SELECTIVE INSURANCE GROUP INC
Form 10-Q
October 29, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: September 30, 2009

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: 001-33067

SELECTIVE INSURANCE GROUP, INC.
(Exact name of registrant as specified in its charter)

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such report), and (2) has been subject to such filing requirements for the past 90 days.
Yesx 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 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 a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company ¨

(Do not check if a 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 x

As of September 30, 2009, there were 53,074,432 shares of common stock, par value $2.00 per share, outstanding.

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PART I. FINANCIAL INFORMATION

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

($ in thousands, except share amounts)	Unaudited September 30, 2009	December 31, 2008
ASSETS		
Investments:		
Fixed maturity securities, held-to-maturity – at carry value (fair value of: $1,839,893 – 2009; $1,178 – 2008)	$ 1,804,240	1,163
Fixed maturity securities, available-for-sale – at fair value (amortized cost of: $1,454,184 – 2009; $3,123,346 – 2008)	1,488,186	3,034,278
Equity securities, available-for-sale – at fair value (cost of: $76,805 – 2009; $125,947 – 2008)	89,892	132,131
Short-term investments – at cost which approximates fair value	236,896	198,111
Equity securities, trading – at fair value	-	2,569
Other investments	147,482	172,057
Total investments	3,766,696	3,540,309
Cash and cash equivalents	742	3,606
Interest and dividends due or accrued	35,494	36,538
Premiums receivable, net of allowance for uncollectible accounts of: $5,983 – 2009; $4,237 – 2008	491,169	480,894
Reinsurance recoverable on paid losses and loss expenses	5,202	6,513
Reinsurance recoverable on unpaid losses and loss expenses	256,571	224,192
Prepaid reinsurance premiums	108,055	96,617
Current federal income tax	12,788	26,593
Deferred federal income tax	115,009	150,759
Property and equipment – at cost, net of accumulated depreciation and amortization of: $138,756 – 2009; $129,333 – 2008	45,771	51,580
Deferred policy acquisition costs	223,694	212,319
Goodwill	7,849	7,849
Assets of discontinued operations	44,245	56,468
Other assets	45,018	51,319
Total assets	$ 5,158,303	4,945,556
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Reserve for losses	$ 2,318,856	2,256,329
Reserve for loss expenses	399,999	384,644
Unearned premiums	895,446	844,334
Notes payable	261,599	273,878
Commissions payable	43,666	48,560
Accrued salaries and benefits	104,362	118,422
Liabilities of discontinued operations	27,192	34,138
Other liabilities	120,854	94,758
Total liabilities	4,171,974	4,055,063

Stockholders' Equity:			
Preferred stock of $0 par value per share:			
Authorized shares: 5,000,000; no shares issued or outstanding			
Common stock of $2 par value per share:			
Authorized shares: 360,000,000			
Issued: 95,634,290 – 2009; 95,263,508 – 2008		191,269	190,527
Additional paid-in capital		228,204	217,195
Retained earnings		1,125,415	1,128,149
Accumulated other comprehensive loss		(11,138)	(100,666)
Treasury stock – at cost (shares: 42,559,858 – 2009; 42,386,921 – 2008)		(547,421)	(544,712)
Total stockholders' equity		986,329	890,493
Commitments and contingencies			
Total liabilities and stockholders' equity	$	5,158,303	4,945,556

