

SAFETY INSURANCE GROUP INC
Form 10-Q
August 08, 2011
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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2011

OR

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

For the transition period from _____ to _____

Commission File Number: 000-50070

SAFETY INSURANCE GROUP, INC.

(Exact name of registrant as specified in its charter)

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Delaware

(State or other jurisdiction of incorporation or organization)

13-4181699

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

20 Custom House Street, Boston, Massachusetts 02110

(Address of principal executive offices including zip code)

(617) 951-0600

(Registrant's telephone number, including area code)

Not Applicable

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

As of August 3, 2011, there were 15,187,777 shares of common stock with a par value of \$0.01 per share outstanding.

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

	June 30, 2011 (Unaudited)	December 31, 2010
Assets		
Investments:		
Securities available for sale:		
Fixed maturities, at fair value (amortized cost: \$994,387 and \$1,030,354)	\$ 1,033,321	\$ 1,063,237
Equity securities, at fair value (cost: \$20,002 and \$13,704)	21,446	14,624
Other invested assets, at cost, which approximates fair value	5,818	2,817
Total investments	1,060,585	1,080,678
Cash and cash equivalents	55,511	40,291
Accounts receivable, net of allowance for doubtful accounts	160,434	145,726
Receivable for securities sold	10,675	
Accrued investment income	9,558	9,471
Taxes recoverable	11,719	5,061
Receivable from reinsurers related to paid loss and loss adjustment expenses	8,419	4,579
Receivable from reinsurers related to unpaid loss and loss adjustment expenses	52,475	53,147
Ceded unearned premiums	11,552	12,461
Deferred policy acquisition costs	57,979	52,824
Deferred income taxes	1,340	3,643
Equity and deposits in pools	13,308	19,971
Other assets	13,038	11,600
Total assets	\$ 1,466,593	\$ 1,439,452
Liabilities		
Loss and loss adjustment expense reserves	\$ 403,750	\$ 404,391
Unearned premium reserves	337,122	306,053
Accounts payable and accrued liabilities	39,286	54,239
Payable for securities purchased	10,532	
Payable to reinsurers	7,296	5,571
Other liabilities	22,185	15,722
Total liabilities	820,171	785,976
Commitments and contingencies (Note 7)		
Shareholders equity		
Common stock: \$0.01 par value; 30,000,000 shares authorized; 16,915,032 and 16,795,504 shares issued	169	168
Additional paid-in capital	154,991	151,317
Accumulated other comprehensive income, net of taxes	26,246	21,972
Retained earnings	520,542	535,545
Treasury stock, at cost: 1,727,455 shares	(55,526)	(55,526)
Total shareholders equity	646,422	653,476
Total liabilities and shareholders equity	\$ 1,466,593	\$ 1,439,452

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Net earned premiums	\$ 148,720	\$ 136,143	\$ 293,366	\$ 269,300
Net investment income	9,470	10,857	19,635	21,649
Net realized gains (losses) on investments	1,277	(178)	858	(68)
Finance and other service income	4,470	4,576	8,875	8,872
Total revenue	163,937	151,398	322,734	299,753
Losses and loss adjustment expenses	114,184	87,776	235,814	176,450
Underwriting, operating and related expenses	44,071	42,257	86,700	84,125
Interest expense	21	22	43	44
Total expenses	158,276	130,055	322,557	260,619
Income before income taxes	5,661	21,343	177	39,134
Income tax expense	1,576	6,254	45	11,271
Net income	\$ 4,085	\$ 15,089	\$ 132	\$ 27,863
Earnings per weighted average common share:				
Basic	\$ 0.27	\$ 1.00	\$ 0.01	\$ 1.85
Diluted	\$ 0.27	\$ 1.00	\$ 0.01	\$ 1.84
Cash dividends paid per common share	\$ 0.50	\$ 0.40	\$ 1.00	\$ 0.80
Number of shares used in computing earnings per share:				
Basic	15,184,605	15,113,357	15,142,682	15,099,304
Diluted	15,198,804	15,130,393	15,159,513	15,116,127

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

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Safety Insurance Group, Inc. and Subsidiaries

Consolidated Statements of Changes in Shareholders' Equity

(Unaudited)

(Dollars in thousands)

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income, Net of Taxes	Retained Earnings	Treasury Stock	Total Shareholders Equity
Balance at December 31, 2009	\$ 166	\$ 144,814	\$ 18,866	\$ 506,301	\$ (49,712)	\$ 620,435
Net income, January 1 to June 30, 2010				27,863		27,863
Other comprehensive income, net of deferred federal income taxes			10,753			10,753
Unearned compensation on restricted stock, net of deferred federal income taxes	1	2,095				2,096
Exercise of options, net of federal income taxes		416				416
Dividends paid				(12,062)		(12,062)
Acquisition of treasury stock					(5,814)	(5,814)
Balance at June 30, 2010	\$ 167	\$ 147,325	\$ 29,619	\$ 522,102	\$ (55,526)	\$ 643,687

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income, Net of Taxes	Retained Earnings	Treasury Stock	Total Shareholders Equity
Balance at December 31, 2010	\$ 168	\$ 151,317	\$ 21,972	\$ 535,545	\$ (55,526)	\$ 653,476
Net income, January 1 to June 30, 2011				132		132
Other comprehensive income, net of deferred federal income taxes			4,274			4,274
Unearned compensation on restricted stock, net of deferred federal income taxes	1	2,714				2,715
Exercise of options, net of federal income taxes		960				960
Dividends paid				(15,135)		(15,135)
Balance at June 30, 2011	\$ 169	\$ 154,991	\$ 26,246	\$ 520,542	\$ (55,526)	\$ 646,422

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

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

	Three Months Ended June 30,		Six Months Ended June 30,					
	2011	2010	2011	2010				
Net income	\$	4,085	\$	15,089	\$	132	\$	27,863
Other comprehensive income, net of tax:								
Unrealized holding gains during the period, net of tax expense of \$3,723, \$3,368, \$2,601, and \$5,766		6,914		6,255		4,832		10,708
Reclassification adjustment for (gains) losses included in net income, net of tax (expense) benefit of (\$447), \$62, (\$300), and \$23		(830)		116		(558)		45
Unrealized gains on securities available for sale		6,084		6,371		4,274		10,753
Comprehensive income	\$	10,169	\$	21,460	\$	4,406	\$	38,616

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

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Safety Insurance Group, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(Unaudited)

(Dollars in thousands)

