to securities and sectors based upon economic evaluations or if the fundamentals for that security or sector have deteriorated. We typically have a long investment time horizon and our turnover is low, which has resulted in many securities accumulating large unrealized gains. Every purchase or sale is made with the intent of improving future investment returns.

The following table summarizes our net realized gains by investment type:

($ in thousands)	2007	2006	2005
Held-to-maturity fixed maturities			
Gains	$	16	106
Available-for-sale fixed maturities			
Gains	**445**	2,460	1,468
Losses	**(7,150)**	(6,756)	(4,196)
Available-for-sale equity securities			
Gains	**50,254**	43,542	21,149
Losses	**(9,359)**	(3,783)	(4,063)
Available-for-sale other investments			
Gains	**847**		
Losses	**(1,683)**		
Total net realized gains	**$ 33,354**	35,479	14,464

Realized losses within the available-for-sale fixed maturity securities increased in 2007 as compared to 2006 and 2005. This is primarily the result of other than temporary impairment charge associated with two commercial real estate collateralized debt obligations (CDO) for $4.9 million. During the second half of 2007, the market for lower-rated commercial mortgage-backed securities (CMBS) saw severe contagion effects from the sub-prime mortgage crisis. CMBS spreads, particularly subordinated tranche CMBS, widened dramatically over the course of the second half of the year. As a result, CDOs in general have become extremely dislocated and difficult to value as the market spreads between bid and ask prices are very wide, even for CDOs that do not have any sub-prime asset backed exposure. At this time, there have been no credit defaults or rating downgrades on CDOs in our portfolio. However, given the severe lack of liquidity currently being experienced in the marketplace, it is difficult to value certain securities and, as a result, we recorded an other than temporary impairment charge on two commercial real estate CDOs in 2007. During 2006, Selective had not recognized any realized losses from other than temporary charges, whereas during 2005 Selective had recorded $1.2 million in realized losses related to other than temporary charges.

The dislocation in the sub-prime mortgage sector had also extended more broadly into both the credit and equity markets in early August 2007. These events adversely affected quantitative strategies that use factor-based models to identify incorrectly priced securities, and produced widespread de-leveraging and unprecedented negative returns to all standard quantitative factors in the U.S. during early August. With the increased uncertainty and risk of the equity markets at that time, we had hedged our direct exposure to the S&P 500 by investing in an exchange-traded fund (ETF). The fund was set up to perform inversely to the S&P 500 Index at a 2:1 ratio. Through this action, we had protected $90 million of our equity capital base. While the investment limited the upside of the equity portfolio, we believed that this strategy was appropriate during this period of extreme market uncertainty. As a result of the aggressive actions by the Federal Reserve to lower the federal funds rate later in the third quarter, improvements were seen in the equity markets leading us to sell our interest in the ETF. This sale resulted in a $4.3 million realized loss in the third quarter of 2007.

In light of the market conditions, we also decided to dispose of one of our other investments, a global quantitative market-neutral equity hedge fund, primarily due to its undifferentiated model and greater than anticipated volatility. This disposition resulted in a $1.7 million realized loss and is reflected in the available-for-sale other investment category in the table above.

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The following tables present the period of time that securities sold at a loss were continuously in an unrealized loss position prior to sale:

Period of time in an Unrealized loss position ($ in millions)	**2007** Fair Value on Sale Date	**2007** Realized Loss	2006 Fair Value on Sale Date	2006 Realized Loss	2005 Fair Value on Sale Date	2005 Realized Loss
Fixed maturities:						
0 6 months	$ **29.0**	**0.7**	94.9	1.5	67.1	1.4
7 12 months	**31.6**	**0.4**	76.6	2.5	32.4	0.7
Greater than 12 months	**10.2**	**0.2**	35.8	1.5	33.0	1.1
Total fixed maturities	**70.8**	**1.3**	207.3	5.5	132.5	3.2
Equity Securities:						
0 6 months	**60.0**	**8.8**	15.5	3.1	11.2	1.8
7 12 months	**1.6**	**0.4**	3.2	0.7	3.6	1.0
Greater than 12 months	**0.4**	**0.2**			0.7	0.1
Total equity securities	**62.0**	**9.4**	18.7	3.8	15.5	2.9
Other investments:						
0 6 months	**5.3**	**1.7**				
7 12 months						
Greater than 12 months						
Total other investments	**5.3**	**1.7**				
Total	$ **138.1**	**12.4**	226.0	9.3	148.0	6.1

Unrealized Losses

The following table summarizes the aggregate fair value and gross pre-tax unrealized loss recorded in our accumulated other comprehensive income, by asset class and by length of time, for all available-for-sale securities that have continuously been in an unrealized loss position at December 31, 2007 and December 31, 2006:

Period of time in an Unrealized loss position ($ in millions)	**2007** Fair Value	**2007** Gross Unrealized Loss	2006 Fair Value	2006 Gross Unrealized Loss
Fixed maturities:				
0 6 months	$ **219.2**	**8.0**	376.6	1.7
7 12 months	**188.6**	**11.6**	107.6	0.7
Greater than 12 months	**340.5**	**5.7**	705.8	10.1
Total fixed maturities	**748.3**	**25.3**	1,190.0	12.5
Equities:				
0 6 months	**25.7**	**1.1**	7.8	0.2