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

SELECTIVE INSURANCE GROUP, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

		Quarter ended September 30,		Nine Months ended September 30,	
($ in thousands, except per share amounts)		2009	2008	2009	2008
Revenues:					
Net premiums written	$	376,718	402,739	1,117,764	1,184,087
Net increase in unearned premiums and prepaid reinsurance premiums		(20,812)	(28,031)	(39,674)	(48,738)
Net premiums earned		355,906	374,708	1,078,090	1,135,349
Net investment income earned		36,585	36,134	78,670	112,515
Net realized (losses) gains:					
Net realized investment (losses) gains		(741)	12,277	3,515	25,499
Other-than-temporary impairments		(5,833)	(34,854)	(45,467)	(44,638)
Other-than-temporary impairments on fixed maturity securities recognized in other comprehensive income		1,591	-	1,650	-
Total net realized investment losses		(4,983)	(22,577)	(40,302)	(19,139)
Other income		2,667	946	7,758	4,270
Total revenues		390,175	389,211	1,124,216	1,232,995
Expenses:					
Losses incurred		198,495	215,095	602,161	635,140
Loss expenses incurred		43,537	39,453	131,114	125,288
Policy acquisition costs		114,520	119,825	342,148	370,468
Dividends to policyholders		991	1,151	2,268	3,265
Interest expense		4,751	5,036	14,618	15,472
Other expenses		6,054	7,175	18,815	20,776
Total expenses		368,348	387,735	1,111,124	1,170,409
Income from continuing operations, before federal income tax		21,827	1,476	13,092	62,586
Federal income tax expense (benefit):					
Current		(426)	10,252	3,818	34,140
Deferred		1,647	(17,016)	(13,740)	(27,834)
Total federal income tax (benefit) expense		1,221	(6,764)	(9,922)	6,306
Net income from continuing operations		20,606	8,240	23,014	56,280
(Loss) income from discontinued operations		(11,746)	1,090	(11,302)	2,667
Federal income tax (benefit) expense		(4,147)	338	(4,106)	801
Total (loss) income from discontinued operations, net of tax		(7,599)	752	(7,196)	1,866
Net income	$	13,007	8,992	15,818	58,146
Earnings per share:					
Basic net income from continuing operations		0.39	0.16	0.44	1.07
Basic net income from discontinued operations		(0.14)	0.01	(0.14)	0.04
Basic net income	$	0.25	0.17	0.30	1.11

Diluted net income from continuing operations		0.38	0.16	0.43	1.06
Diluted net income from discontinued operations		(0.14)	0.01	(0.13)	0.03
Diluted net income	$	0.24	0.17	0.30	1.09
Dividends to stockholders	$	0.13	0.13	0.39	0.39

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

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

	Nine Months Ended September 30,			
($ in thousands, except per share amounts)	2009		2008	
Common stock:				
Beginning of year	$ 190,527		189,306	
Dividend reinvestment plan (shares: 96,265 – 2009; 59,704 – 2008)	193		119	
Convertible debentures (shares: 45,759 – 2008)	-		92	
Stock purchase and compensation plans (shares: 274,517 – 2009; 336,191 – 2008)	549		672	
End of period	191,269		190,189	
Additional paid-in capital:				
Beginning of year	217,195		192,627	
Dividend reinvestment plan	1,136		1,267	
Convertible debentures	-		645	
Stock purchase and compensation plans	9,873		18,004	
End of period	228,204		212,543	
Retained earnings:				
Beginning of year	1,128,149		1,105,946	
Cumulative-effect adjustment due to fair value election under ASC 825, net of deferred income tax effect of $3,344	-		6,210	
Cumulative-effect adjustment due to adoption of other-than-temporary impairment guidance under ASC 320, net of deferred income tax effect of $1,282	2,380		-	
Net income	15,818	15,818	58,146	58,146
Cash dividends to stockholders ($0.39 per share – 2009; $0.39 per share – 2008)	(20,932)		(20,922)	
End of period	1,125,415		1,149,380	
Accumulated other comprehensive (loss) income:				
Beginning of year	(100,666)		86,043	
Cumulative-effect adjustment due to fair value election under ASC 825, net of deferred income tax effect of $(3,344)	-		(6,210)	
Cumulative-effect adjustment due to adoption of other-than-temporary impairment guidance under ASC 320, net of deferred income tax effect of $(1,282)	(2,380)		-	
Other comprehensive income (loss), increase (decrease) in:				
Unrealized (losses) gains on investment securities:				
Non-credit portion of other-than-temporary impairment losses recognized in other comprehensive income, net of deferred income tax effect of $(537)	(998)		-	
Other net unrealized gains (losses) on investment securities, net of deferred income tax effect of: $49,285 – 2009; $(59,737) – 2008	91,529		(110,940)	

Total unrealized gains (losses) on investment securities	90,531	90,531	(110,940)	(110,940)
Defined benefit pension plans, net of deferred income tax effect of: $742 – 2009; $48 – 2008	1,377	1,377	88	88
End of period	(11,138)		(31,019)	
Comprehensive income (loss)		107,726		(52,706)
Treasury stock:				
Beginning of year	(544,712)		(497,879)	
Acquisition of treasury stock (shares: 172,937 – 2009; 1,979,043 – 2008)	(2,709)		(45,450)	
End of period	(547,421)		(543,329)	
Total stockholders' equity	$ 986,329		977,764	