	Six Months Ended June 30,	
	2011	2010
Cash flows from operating activities:		
Net income	\$ 132	\$ 27,863
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization, net	6,252	6,120
Provision (benefit) for deferred income taxes	1	(78)
Net realized (gains) losses on investments	(858)	68
Changes in assets and liabilities:		
Accounts receivable	(14,708)	(17,358)
Accrued investment income	(87)	349
Receivable from reinsurers	(3,168)	7,396
Ceded unearned premiums	909	744
Deferred policy acquisition costs	(5,155)	(5,451)
Other assets	(393)	(7,548)
Loss and loss adjustment expense reserves	(641)	(19,091)
Unearned premium reserves	31,069	30,575
Accounts payable and accrued liabilities	(14,952)	(20,699)
Payable to reinsurers	1,725	3,738
Other liabilities	6,463	(4,243)
Net cash provided by operating activities	6,589	2,385
Cash flows from investing activities:		
Fixed maturities purchased	(121,320)	(128,337)
Equity securities purchased	(10,360)	(5,797)
Other invested assets purchased	(3,060)	
Proceeds from sales and paydowns of fixed maturities	123,453	79,183
Proceeds from maturities, redemptions, and calls of fixed maturities	31,988	33,973
Proceed from sales of equity securities	4,166	2,079
Proceeds from sales of other invested assets	59	45
Fixed assets purchased	(2,051)	(296)
Net cash provided by (used for) investing activities	22,875	(19,150)
Cash flows from financing activities:		
Proceeds from stock options exercised	897	177
Excess tax benefits from stock options exercised	(6)	37
Dividends paid to shareholders	(15,135)	(12,062)
Acquisition of treasury stock		(5,814)
Net cash used for financing activities	(14,244)	(17,662)
Net increase (decrease) in cash and cash equivalents	15,220	(34,427)
Cash and cash equivalents at beginning of year	40,291	74,470
Cash and cash equivalents at end of period	\$ 55,511	\$ 40,043

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

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Safety Insurance Group, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands except per share and share data)

1. Basis of Presentation

The consolidated financial statements have been prepared on the basis of accounting principles generally accepted in the United States of America (GAAP). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates.

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

The financial information as of June 30, 2011 and for the three and six months ended June 30, 2011 and 2010 is unaudited; however, in the opinion of the Company, the information includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the financial condition and results of operations for the periods. These unaudited consolidated financial statements may not be indicative of financial results for the full year and should be read in conjunction with the audited financial statements included in the Company s annual report on Form 10-K filed with the U.S. Securities and Exchange Commission (SEC) on March 14, 2011.

The Company is a leading provider of personal lines property and casualty insurance focused primarily on the Massachusetts market. The Company s principal product line is private passenger automobile insurance, which accounted for 68.7% of its direct written premiums in 2010. The Company operates through its insurance company subsidiaries, Safety Insurance Company, Safety Indemnity Insurance Company, and Safety Property and Casualty Insurance Company (together referred to as the Insurance Subsidiaries).

The Insurance Subsidiaries began writing private passenger automobile and homeowners insurance in New Hampshire during 2008 and began writing New Hampshire personal umbrella business during 2009. For the six months ended June 30, 2011 and 2010, the Company wrote \$2,462 and \$1,191, respectively, in direct written premiums in New Hampshire.

2. Recent Accounting Pronouncements

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

In January 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-06 (Topic 820), *Improving Disclosures about Fair Value Measurements*, which amends and clarifies existing guidance related to fair value measurements and disclosures. This guidance requires new disclosures for (1) transfers in and out of Level 1 and Level 2 and reasons for such transfers; and (2) the separate presentation of purchases, sales, issuances and settlement in the Level 3 reconciliation. It also clarifies guidance around disaggregation and disclosures of inputs and valuation techniques for Level 2 and Level 3 fair value measurements. The Company adopted this guidance effective for quarter ended March 31, 2010, except for the new disclosures in the Level 3 reconciliation. The Level 3 disclosures are effective for periods ending after December 15, 2010 and were implemented for year-end December 31, 2010. The adoption of the guidance had no impact on the Company's consolidated financial condition or results of operations.

In October 2010, the FASB issued ASU No. 2010-26 (Topic 944), *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts*, which updated guidance to address diversity in practice for the accounting of costs associated with acquiring or renewing insurance contracts. This guidance modifies the definition of acquisition costs to specify that a cost be directly related to the successful acquisition of a new or renewal insurance contract in order to be deferred. The guidance also specifies that advertising costs only should be included as deferred acquisition costs if the direct-response advertising accounting criteria are met. The new guidance is effective for reporting periods beginning after December 15, 2011 and should be applied prospectively, with retrospective application permitted. The impact of adoption is not expected to be material to the Company's consolidated financial condition and results of operations.

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

In May 2011, the FASB issued ASU No. 2011-04 (Topic 820), *Fair Value Measurements, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (IFRS)*, which clarifies the application of existing fair value measurement and disclosure requirements and amends certain fair value measurement principles, requirements and disclosures. To improve consistency in global application, changes in wording were made. The guidance is to be applied prospectively for reporting periods beginning after December 15, 2011. Early adoption is not permitted. The impact of adoption is not expected to be material to the Company's consolidated financial condition and results of operations.

In June 2011, the FASB issued ASU 2011-05 (Topic 220), *Presentation of Comprehensive Income*, which amends the presentation of comprehensive income and its components. Under the new guidance, an entity has the option to present comprehensive income in a single continuous statement or in two separate but consecutive statements. Both options require an entity to present reclassification adjustments for items reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of comprehensive income are presented. The guidance is effective for reporting periods beginning after December 15, 2011 and is to be applied retrospectively. Early adoption is permitted. The impact of adoption is related to presentation only and will have no impact on the Company's results of operations and financial position.