7 12 months		**1.1**	**0.4**		
Greater than 12 months				0.4	0.2
Total equity securities		**26.8**	**1.5**	8.2	0.4
Other:					
0 6 months				6.9	0.1
7 12 months					
Greater than 12 months					
Total other securities				6.9	0.1
Total	$	**775.1**	**26.8**	1,205.1	13.0

Although overall interest rates decreased in 2007, the unrealized losses for fixed maturity securities increased due primarily to the credit stress and dislocation in the capital markets, along with inflation worries and uncertainty about the U.S. economy in general caused fixed maturities credit spreads to widen. As of December 31, 2007, there are 240 securities in an unrealized loss position. Broad changes in the overall market or interest rate environment generally do not lead to impairment charges.

The following table presents information regarding our available-for-sale fixed maturities that were in an unrealized loss position at December 31, 2007 by contractual maturity:

Contractual Maturities ($ in millions)		Amortized Cost	Fair Value
One year or less	$	91.7	90.1
Due after one year through five years		373.4	365.0
Due after five years through ten years		233.7	223.2
Due after ten years through fifteen years		40.2	36.9
Due after fifteen years		34.6	33.1
Total	$	773.6	748.3

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Investment Outlook

As we look forward, we see a number of risks that could contribute to an extended period of uncertainty and volatility in the financial markets. Recession fears abound and negative economic predictions are increasingly more common. We foresee no stabilizing signs in the U.S. housing market. Declining home prices are seemingly already affecting retail sales and other consumer discretionary spending. A return to a more normally functioning housing market may not truly occur until the securitization markets start to properly function again. We are encouraged by signs pointing to a possible mortgage refinance wave that could occur in 2008 as interest rates and mortgage rates have declined. However, we believe the post-credit bubble effects will continue to keep volatility high in the financial markets for some time. Another concern is whether a financial market malaise will result in a global recession. Given the surge in prices of oil and other commodities, pricing inflation also remains a risk.

Our fixed income focus will be to seek high quality securities to reduce portfolio volatility and to maximize after tax investment yield. This will entail maintaining a fairly elevated level of new purchase allocations to municipal securities, as they present attractive relative value on a taxable equivalent yield basis. Volatility, downgrades, and a lack of market liquidity in ABS and CMBS may also present some interesting opportunities in those sectors, as new issue volumes are expected to be down by well over 25% or more by some estimates. The volatility in this sector is not expected to end soon as leveraged positions in structured bonds are unwound. Nonetheless, we expect that further Federal Reserve rate cuts may certainly aid the markets in 2008; although additional cuts could further weaken the U.S. dollar, which could have a far-reaching negative impact in the U.S. financial markets.

Considering all the volatility in the equity market, we are even more cautious now than we were in late 2007. We will continue to manage through this period of uncertainty by investing in companies with more defensive characteristics, such as solid free cash flow, exposure to secular growth themes, strong balance sheets and reasonable valuations. Other considerations are favorable long-term corporate performance and attractive relative historical valuations.

Our outlook for the alternative investment strategy continues to be positive over the longer-term. In the near term, we expect the current credit crisis to slow the pace of merger and acquisitions, as potential buyers no longer have access to large quantities of debt with favorable credit terms. This will reduce the return that many private equity sponsors have been able to realize over the past few years. Therefore, we expect a slowdown in deal activity and a reduction in distributions to private equity investors.

Diversified Insurance Services Segment

The Diversified Insurance Services operations include two core functions: (i) human resource administration outsourcing (HR Outsourcing); and (ii) flood insurance. We believe these operations are in markets that continue to offer growth opportunities. During 2007, these operations provided a contribution of $0.22 per diluted share, compared to $0.19 per diluted share in 2006. Contributions from the Diversified Insurance Services segment, particularly the flood business, continue to provide some mitigation of insurance pricing cycles and the adverse impact that catastrophe losses have on our Insurance Operations segment. We evaluate the performance of these operations based on several measures, including, but not limited to, results of operations in accordance with GAAP, with a focus on our return on revenue (net income divided by revenues). The results for this segment s continuing operations are as follows:

For the Year Ended December 31, ***($ in thousands)***	**2007**	2006	2005
HR Outsourcing			
Revenue	$ **59,109**	63,322	60,227
Pre-tax profit (loss)	**3,993**	4,810	3,793
Flood Insurance			
Revenue	**47,842**	41,522	34,320
Pre-tax profit	**10,360**	10,167	9,060
Other			
Revenue	**8,615**	5,682	4,164
Pre-tax profit	**4,270**	2,831	1,940

Total			
Revenue from continuing operations	**115,566**	110,526	98,711
Pre-tax profit from continuing operations	**18,623**	17,808	14,793
After-tax profit from continuing operations	**12,355**	11,848	9,844
After-tax return on revenue	**10.7%**	10.7%	10.0%

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HR Outsourcing

HR Outsourcing revenue declined in 2007 compared to 2006 and 2005, primarily as a result of a reduction in worksite lives. As of December 31, 2007, our worksite lives were down 7% to 25,111 compared to 26,952 as of December 31, 2006 and 23,974 as of December 31, 2005, resulting from recent economic trends as well as the sale,