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

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

($ in thousands)	Nine Months ended September 30, 2009	2008
Operating Activities		
Net income	$ 15,818	58,146
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	21,045	21,329
Stock-based compensation expense	9,178	14,094
Undistributed losses of equity method investments	26,744	812
Net realized losses	40,302	19,139
Postretirement life curtailment benefit	(4,217)	-
Deferred tax	(17,666)	(27,360)
Unrealized loss on trading securities	(262)	6,448
Goodwill impairment	12,214	-
Changes in assets and liabilities:		
Increase in reserves for losses and loss expenses, net of reinsurance recoverable on unpaid losses and loss expenses	46,320	88,638
Increase in unearned premiums, net of prepaid reinsurance and advance premiums	39,121	48,609
Decrease in net federal income tax recoverable	13,252	7,842
Increase in premiums receivable	(10,275)	(46,697)
(Increase) decrease in deferred policy acquisition costs	(11,375)	2,331
Decrease in interest and dividends due or accrued	1,038	623
Decrease in reinsurance recoverable on paid losses and loss expenses	1,311	2,363
Decrease in accrued salaries and benefits	(10,920)	(6,473)
Decrease in accrued insurance expenses	(4,242)	(15,849)
Purchase of trading securities	-	(6,587)
Sale of trading securities	2,831	17,586
Other-net	(2,905)	7,097
Net adjustments	151,494	133,945
Net cash provided by operating activities	167,312	192,091
Investing Activities		
Purchase of fixed maturity securities, held-to-maturity	(158,827)	-
Purchase of fixed maturity securities, available-for-sale	(757,538)	(437,003)
Purchase of equity securities, available-for-sale	(75,856)	(50,551)
Purchase of other investments	(13,466)	(44,380)
Purchase of short-term investments	(1,600,685)	(1,591,302)
Sale of fixed maturity securities, held-to-maturity	5,819	-
Sale of fixed maturity securities, available-for-sale	470,202	112,890
Sale of short-term investments	1,561,901	1,599,629
Redemption and maturities of fixed maturity securities, held-to-maturity	197,095	4,530
Redemption and maturities of fixed maturity securities, available-for-sale	88,402	229,598
Sale of equity securities, available-for-sale	125,211	63,143
Proceeds from other investments	23,149	11,263
Purchase of property and equipment	(4,139)	(5,535)

Net cash used in investing activities	(138,732)	(107,718)
Financing Activities		
Dividends to stockholders	(19,833)	(19,391)
Acquisition of treasury stock	(2,709)	(45,450)
Principal payment of notes payable	(12,300)	(12,300)
Net proceeds from stock purchase and compensation plans	2,914	5,747
Excess tax benefits from share-based payment arrangements	(1,125)	1,570
Principal payments of convertible bonds	-	(8,754)
Net cash used in financing activities	(33,053)	(78,578)
Net (decrease) increase in cash and cash equivalents	(4,473)	5,795
Net (decrease) increase in cash and cash equivalents from discontinued operations	(1,609)	4,334
Net (decrease) increase in cash and cash equivalents from continuing operations	(2,864)	1,461
Cash and cash equivalents from continuing operations, beginning of year	3,606	1,965
Cash and cash equivalents from continuing operations, end of period	$ 742	3,426

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

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. Organization

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

We classify our business into two operating segments:

- Insurance Operations, which sells property and casualty insurance products and services primarily in 22 states in the Eastern and Midwestern U.S.; and
- Investments.

These segments reflect the following changes from our historical segments of: Insurance Operations, Investments, and Diversified Insurance Services (which included federal flood insurance administrative services ("Flood") and human resource administration outsourcing ("HR Outsourcing")):

- In the process of periodically reviewing our operating segments, we reclassified our Flood operations in the first quarter of 2009 to be included within our Insurance Operations segment, reflecting the way we are now managing this business. We believe these reporting changes better enable investors to view us the way our management views our operations.
- During Third Quarter 2009, we entered into a plan to dispose of Selective HR Solutions, Inc. ("Selective HR"), which comprised our HR Outsourcing segment, causing the elimination of this operating segment. See Note 15. "Discontinued Operations" of this Form 10-Q for additional information.