3. Earnings per Weighted Average Common Share

Basic earnings per weighted average common share (EPS) is calculated by dividing net income by the weighted average number of basic common shares outstanding during the period including unvested restricted shares which are considered participating securities. Diluted earnings per share amounts are based on the weighted average number of common shares including unvested restricted shares and the net effect of potentially dilutive common shares outstanding. At June 30, 2011 and 2010, the Company's potentially dilutive instruments were common shares under options of 126,100 and 206,580, respectively.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Net income as reported	\$ 4,085	\$ 15,089	\$ 132	\$ 27,863
Less dividends:				
Distributed to common shareholders	7,466	5,928	14,869	11,840
Distributed to participating security holders	127	111	266	222
Total undistributed earnings	\$ (3,508)	\$ 9,050	\$ (15,003)	\$ 15,801
Undistributed earnings to common shareholders	\$ (3,449)	\$ 8,884	\$ (14,742)	\$ 15,511
	\$ (59)	\$ 166	\$ (261)	\$ 290

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Undistributed earnings to participating security holders

Net income available to common shareholders for basic and diluted earnings per share	\$	4,085	\$	15,089	\$	132	\$	27,863
Weighted average number of common shares outstanding		14,930,086		14,835,856		14,879,160		14,822,545
Common equivalent shares- restricted stock		254,519		277,501		263,522		276,759
Weighted average common and common equivalent shares outstanding used to calculate basic earnings per share		15,184,605		15,113,357		15,142,682		15,099,304
Common equivalent shares- stock options		14,199		17,036		16,831		16,823
Weighted average common and common equivalent shares outstanding used to calculate diluted earnings per share		15,198,804		15,130,393		15,159,513		15,116,127
Basic earnings per share	\$	0.27	\$	1.00	\$	0.01	\$	1.85
Diluted earnings per share	\$	0.27	\$	1.00	\$	0.01	\$	1.84

Diluted EPS excludes stock options with exercise prices and exercise tax benefits greater than the average market price of the Company's common stock during the period because their inclusion would be anti-dilutive. There were no anti-dilutive stock options

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for both the three and six months ended June 30, 2011. There were 119,725 anti-dilutive stock options for both the three and six months ended June 30, 2010.

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

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

The maximum number of shares of common stock with respect to which awards may be granted is 2,500,000. Shares of stock covered by an award under the Incentive Plan that are forfeited will again be available for issuance in connection with future grants of awards under the plan. At June 30, 2011, there were 718,859 shares available for future grant. The Board of Directors and the Compensation Committee intend to issue more awards under the Incentive Plan in the future.

A summary of stock based awards granted under the Incentive Plan during the six months ended June 30, 2011 is as follows:

Type of Equity Awarded	Effective Date	Number of Awards Granted	Fair Value per Share (1)	Vesting Terms
RS	March 9, 2011	68,637	\$ 47.35	3 years, 30%-30%-40%
RS	March 9, 2011	4,000	\$ 47.35	No vesting period (2)
RS	March 23, 2011	22,567	\$ 44.94	5 years, 20% annually

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

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

Accounting and Reporting for Stock-Based Awards

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

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

Stock Options

The fair value of stock options used to compute net income and EPS for the three months ended June 30, 2010 and six months ended June 30, 2011 and 2010 is the estimated fair value at grant date using the Black-Scholes option-pricing model with the following assumptions:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Expected dividend yield	NA	1.68%	1.68%	1.36% - 1.68%
Expected volatility	NA	0.36	0.36	0.31 - 0.36
Risk-free interest rate	NA	4.76%	4.76%	4.35% - 4.76%
Expected holding period	NA	6.5 years	6.5 years	6.5 - 7 years

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

Expected dividend yield is the Company's dividend yield on the measurement date and is based on the assumption that the current yield will continue in the future. Expected volatility is based on historical volatility of the Company's common stock as well as the volatility of a peer group of property and casualty insurers measured for a period equal to the expected holding period of the option. The risk-free interest rate is based upon the yield on the measurement date of a zero-coupon U.S. Treasury bond with a maturity period equal to the expected holding period of the option. The expected holding period is based upon the simplified method provided in SEC Staff Accounting Bulletin No. 107, *Share-Based Payment*, which utilizes the mid-points between the vesting dates and the expiration date of the option award to calculate the overall expected term. There were no stock options granted during the three and six month periods ended June 30, 2011 and 2010.

The following table summarizes stock option activity under the Incentive Plan for the six months ended June 30, 2011.

	Shares Under Option	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at beginning of year	151,003	\$ 37.30		
Exercised	(24,903)	\$ 36.02		
Outstanding at end of period	126,100	\$ 37.56	4.2 years	\$ 632
Exercisable at end of period	126,100	\$ 37.56	4.2 years	\$ 632

The aggregate intrinsic value in the preceding table represents the total pre-tax intrinsic value, based upon the Company's closing stock price of \$42.04 on June 30, 2011, which would have been received by the option holders had all option holders exercised their options as of that date. The range of exercise prices on stock options outstanding under the Incentive Plan was \$13.30 to \$42.85 at June 30, 2011 and \$12.00 to \$42.85 at June 30, 2010. The total intrinsic value of options exercised during the six months ended June 30, 2011 and 2010 was \$162 and \$147, respectively.

A summary of the status of non-vested options as of June 30, 2011 is presented below.

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

As of March 31, 2011, all compensation expense related to non-vested option awards had been recognized. Cash received from options exercised was \$897 and \$177 for the six months ended June 30, 2011 and 2010, respectively.

Restricted Stock

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

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

The following table summarizes restricted stock activity under the Incentive Plan during the six months ended June 30, 2011.

	Shares Under Restriction	Weighted Average Fair Value
Outstanding at beginning of the year	301,501	\$ 35.13
Granted	95,204	\$ 46.78
Vested and unrestricted	(114,009)	\$ 34.67
Forfeited	(579)	\$ 37.75
Outstanding at end of period	282,117	\$ 39.24

As of June 30, 2011, there was \$8,694 of unrecognized compensation expense related to non-vested restricted stock awards that is expected to be recognized over a weighted average period of 1.8 years. The total fair value of the shares that were vested and unrestricted during the six months ended June 30, 2011 and 2010 was \$3,953 and \$3,782, respectively. For the six months ended June 30, 2011 and 2010, the Company recorded compensation expense related to restricted stock of \$1,461 and \$1,322, net of income tax benefits of \$787 and \$712, respectively.

5. Investments

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

	As of June 30, 2011				
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (3) Non-OTTI Unrealized Losses	OTTI Unrealized Losses (4)	Estimated Fair Value
U.S. Treasury securities	\$ 90,798	\$ 306	\$ (971)	\$	\$ 90,133
Obligations of states and political subdivisions	381,826	12,932	(1,351)		393,407
Residential mortgage-backed securities (1)	232,720	16,493	(32)		249,181
Commercial mortgage-backed securities	52,621	2,014	(11)		54,624
Other asset-backed securities	14,360	797			15,157
Corporate and other securities	222,062	9,323	(566)		230,819
Subtotal, fixed maturity securities	994,387	41,865	(2,931)		1,033,321
Equity securities (2)	20,002	1,452	(8)		21,446

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Other invested assets	5,818				5,818			
Totals	\$	1,020,207	\$	43,317	\$	(2,939)	\$	1,060,585

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	As of December 31, 2010				Estimated Fair Value
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Non-OTTI Unrealized Losses	Losses (3) OTTI Unrealized Losses (4)	
U.S. Treasury securities	\$ 87,830	\$ 280	\$ (1,841)	\$	\$ 86,269
Obligations of states and political subdivisions	436,082	12,014	(2,906)	\$	445,190
Residential mortgage-backed securities (1)	237,405	15,295	(39)	\$	252,661
Commercial mortgage-backed securities	61,259	2,332	\$	\$	63,591
Other asset-backed securities	16,543	862	\$	\$	17,405
Corporate and other securities	191,235	7,769	(883)	\$	198,121
Subtotal, fixed maturity securities	1,030,354	38,552	(5,669)	\$	1,063,237
Equity securities (2)	13,704	920	\$	\$	14,624
Other invested assets	2,817	\$	\$	\$	2,817
Totals	\$ 1,046,875	\$ 39,472	\$ (5,669)	\$	\$ 1,080,678

(1) Residential mortgage-backed securities consists primarily of obligations of U.S. Government agencies including collateralized mortgage obligations issued, guaranteed and/or insured by the following issuers: Government National Mortgage Association (GNMA), Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA) and the Federal Home Loan Bank (FHLB). The total of these fixed maturity securities was \$232,720 and \$237,335 at amortized cost and \$249,181 and \$252,592 at fair value as of June 30, 2011 and December 31, 2010, respectively.

(2) Equity securities includes interests in mutual funds of \$12,507 and \$11,210 at cost and \$13,062 and \$11,699 at fair value as of June 30, 2011 and December 31, 2010, respectively, held to fund the Company's executive deferred compensation plan.

(3) Our investment portfolio included 64 and 80 securities in an unrealized loss position at June 30, 2011 and December 31, 2010, respectively.

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

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

	As of June 30, 2011	
	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 64,974	\$ 65,610
Due after one year through five years	230,781	240,224

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Due after five years through ten years	242,956	251,054
Due after ten years through twenty years	119,858	121,470
Due after twenty years	36,117	36,001
Asset-backed securities	299,701	318,962
Totals	\$ 994,387	\$ 1,033,321

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Gross realized gains				
Fixed maturity securities	\$ 1,254	\$ 366	\$ 1,577	\$ 608
Equity securities	31		102	
Gross realized losses				
Fixed maturity securities	(8)	(537)	(821)	(669)
Equity securities		(7)		(7)
Net realized gains (losses) on investments	\$ 1,277	\$ (178)	\$ 858	\$ (68)

Proceeds from maturities, redemptions and calls of fixed maturity securities were \$30,731 and \$361 for the three months ended June 30, 2011 and 2010, respectively. Proceeds from maturities, redemptions and calls of fixed maturity securities were \$31,988 and \$33,973 for the six months ended June 30, 2011 and 2010, respectively.

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

The following tables as of June 30, 2011 and December 31, 2010 present the gross unrealized losses included in the Company's investment portfolio and the fair value of those securities aggregated by investment category. The tables also present the length of time that they have been in a continuous unrealized loss position.

	Less than 12 Months		As of June 30, 2011 12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
U.S. Treasury securities	\$ 42,279	\$ 971	\$	\$	\$ 42,279	\$ 971
Obligations of states and political subdivisions	77,623	798	18,714	553	96,337	1,351
Residential mortgage-backed securities	15,635	25	221	7	15,856	32
	2,839	11			2,839	11

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Commercial mortgage-backed securities

Corporate and other securities	24,120	566			24,120	566
Subtotal, fixed maturity securities	162,496	2,371	18,935	560	181,431	2,931
Equity securities	440	8			440	8
Total temporarily impaired securities	\$ 162,936	\$ 2,379	\$ 18,935	\$ 560	\$ 181,871	\$ 2,939

	Less than 12 Months		As of December 31, 2010 12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
U.S. Treasury securities	\$ 38,318	\$ 1,841	\$	\$	\$ 38,318	\$ 1,841
Obligations of states and political subdivisions	109,883	2,490	7,325	416	117,208	2,906
Residential mortgage-backed securities	1,312	31	298	8	1,610	39
Corporate and other securities	27,736	883			27,736	883
Total temporarily impaired securities	\$ 177,249	\$ 5,245	\$ 7,623	\$ 424	\$ 184,872	\$ 5,669

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As of June 30, 2011, we held insured investment securities of approximately \$168,546, which represented approximately 15.9% of our total investments. Approximately \$55,898 of these securities are pre-refunded, meaning that funds have been set aside in escrow to satisfy the future interest and principal obligations of the bond.

The following table shows our insured investment securities that are backed by financial guarantors including pre-refunded securities as of June 30, 2011. We do not have any direct investment holdings in a financial guarantee insurance company.

Financial Guarantor	Total	As of June 30, 2011	
		Pre-refunded Securities	Exposure Net of Pre-refunded Securities
Municipal bonds			
Ambac Assurance Corporation	\$ 23,606	\$ 8,557	\$ 15,049
Financial Guaranty Insurance Company	272	272	
Assured Guaranty Municipal Corporation	72,310	34,587	37,723
National Public Finance Guaranty Corporation	68,375	12,482	55,893
Total municipal bonds	164,563	55,898	108,665
Other asset-backed securities			
Ambac Assurance Corporation	3,983		3,983
Total other asset-backed securities	3,983		3,983
Total	\$ 168,546	\$ 55,898	\$ 112,648

The following table shows the Company's insured investments by Moody's rating where it is available both with and without the impact of the insurance guarantee as of June 30, 2011.

Rating	As of June 30, 2011	
	Rating With Insurance	Rating Without Insurance
Aaa	\$ 3,805	\$ 3,805
Aa1	20,509	20,509
Aa2	55,315	55,315
Aa3	53,439	45,193
A1		5,114
A2	4,945	4,945
A3	7,698	10,830
Baa1	272	272
Baa2	3,983	3,983
Total	\$ 149,966	\$ 149,966

Other-Than-Temporary Impairments

ASC 320, *Investments - Debt and Equity Securities* requires entities to separate an OTTI of a debt security into two components when there are credit related losses associated with the impaired debt security for which the Company asserts that it does not have the intent to sell the security, and it is more likely than not that it will not be required to sell the security before recovery of its cost basis. Under ASC 320, the amount of the OTTI related to a credit loss is recognized in earnings, and the amount of the OTTI related to other factors is recorded as a component of other comprehensive income (loss). In instances where no credit loss exists but it is more likely than not that the Company will have to sell the debt security prior to the anticipated recovery, the decline in market value below amortized cost is recognized as an OTTI in earnings. In periods after the recognition of an OTTI on debt securities, the Company accounts for such securities as if they had been purchased on the measurement date of the OTTI at an amortized cost basis equal to the previous amortized cost basis less the OTTI recognized in earnings. For debt securities for which OTTI was recognized

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in earnings, the difference between the new amortized cost basis and the cash flows expected to be collected will be accreted or amortized into net investment income.