Our revised segments are reflected throughout this report for all periods presented.

NOTE 2. Basis of Presentation

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

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

NOTE 3. Reclassification

Certain prior year amounts in these Financial Statements and related footnotes have been reclassified to reflect Selective HR as a discontinued operation. For additional information regarding our plan to dispose of this subsidiary, see Note 15. "Discontinued Operations" of this Form 10-Q. Such reclassifications had no effect on our net income, stockholders' equity, or cash flows.

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NOTE 4. Adoption of Accounting Pronouncements

In February 2008, the Financial Accounting Standards Board ("FASB") issued guidance under Accounting Standards Codification ("ASC") 820, Fair Value Measurements and Disclosures ("ASC 820"), which was formerly referred to as FASB Staff Position ("FSP") FAS 157-2, Effective Date of FASB Statement No. 157 . This guidance delayed previously issued fair value guidance until January 1, 2009 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis. The adoption of this guidance did not have an impact on our results of operations or financial condition.

In May 2008, the FASB issued guidance under ASC 944, Financial Services – Insurance ("ASC 944"), which was formerly referred to as FASB Statement of Financial Accounting Standards No. 163, Accounting for Financial Guarantee Insurance Contracts – an interpretation of FASB Statement No. 60. This guidance applies to financial guarantee insurance and reinsurance contracts that are: (i) issued by enterprises that are included within the scope of ASC 944; and (ii) not accounted for as derivative instruments. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The adoption of this guidance did not have an impact on our results of operations or financial condition.

In May 2008, the FASB issued guidance under ASC 470, Debt , which was formerly referred to as FSP No. APB 14-1, Accounting for Convertible Debt Instruments that may be Settled in Cash upon Conversion (Including Partial Cash Settlement) . This guidance applies to convertible debt instruments that, by their stated terms, may be completely or partially settled in cash (or other assets) upon conversion, unless the embedded conversion option is required to be separately accounted for as a derivative under ASC 815, Derivatives and Hedging .. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The adoption did not have a material impact on our financial condition or results of operations for any period presented.

In June 2008, the FASB issued guidance under ASC 260, Earnings Per Share , which was formerly referred to as FSP No. EITF 03-6-1, D etermining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities. This guidance addresses the treatment of unvested share-based payment awards containing nonforfeitable rights to dividends or dividend equivalents in the calculation of earnings per share and is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. The adoption did not have a material impact on our calculation of earnings per share for any period presented.

In December 2008, the FASB issued guidance under ASC 715, Compensation – Retirement Benefits , which was formerly referred to as FSP FAS 132(R)-1, an amendment to FASB Statement No. 132 (revised 2003), Employers' Disclosure about Pensions and Other Post-retirement Benefits, to provide guidance on an employer's disclosures about plan assets of a defined benefit pension or other postretirement plan. This guidance requires employers of public and nonpublic entities to disclose more information about the following:

- How investment allocation decisions are made (including investment policies and strategies, as well as the company's strategy for funding the benefit obligations);
- The major categories of plan assets, including cash and cash equivalents; equity securities (segregated by industry type, company size, or investment objective); debt securities (segregated by those issued by national, state, and local governments); corporate debt securities; asset-backed securities; structured debt; derivatives (segregated by the type of underlying risk in the contract); investment funds (segregated by type of fund); and real estate;
- Fair-value measurements, and the fair-value techniques and inputs used to measure plan assets similar to the requirements set forth under ASC 820 (i.e.: Level 1, 2 & 3); and
- Significant concentrations of risk within plan assets.

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

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In April 2009, the FASB issued guidance under ASC 820, which was formerly referred to as FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly. This guidance addresses the factors that determine whether there has been a significant decrease in the volume and level of activity for an asset or liability when compared to the normal market activity. Under this guidance, if the reporting entity has determined that the volume and level of activity has significantly decreased and transactions are not orderly, further analysis is required and significant adjustments to the quoted prices or transactions may be needed. This guidance is effective for interim and annual reporting periods ending after June 15, 2009 and our adoption on April 1, 2009 did not have a material impact on our financial condition or results of operations. We have included the required disclosures in the following notes to the consolidated financial statements where applicable.