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

The unrealized losses in the Company's fixed income and equity portfolio as of June 30, 2011 were reviewed for potential other-than-temporary asset impairments. The Company held no securities at June 30, 2011 with a material (20% or greater) unrealized loss for four or more consecutive quarters. Specific qualitative analysis was also performed for any additional securities appearing on the Company's Watch List, if any. Qualitative analysis considered such factors as the financial condition and the near term prospects of the issuer, whether the debtor is current on its contractually obligated interest and principal payments, changes to the rating of the security by a rating agency and the historical volatility of the fair value of the security.

The qualitative analysis performed by the Company concluded that the unrealized losses recorded on the investment portfolio at June 30, 2011 resulted from fluctuations in market interest rates and other temporary market conditions as opposed to fundamental changes in the credit quality of the issuers of such securities. Therefore, decreases in fair values of the Company's securities are viewed as being temporary.

During the six months ended June 30, 2011 and 2010 there was no significant deterioration in the credit quality of any of the Company's holdings and no OTTI charges were recorded related to the Company's portfolio of investment securities. At June 30, 2011 and December 31, 2010, there were no amounts included in accumulated other comprehensive income related to securities which were considered by the Company to be other-than-temporarily impaired.

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

Net Investment Income

The components of net investment income were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Interest on fixed maturity securities	\$ 9,698	\$ 11,123	\$ 20,096	\$ 22,187
Dividends on equity securities	42	56	85	98
Interest on other invested assets	45	3	90	6
Interest on cash and cash equivalents	12	16	23	32
Total investment income	9,797	11,198	20,294	22,323
Investment expenses	327	341	659	674
Net investment income	\$ 9,470	\$ 10,857	\$ 19,635	\$ 21,649

Fair Value Measurements

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

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

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

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Level 3 Valuations based on unobservable inputs.

Fair values for the Company's fixed maturity securities are based on prices provided by its custodian bank and its investment manager. Both the Company's custodian bank and investment manager use a variety of independent, nationally recognized pricing services to determine market valuations. If the pricing service cannot provide fair value determinations, the Company obtains non-binding price quotes from broker-dealers. A minimum of two quoted prices is obtained for the majority of the Company's available for sale fixed maturity securities in its investment portfolio. The Company's custodian bank is its primary provider of quoted prices from third-party pricing services and broker-dealers. To provide reasonable assurance of the validity of each price or quote, a secondary third-party pricing service or broker-dealer quote is obtained from the Company's investment manager. An examination of the pricing data is then performed for each security. If the variance between the primary and secondary price quotes for a security is within an accepted tolerance level, the quoted price obtained from the Company's custodian bank is used in the financial statements for the security. If the variance between the primary and secondary price quotes exceeds an accepted tolerance level, the Company obtains a quote from an alternative source, if possible, and documents and resolves any differences between the pricing sources. In addition, the Company may request that its investment manager and its traders provide input as to which vendor is providing prices that its traders believe are reflective of fair value for the security. Following this process, the Company may decide to value the security in its financial statements using the secondary or alternative source if it believes that pricing is more reflective of the security's value than the primary pricing provided by its custodian bank. The Company analyzes market valuations received to verify reasonableness, to understand the key assumptions used and their sources, and to determine an appropriate ASC 820 fair value hierarchy level based upon trading activity and the observability of market inputs. Based on this evaluation and investment class analysis, each price is classified into Level 1, 2 or 3.

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

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

- *States and political subdivisions*: overall credit quality, including assessments of market sectors and the level and variability of sources of payment such as general obligation, revenue or lease; credit support such as insurance, state or local economic and political base, prefunded and escrowed to maturity covenants.

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- *Corporate fixed maturities:* overall credit quality, the establishment of a risk adjusted credit spread over the applicable risk free yield curve for discounted cash flow valuations; assessments of the level of industry economic sensitivity, company financial policies, indenture restrictive covenants, and/or security and collateral.
- *Residential mortgage-backed securities, U.S. agency pass-throughs, collateralized mortgage obligations (CMOs), non U.S. agency CMOs:* estimates of prepayment speeds based upon historical prepayment rate trends, underlying collateral interest rates, original weighted average maturity, vintage year, borrower credit quality characteristics, interest rate and yield curve forecasts, U.S. government support programs, tax policies, and delinquency/default trends.
- *Commercial mortgage-backed securities:* overall credit quality, including assessments of the level and variability of credit support and collateral type such as office, retail, or lodging, predictability of cash flows for the deal structure, prevailing economic market conditions.
- *Other asset-backed securities:* overall credit quality, estimates of prepayment speeds based upon historical trends and characteristics of underlying loans, including assessments of the level and variability of collateral, revenue generating agreements, area licenses agreements, product sourcing agreements and equipment and property leases.
- *Real estate investment trust (REIT):* net asset value per share derived from member ownership in capital venture to which a proportionate share of independently appraised net assets is attributed.

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

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

The Company's entire available for sale portfolio was priced based upon quoted market prices or other observable inputs as of June 30, 2011. There were no significant changes to the valuation process during the six months ending June 30, 2011. As of June 30, 2011 and December 31, 2010, no quotes or prices obtained were adjusted by management. All broker quotes obtained were non-binding.

The following tables summarize the Company's total fair value measurements for available for sale investments for the periods indicated.

	As of June 30, 2011			
	Total	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
U.S. Treasury securities	\$ 90,133	\$	\$ 90,133	\$
Obligations of states and political subdivisions	393,407		393,407	
Residential mortgage-backed securities	249,181		249,181	
Commercial mortgage-backed securities	54,624		54,624	
Other asset-backed securities	15,157		15,157	
Corporate and other securities	230,819		230,819	
Equity securities	21,446	16,318	5,128	
Total investment securities	\$ 1,054,767	\$ 16,318	\$ 1,038,449	\$

	As of December 31, 2010			
	Total	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
U.S. Treasury securities	\$ 86,269	\$	\$ 86,269	\$
Obligations of states and political subdivisions	445,190		445,190	
Residential mortgage-backed securities	252,661		252,661	
Commercial mortgage-backed securities	63,591		63,591	
Other asset-backed securities	17,405		17,405	
Corporate and other securities	198,121		198,121	
Equity securities	14,624	14,624		
Total investment securities	\$ 1,077,861	\$ 14,624	\$ 1,063,237	\$

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There were no transfers between Level 1 and Level 2 during the three and six months ended June 30, 2011 and 2010.

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The following tables summarize the changes in the Company's Level 3 fair value measurements for the periods indicated.

	Three Months Ended June 30,	
	2011	2010
	Level 3	Level 3
	Fair Value	Fair Value
	Securities	Securities
Balance at April 1	\$	\$ 2,506
Net gains and losses included in earnings		
Net gains included in other comprehensive income		676
Purchases and sales		
Transfers in (out) of Level 3		
Balance at June 30	\$	\$ 3,182
Amount of total losses included in earnings attributable to the change in unrealized losses related to assets still held at June 30	\$	\$

	Six Months Ended June 30,	
	2011	2010
	Level 3	Level 3
	Fair Value	Fair Value
	Securities	Securities
Balance at January 1	\$	\$ 2,504
Net gains and losses included in earnings		
Net gains included in other comprehensive income		678
Purchases and sales		
Transfers in (out) of Level 3		
Balance at June 30	\$	\$ 3,182
Amount of total losses included in earnings attributable to the change in unrealized losses related to assets still held at June 30	\$	\$

Transfers in and out of Level 3 are attributable to changes in the ability to observe significant inputs in determining fair value exit pricing. As noted in the tables above, no transfers were made in or out of Level 3 during the three and six months ended June 30, 2011 and 2010.

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

	Six Months Ended June 30,	
	2011	2010
Reserves for losses and LAE at beginning of year	\$ 404,391	\$ 439,706
Less receivable from reinsurers related to unpaid losses and LAE	(53,147)	(64,874)
Net reserves for losses and LAE at beginning of year	351,244	374,832
Incurring losses and LAE, related to:		
Current year	254,661	199,008
Prior years	(18,847)	(22,558)
Total incurred losses and LAE	235,814	176,450
Paid losses and LAE related to:		
Current year	143,512	106,607
Prior years	92,271	82,894
Total paid losses and LAE	235,783	189,501
Net reserves for losses and LAE at end of period	351,275	361,781
Plus receivable from reinsurers related to unpaid losses and LAE	52,475	58,834
Reserves for losses and LAE at end of period	\$ 403,750	\$ 420,615

At the end of each period, the reserves were re-estimated for all prior accident years. The Company's prior year reserves decreased by \$18,847 and \$22,558 for the six months ended June 30, 2011 and 2010, respectively, and resulted from re-estimations of prior years ultimate loss and LAE liabilities. The decrease in prior years reserves during the 2011 period is primarily composed of reductions of \$14,289 in the Company's retained automobile reserves and \$2,580 in the Company's retained homeowners reserves. The decrease in prior year reserves during the 2010 period is primarily composed of reductions of \$15,679 in the Company's retained automobile reserves, \$3,080 in reserves assumed from Commonwealth Automobile Reinsurers (CAR), and \$3,037 in the Company's retained homeowners reserves.

The Company's private passenger automobile line of business prior year reserves decreased by \$12,419 for the six months ended June 30, 2011. The decrease was primarily due to improved retained private passenger results of \$11,168 for the accident years 2005 through 2009. The Company's private passenger automobile line of business prior year reserves decreased by \$15,498 for the six months ended June 30, 2010. The decrease was primarily due to improved retained private passenger results of \$11,582 for accident years 2005 through 2009, and improved assumed CAR results for the private passenger automobile pool of \$2,124 for accident years 2007 through 2009. The improved retained private passenger results were primarily due to fewer incurred but not yet reported claims than previously estimated and better than previously estimated severity on the Company's established bodily injury and property damage case reserves. The improved CAR results were due primarily to improved CAR private passenger loss ratios as published and reported by the CAR Loss Reserving Committee.

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

7. Commitments and Contingencies

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

Massachusetts law requires that insurers licensed to do business in Massachusetts participate in the Massachusetts Insurers Insolvency Fund (Insolvency Fund). Members of the Insolvency Fund are assessed a proportionate share of the obligations and

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expenses of the Insolvency Fund in connection with an insolvent insurer. It is anticipated that there will be additional assessments from time to time relating to various insolvencies. Although the timing and amounts of any future assessments are not known, based upon existing knowledge, management's opinion is that such future assessments will not have a material effect upon the financial position of the Company.

8. Debt

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

The Company's obligations under the credit facility are secured by pledges of its assets and the capital stock of its operating subsidiaries. The credit facility is guaranteed by the Company's non-insurance company subsidiaries. The credit facility contains covenants including requirements to maintain minimum risk based capital ratios and statutory surplus of Safety Insurance Company as well as limitations or restrictions on indebtedness, liens, and other matters. Among other covenants, the credit facility restricts the Company's payment of dividends (i) if a default under the credit facility is continuing or would result therefrom or (ii) in an amount in excess of 50% of the Company's prior year's net income, as determined in accordance with GAAP. As of June 30, 2011, the Company was in compliance with all such covenants. In addition, the credit facility includes customary events of default, including a cross-default provision permitting the lenders to accelerate the facility if the Company (i) defaults in any payment obligation under debt having a principal amount in excess of \$10,000 or (ii) fails to perform any other covenant permitting acceleration of all such debt.

The Company had no amounts outstanding on its credit facility at June 30, 2011 and December 31, 2010. The credit facility commitment fee included in interest expenses was computed at a rate of 0.25% on the \$30,000 commitment at June 30, 2011 and 2010.

9. Income Taxes

Federal income tax expense for the six months ended June 30, 2011 and 2010 has been computed using estimated effective tax rates. These rates are revised, if necessary, at the end of each successive interim period to reflect the current estimates of the annual effective tax rates.

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The Company believes that the positions taken on its income tax returns for open tax years will be sustained upon examination by the Internal Revenue Service (IRS). Therefore, the Company has not recorded a liability under ASC 740, *Income Taxes*.

During the six months ended June 30, 2011, there were no material changes to the amount of the Company's unrecognized tax benefits or to any assumptions regarding the amount of its ASC 740 liability.

As of June 30, 2011 and December 31, 2010, the Company was no longer subject to examination of its U.S. federal tax returns for years prior to 2007. The Company is not currently under examination by the IRS.