In April 2009, the FASB issued guidance under ASC 320, Investments – Debt and Equity Securities , which was formerly referred to as FSP FAS 115-2 and FSP FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments. This guidance introduces the concept of credit and non-credit other-than-temporary impairment (“OTTI”) charges on fixed maturity securities. Under this guidance, when an OTTI of a fixed maturity security has occurred, the amount of the OTTI charge recognized in earnings depends on whether a company: (i) intends to sell the security; or (ii) will more likely than not will be required to sell the security before recovery of its amortized cost basis. If the debt security meets either of these two criteria, the OTTI recognized in earnings is equal to the entire difference between the security’s amortized cost basis and its fair value at the impairment measurement date. For impairments of fixed maturity securities that do not meet these two criteria, the net amount recognized in earnings is equal to the difference between the amortized cost of the debt security and its projected net present value of future cash flows (referred to as the “credit impairment”). Any difference between the fair value and the projected net present value of future cash flows at the impairment measurement date is recorded in other comprehensive income (“OCI”) (referred to as the “non-credit impairment”). Prior to our adoption of this guidance on April 1, 2009, an OTTI recognized in earnings for fixed maturity securities was equal to the total difference between its amortized cost and fair value at the time of impairment. We were also required to analyze securities held as of the adoption date which have had past OTTI charges in order to quantify a cumulative effect adjustment to the opening balance of retained earnings with a corresponding adjustment to accumulated OCI upon adoption. This cumulative effect adjustment amounted to $2.4 million, net of deferred tax, which decreased accumulated OCI and increased retained earnings. Also upon adoption, we increased the amortized cost of these securities by $3.7 million, representing non-credit related impairments recognized in earnings prior to our adoption of this guidance. This guidance is effective for interim and annual reporting periods ending after June 15, 2009. See Note 6. “Investments” below for information regarding our credit and non-credit OTTI charges. In addition, we have included the required disclosures in the following notes to the consolidated financial statements where applicable.

In April 2009, the FASB issued guidance under ASC 825, Financial Instruments , which was formerly referred to as FSP FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments to provide guidance on additional disclosures surrounding fair value of financial instruments required when a publicly traded company issues financial information for interim reporting periods. The disclosure requirements of this guidance are effective for interim reporting periods ending after June 15, 2009. We have included the required disclosures of the update in the following notes to the consolidated financial statements where applicable.

In June 2009, the FASB issued an update to ASC 855, Subsequent Events , which was formerly referred to as FASB Statement of Financial Accounting Standards No. FAS 165, Subsequent Events. Under this guidance, we are required to disclose that we have analyzed subsequent events through October 29, 2009, the date on which these Financial Statements are issued. Requirements concerning the accounting and disclosure of subsequent events under this guidance are not significantly different from those contained in existing auditing standards and, as a result, our adoption of the update did not have a material impact on our financial condition or results of operations.

In June 2009, the FASB issued guidance under ASC 860, Transfers and Servicings , which was previously referred to as FASB Statement of Financial Accounting Standards No. 166, Accounting for Transfers of Financial Assets . This guidance: (i) eliminates the concept of a qualifying "special-purpose entity" ("SPE"); (ii) alters the requirements for transferring assets off of the reporting company's balance sheet; (iii) requires additional disclosure about a transferor's involvement in transferred assets; and (iv) eliminates special treatment of guaranteed mortgage securitizations. This guidance is effective for fiscal years beginning after November 15, 2009. We do not expect that the adoption of this guidance will have a material impact on our financial condition or results of operations.

In June 2009, the FASB issued guidance under ASC 810, Consolidation, which was formerly referred to as FASB Statement of Financial Accounting Standards No. 167, Amendments to FASB Interpretation No. (46). This guidance requires a company to perform a qualitative analysis that results in a variable interest entity ("VIE") being consolidated if the company: (i) has the power to direct activities of the VIE that significantly impact the VIE's financial performance; and (ii) has an obligation to absorb losses or receive benefits that may be significant to the VIE. This guidance further requires enhanced disclosures, including disclosure of significant judgments and assumptions as to whether a VIE must be consolidated, and how involvement with a VIE affects the company's financial statements. This guidance is effective for fiscal years beginning after November 15, 2009. We do not expect that the adoption of this guidance will have a material impact on our financial condition or results of operations.