10. Share Repurchase Program

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

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Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands except per share and share data)

There was no activity under the program during the six months ended June 30, 2011. During the six months ended June 30, 2010, the Company purchased 162,907 shares of its common shares on the open market under the program at a cost of \$5,815. As of June 30, 2011 and December 31, 2010, the Company had purchased 1,727,455 shares on the open market at a cost of \$55,526.

11. Subsequent Events

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

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Item 2.

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

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

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

Executive Summary and Overview

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

We are a leading provider of private passenger automobile insurance in Massachusetts. In addition to private passenger automobile insurance (which represented 68.7% of our direct written premiums in 2010), we offer a portfolio of other insurance products, including commercial automobile (10.4% of 2010 direct written premiums), homeowners (16.8% of 2010 direct written premiums), dwelling fire, umbrella and business owner policies (totaling 4.1% of 2010 direct written premiums). Operating exclusively in Massachusetts and New Hampshire through our insurance company subsidiaries, Safety Insurance, Safety Indemnity, and Safety P&C (together referred to as the Insurance Subsidiaries), we have established strong relationships with independent insurance agents, who numbered 783 in 939 locations throughout Massachusetts and New Hampshire during 2010. We have used these relationships and our extensive knowledge of the Massachusetts market to become the second largest private passenger automobile and the third largest commercial automobile insurance carrier in Massachusetts, capturing an approximate 11.7% and 11.9% share, respectively, of the Massachusetts private passenger and commercial automobile markets in 2011, according to the Commonwealth Automobile Reinsurers (CAR) Cession Volume Analysis Report of June 23, 2011, based on automobile exposures. These statistics total, for each vehicle insured, the number of months during the year insurance for that vehicle is in effect, to arrive at an aggregate number of car-months for each insurer; this aggregate number, divided by 12, equals the insurer's number of car-years, a measure we refer to in this report as automobile exposures.

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The Insurance Subsidiaries began writing private passenger automobile and homeowners insurance in New Hampshire during 2008 and personal umbrella business during 2009. During the six months ended June 30, 2011 and 2010, we wrote \$2,462 and \$1,191, respectively, in direct written premiums in New Hampshire.

Recent Trends and Events

- We experienced \$16,697 of catastrophe losses in our automobile and property lines for the quarter ended June 30, 2011 as a result of the unusual tornado outbreaks and severe weather across Western and Central Massachusetts which occurred on June 1, 2011.
- A reassessment of our catastrophe and severe weather losses which occurred during the quarter ended March 31, 2011 resulted in an additional \$5,353 of losses recorded during the quarter ended June 30, 2011.
- We increased our Massachusetts private passenger automobile rates 3.9% effective May 15, 2011.
- We increased our Massachusetts homeowners rates 7.5% effective August 15, 2011.

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Massachusetts Automobile Insurance Market

We have been subject to extensive regulation in the private passenger automobile insurance industry in Massachusetts, which represented 68.7% of our direct written premiums in 2010. Owners of registered automobiles in Massachusetts are required to maintain minimum automobile insurance coverage. Prior to April 1, 2008, the Commissioner of Insurance (the "Commissioner") had fixed and established the maximum rates that could be charged for private passenger automobile insurance. Prior to April 1, 2008, as a servicing carrier of CAR, we were required to issue a policy to all qualified applicants. In addition, based on our market share prior to April 1, 2009, we had been assigned certain licensed producers by CAR that were unable to obtain a voluntary contract with another insurer. We call these agents Exclusive Representative Producers, or ERPs.

On July 16, 2007, the Commissioner issued two decisions that significantly changed how private passenger automobile insurance was regulated in Massachusetts. In the first decision, the Commissioner approved and set a time table for the implementation of new CAR rules pursuant to which the reinsurance program run by CAR was replaced with an assigned risk plan, the Massachusetts Automobile Insurance Plan ("MAIP"). Under these new rules, as of April 1, 2009 we are no longer assigned ERPs and instead, we are assigned individual policies by CAR. The MAIP began with business effective on or after April 1, 2008 for new business and those risks that had 10 or more Safe Driver Points. Beginning April 1, 2009, all business was eligible for MAIP except those risks that have no violations or accidents in the preceding three year period (so called "Clean in three" risks). The last policy effective date on which any risk could be ceded to CAR was March 31, 2009.

In the second decision referenced above, the Commissioner announced that the Commissioner would not fix and establish the maximum premium rates that can be charged for private passenger automobile insurance policies issued or renewed after April 1, 2008. In a letter accompanying the decision, the Commissioner stated that in place of the "fixed and established" system, the Commissioner would institute a system that introduces competitive pricing to the Massachusetts private passenger automobile insurance market, which the Commissioner described as "managed competition" ("Managed Competition"). On October 5, 2007, the Commissioner issued regulation that describes the technical details of Managed Competition.

The Commissioner has also issued a number of bulletins addressing issues related to the implementation of Managed Competition.

On May 27, 2010, the Massachusetts Office of the Attorney General (the "AG") issued proposed regulations that would have applied to the sale, marketing, claims processing, rating, and underwriting of private passenger automobile insurance offered or provided in the Commonwealth of Massachusetts. The proposed regulations described various acts by insurers and insurance producers which would be considered to be unfair trade practices under Massachusetts' unfair trade practices act. The AG held two public hearings on the proposed regulations in June 2010. In April 2011, the AG announced that although she continues to believe that additional consumer protections are necessary regarding automobile insurance, the proposed regulations will not be promulgated as proposed. No other regulations have been proposed at this time.

CAR runs a reinsurance pool for commercial automobile policies and, beginning January 1, 2006, CAR implemented a Limited Servicing Carrier Program ("LSC") for ceded commercial automobile policies. CAR approved Safety Insurance and five other servicing carriers through a Request for Proposal to process ceded commercial automobile business, which was spread equitably among the six servicing carriers. In 2010 CAR reduced the number of servicing carriers to four, and CAR has approved Safety Insurance and three other servicing carriers effective July 1, 2011 to continue the program. Subject to the Commissioner's review, CAR sets the premium rates for commercial automobile policies reinsured through CAR and this reinsurance pool can generate an underwriting result that is a profit or deficit based upon CAR's rate level. This underwriting result is allocated among every Massachusetts commercial automobile insurance company, including us, based on a company's commercial automobile voluntary market share.

CAR also runs a reinsurance pool for Taxi, Limousine and Car Service risks (the Taxi/Limo Program). On April 25, 2007, Safety Insurance submitted through a Request for Proposal a bid to process a portion of the Taxi/Limo Program. CAR approved Safety Insurance as one of the two servicing carriers for this program beginning January 1, 2008, and CAR has again approved Safety Insurance beginning January 1, 2011 as one of the two servicing carriers.

During 2009, we increased our private passenger automobile rates an average of 2.6% in a series of rate filings during the year. We began using three rating tiers effective April 1, 2009. We filed and were approved for a 0.3% rate decrease effective June 1, 2009 and a 2.9% rate increase effective October 1, 2009. We filed and were approved for a rate increase of 0.4% and began using four rating tiers effective January 1, 2010. A Companion Policy Client Tier, which is policyholders who have an other than private passenger automobile policy with us, receives a rate decrease of 2.5% from our filed base rates. A Loyal Automobile Client Tier, which is policyholders who have been insured with us for two or more years, receives our filed base rates. A New Insurance Client Tier, which is policyholders with twelve or more months of continuous coverage or who qualify for a multi-car discount, receives a rate increase of 2.5% from our filed base rates. A New Policyholder Tier, which is policyholders who do not qualify for the other

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three tiers, receives MAIP rates. We filed and were approved for a 1.9% increase in our private passenger automobile rates effective April 19, 2010 and we filed and were approved for a 0.5% decrease in those rates effective June 15, 2010. In addition, we filed and have been approved for a 3.9% increase in our private passenger automobile rates effective May 15, 2011. Our rates include a 13.0% commission rate for agents. Our direct written premiums increased by 8.1% in 2010 primarily as a result of increased exposures and average written premium per exposure in our private passenger and homeowner lines of business.

Insurance Ratios

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

Our GAAP insurance ratios are outlined in the following table.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
GAAP ratios:				
Loss ratio	76.8%	64.5%	80.4%	65.5%
Expense ratio	29.6	31.0	29.6	31.2
Combined ratio	106.4%	95.5%	110.0%	96.7%

Stock-Based Compensation

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

The maximum number of shares of common stock with respect to which awards may be granted is 2,500,000. Shares of stock covered by an award under the Incentive Plan that are forfeited will again be available for issuance in connection with future grants of awards under the plan. At June 30, 2011, there were 718,859 shares available for future grant. The Board of Directors and the Compensation Committee intend to issue more awards under the Incentive Plan in the future.

A summary of stock based awards granted under the Incentive Plan during the six months ended June 30, 2011 is as follows:

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Type of Equity Awarded	Effective Date	Number of Awards Granted	Fair Value per Share (1)	Vesting Terms
RS	March 9, 2011	68,637	\$ 47.35	3 years, 30%-30%-40%
RS	March 9, 2011	4,000	\$ 47.35	No vesting period (2)
RS	March 23, 2011	22,567	\$ 44.94	5 years, 20% annually

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

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

Reinsurance

We reinsure with other insurance companies a portion of our potential liability under the policies we have underwritten, thereby protecting us against an unexpectedly large loss or a catastrophic occurrence that could produce large losses, primarily in our homeowners line of business. We use various software products to measure our exposure to catastrophe losses and the probable maximum loss to us for catastrophe losses such as hurricanes. The models include estimates for our share of the catastrophe losses generated in the residual market for property insurance by the Massachusetts Property Insurance Underwriting Association (FAIR Plan). In the aftermath of Hurricane Katrina in 2005, the reinsurance market has seen from the various software modelers, increases

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in the estimate of damage from hurricanes in the southern and northeast portions of the United States due to revised estimations of increased hurricane activity and increases in the estimation of demand surge in the periods following a significant event. We continue to adjust our reinsurance programs as a result of the changes to the models. As of January 1, 2011, we have purchased four layers of excess catastrophe reinsurance providing \$505,000 of coverage for property losses in excess of \$30,000 up to a maximum of \$535,000. Our reinsurers co-participation is 85.0% of \$50,000 for the 1st layer, 85.0% of \$80,000 for the 2nd layer, 80.0% of \$250,000 for the 3rd layer, and 80.0% of \$125,000 for the 4th layer. As a result of the changes to the models, and our revised reinsurance program, our catastrophe reinsurance in 2011 protects us in the event of a 125-year storm (that is, a storm of a severity expected to occur once in a 125-year period). Swiss Re, our primary reinsurer, maintains an A.M. Best rating of A (Excellent). Most of our other reinsurers have an A.M. Best rating of A (Excellent) however in no case is a reinsurer rated below A- (Excellent). Our losses from the June 1, 2011 tornado outbreaks and storms in Massachusetts have been less than our retention to date.

We are a participant in CAR, a state-established body that runs the residual market reinsurance programs for both private passenger and commercial automobile insurance in Massachusetts under which premiums, expenses, losses and loss adjustment expenses on ceded business are shared by all insurers writing automobile insurance in Massachusetts. We also participate in the FAIR Plan in which premiums, expenses, losses and loss adjustment expenses on homeowners business that cannot be placed in the voluntary market are shared by all insurers writing homeowners insurance in Massachusetts. The FAIR Plan has grown dramatically over the past few years as insurance carriers have reduced their exposure to coastal property. The FAIR Plan's exposure to catastrophe losses increased and as a result, the FAIR Plan decided to buy reinsurance to reduce their exposure to catastrophe losses. On July 1, 2011, the FAIR Plan purchased \$1,000,000 of catastrophe reinsurance for property losses in excess of \$200,000. At June 30, 2011, we had no material amounts recoverable from any reinsurer, excluding \$44,681 recoverable from CAR.

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

Effects of Inflation

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

Table of Contents**Results of Operations****Three and Six Months Ended June 30, 2011 Compared to Three and Six Months Ended June 30, 2010**

The following table shows certain of our selected financial results.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Direct written premiums	\$ 173,130	\$ 160,383	\$ 337,214	\$ 314,489
Net written premiums	\$ 167,825	\$ 153,531	\$ 325,344	\$ 300,619
Net earned premiums	\$ 148,720	\$ 136,143	\$ 293,366	\$ 269,300
Net Investment income	9,470	10,857	19,635	21,649
Net realized gains (losses) on investments	1,277	(178)	858	(68)
Finance and other service income	4,470	4,576	8,875	8,872
Total revenue	163,937	151,398	322,734	299,753
Loss and loss adjustment expenses	114,184	87,776	235,814	176,450
Underwriting, operating and related expenses	44,071	42,257	86,700	84,125
Interest expenses	21	22	43	44
Total expenses	158,276	130,055	322,557	260,619
Income before income taxes	5,661	21,343	177	39,134
Income tax expense	1,576	6,254	45	11,271
Net income	\$ 4,085	\$ 15,089	\$ 132	\$ 27,863
Earnings per weighted average common share:				