In June 2009, the FASB issued guidance under ASC 105 , Generally Accepted Accounting Principles, which was formerly known as FASB Statement of Financial Accounting Standards No. 168, FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles – A Replacement of FASB Statement No. 162 . This guidance establishes the FASB Accounting Standards Codification (the "Codification") as the source of authoritative GAAP for nongovernmental entities. The Codification supersedes all existing non-SEC accounting and reporting standards. Rules and interpretive releases of the SEC under authority of federal security laws will remain authoritative GAAP for SEC registrants. This guidance and the Codification are effective for financial statements issued for interim and annual periods ending after September 15, 2009. As the Codification did not change existing GAAP, the adoption did not have an impact on our financial condition or results of operations.

In August 2009, the FASB issued ASC Update 2009-05, Fair Value Measurements and Disclosures (Topic 820) – Measuring Liabilities at Fair Value, which provides guidance on the fair value measurement of liabilities that are traded as assets in the marketplace (i.e. debt obligations). In circumstances in which the quoted price in an active market is not available for an identical liability, a company should measure fair value using one or more of the following valuation techniques: (i) quoted price of the identical liability when traded as an asset; (ii) quoted prices for similar liabilities when traded as an asset; or (iii) a valuation technique that is based on the amount that the company would pay or receive to transfer an identical liability. This guidance is effective for the first reporting period beginning after August 26, 2009. The adoption did not have a material impact on our financial condition or results of operations.

In September 2009, the FASB issued ASC Update 2009-12, Fair Value Measurements and Disclosures (Topic 820) – Investments in Certain Entities that Calculate New Asset Value per Share (or Its Equivalent) .. This update provides guidance in estimating the fair value of a company's investments in investment companies when the investment does not have a readily determinable fair value. It permits the use of the investment's net asset value as a practical expedient to determine fair value. This guidance also requires additional disclosure of the attributes of these investments such as: (i) the nature of any restrictions on the reporting entity's ability to redeem its investment; (ii) unfunded commitments; and (iii) investment strategies of the investees. This guidance is effective for periods ending after December 15, 2009. We expect that the adoption will not have a material impact on our financial condition or results of operations.

NOTE 5. Statement of Cash Flows

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

($ in thousands)		Nine Months 2009	Nine Months 2008
Cash paid (received) during the period for:			
Interest	$	11,879	12,518
Federal income tax		(8,500)	25,050

Supplemental schedule of non-cash financing transactions:		
Conversion of convertible debentures	-	169

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NOTE 6. Investments

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

($ in thousands)		September 30, 2009	December 31, 2008
Available-for-sale ("AFS") securities:			
Fixed maturity securities	$	34,002	(89,068)
Equity securities		13,087	(3,370)
Other investments		-	(1,478)
Total AFS securities		47,089	(93,916)
Held-to-maturity ("HTM") securities:			
Fixed maturity securities		4,165	-
Total HTM securities		4,165	-
Total net unrealized gains (losses)		51,254	(93,916)
Deferred income tax (expense) benefit		(17,938)	32,871
Cumulative effect adjustment due to adoption of OTTI accounting guidance, net of deferred income tax		2,380	-
Cumulative effect adjustment due to adoption of fair value option, net of tax		-	6,210
Net unrealized gains (losses), net of deferred income tax	$	35,696	(54,835)
Increase (decrease) in net unrealized gains, net of deferred income tax expense (benefit)	$	90,531	(148,895)

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

September 30, 2009 ($ in thousands)	Amortized Cost	Net Unrealized Gains (Losses)	Carrying Value	Unrecognized Holding Gains	Unrecognized Holding Losses	Fair Value
U.S. government and government agencies1	$ 171,071	5,946	177,017	2,838	(154)	179,701
Obligations of states and political subdivisions	1,197,409	36,072	1,233,481	22,143	(1,185)	1,254,439
Corporate securities	107,526	(6,320)	101,206	9,093	(699)	109,600
Asset-backed securities ("ABS")	37,515	(6,867)	30,648	3,539	(145)	34,042
Commercial mortgage-backed securities ("CMBS")	130,020	(26,562)	103,458	6,959	(9,671)	100,746
Residential mortgage-backed securities ("RMBS")	156,534	1,896	158,430	3,162	(227)	161,365
Total HTM fixed maturity securities	$ 1,800,075	4,165	1,804,240	47,734	(12,081)	1,839,893

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

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

The increase in our HTM securities in 2009 was primarily attributable to a $1.9 billion transfer of previously designated AFS securities to a HTM designation. We reassess the classification designation of each security we hold at each balance sheet date. The reclassification of these securities is permitted because we have determined that we have the ability and the intent to hold these securities as an investment until maturity or call. We transferred these previously designated AFS securities to a HTM designation to preserve capital. Upon transfer from AFS to HTM, the difference between par value and fair value at the date of transfer is amortized as a yield adjustment over the expected life of the security.

Unrecognized holding gains/losses of HTM securities are not reflected in the financial statements, as they represent market value fluctuations from the later of: (i) the date a security is designated as HTM; or (ii) the date that an OTTI charge is recognized on a HTM security, through the date of the balance sheet. However, the securities transferred have unrealized gains/losses that are reflected in accumulated OCI on the Consolidated Balance Sheet, net of subsequent amortization, which is being recognized over the life of the securities. Our HTM securities had an average duration of 3.5 years as of September 30, 2009.

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

September 30, 2009 ($ in thousands)		Cost/ Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government and government agencies1	$	348,545	4,363	(38)	352,870
Obligations of states and political subdivisions		380,214	26,890	(47)	407,057
Corporate securities		301,500	17,348	(769)	318,079
ABS		24,006	243	(430)	23,819
CMBS		81,598	3,069	-	84,667
RMBS		318,321	4,471	(21,098)	301,694
AFS fixed maturity securities		1,454,184	56,384	(22,382)	1,488,186
AFS equity securities		76,805	14,635	(1,548)	89,892
Total AFS securities	$	1,530,989	71,019	(23,930)	1,578,078

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

December 31, 2008 ($ in thousands)		Cost/ Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government and government agencies1	$	235,540	16,611	-	252,151
Obligations of states and political subdivisions		1,739,349	38,863	(20,247)	1,757,965
Corporate securities		389,386	7,277	(30,127)	366,536
ABS		76,758	6	(15,346)	61,418
MBS		682,313	8,332	(94,437)	596,208
AFS fixed maturity securities		3,123,346	71,089	(160,157)	3,034,278
AFS equity securities		125,947	24,845	(18,661)	132,131
Total AFS securities	$	3,249,293	95,934	(178,818)	3,166,409

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

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

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

September 30, 2009	Less than 12 months1			12 months or longer1		
($ in thousands)	Fair Value	Unrealized (Losses)2	Unrecognized (Losses)3	Fair Value	Unrealized Losses2	Unrecognized Losses3
AFS securities						
U.S. government and government agencies4	$ 19,994	(38)	-	-	-	-
Obligations of states and political subdivisions	-	-	-	3,550	(47)	-
Corporate securities	4,975	(17)	-	22,701	(752)	-
ABS	-	-	-	13,570	(430)	-
CMBS	-	-	-	-	-	-
RMBS	25,933	(6,753)	-	34,629	(14,345)	-
Total fixed maturity securities	50,902	(6,808)	-	74,450	(15,574)	-
Equity securities	5,819	(328)	-	8,154	(1,220)	-
Sub-total	$ 56,721	(7,136)	-	82,604	(16,794)	-
HTM securities						
U.S. government and government agencies4	$ 9,894	-	(106)	-	-	-
Obligations of states and political subdivisions	6,721	(12)	(44)	101,851	(5,820)	2,248
Corporate securities	4,880	(1,102)	982	27,233	(5,362)	3,043
ABS	-	-	-	20,498	(6,683)	2,830
CMBS	593	(555)	(286)	29,798	(24,691)	(5,980)
RMBS	5,150	-	(86)	5,857	(1,110)	(72)
Sub-total	27,238	(1,669)	460	185,237	(43,666)	2,069
Total	$ 83,959	(8,805)	460	267,841	(60,460)	2,069

1 The month count for aging of unrealized losses was reset back to historical unrealized loss month counts for securities impacted by the adoption of OTTI guidance in the second quarter of 2009 and for securities that were transferred from an AFS to an HTM category.
2 Gross unrealized gains/(losses) include non-OTTI unrealized amounts and OTTI losses recognized in accumulated OCI at September 30, 2009. In addition, this column includes remaining unrealized gain or loss amounts on securities that were transferred to a HTM designation in the first quarter of 2009 for those securities that are in a net unrealized/unrecognized loss position at September 30, 2009.
3 Unrecognized holding gains/(losses) represent market value fluctuations from the later of: (i) the date a security is designated as HTM; or (ii) the date that an OTTI charge is recognized on a HTM security.
4 U.S. government includes corporate securities fully guaranteed by the FDIC.

December 31, 20081	Less than 12 months		12 months or longer	
($ in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
AFS securities				
	$ -	-	-	-

U.S. government and government agencies2				
Obligations of states and political subdivisions	354,615	(11,565)	128,130	(8,682)
Corporate securities	162,339	(20,109)	30,087	(10,018)
ABS	42,142	(7,769)	15,336	(7,577)
Agency MBS	2,910	(8)	6,092	(1,241)
Non-agency MBS	178,235	(28,095)	90,937	(65,093)
Total fixed maturity securities	740,241	(67,546)	270,582	(92,611)
Equity securities	61,147	(18,661)	-	-
Other investments	4,528	(1,478)	-	-
Total securities in a temporary unrealized loss position	$ 805,916	(87,685)	270,582	(92,611)

1 2008 HTM securities are not presented in this table, as their fair value was approximately $1.2 million and therefore not material.
2 U.S. government includes corporate securities fully guaranteed by the FDIC.

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Unrealized losses decreased compared to December 31, 2008, primarily because of general improvement in the overall marketplace for our fixed maturity portfolio and the reduction in our equity portfolio as discussed below. As of September 30, 2009, 150 fixed maturity securities and nine equity securities were in an unrealized/unrecognized loss position. At December 31, 2008, 355 fixed maturity securities, 45 equity securities, and one other investment security were in an unrealized loss position.

We have reviewed the securities in the tables above in accordance with our OTTI policy. As of September 2009, the overall Standard and Poor's credit quality rating of our fixed maturity securities was "AA+" and these securities are performing according to their contractual terms. The assessment of whether a decline in value is temporary includes our current judgment as to the financial position and future prospects of the entity that issued the investment security. Broad changes in the overall market or interest rate environment generally will not lead to a credit related write-down. If our judgment about an individual security changes in the future, we may ultimately record a credit loss after having originally concluded that one did not exist, which could have a material impact on our net income and financial position in future periods.

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

In performing our assessment on all of the structured securities in our fixed maturity portfolio, we observed that our HTM CMBS portfolio with unrealized/unrecognized losses greater than 12 months, which was comprised of 14 securities, has shown a decline in fair value of approximately 86%, or $30.7 million, as compared to its carrying value. During our OTTI analysis, we stressed these 14 securities under various scenarios with loss severities that generally ranged from approximately 20% to 50%, based on loan-to-value ratios, as well as conditional default rates that generally ranged from 1.0 to 2.5. In addition, when performing our OTTI analysis, we observed that our AFS RMBS portfolio with unrealized losses of 12 months or greater, which was comprised of 20 securities, has shown a decline in fair value of approximately 29%, or $14.3 million, as compared to its carrying value. During our OTTI analysis, we stressed securities comprising $12.1 million, or 85%, of the $14.3 million unrealized balance under various scenarios with loss severities that generally ranged from approximately 40% to 45%, based on loan-to-value ratios, as well as conditional default rates that generally ranged from 0.33 to 7.0. For both the above mentioned CMBS and RMBS securities, there were no signs of impairment seen under any of the modeled scenarios. Furthermore, we considered the following facts and circumstances: (i) these securities have experienced low delinquencies and in certain cases no losses to date; (ii) generally these securities have experienced increased collateral support over origination; and (iii) generally these securities have loan-to-value ratios that support the valuation. As a result of our analysis and as we do not have the intent to sell these securities and do not believe we will be required to sell these securities, we have concluded that these securities are not other-than-temporarily impaired.

In performing our OTTI analysis for corporate debt securities, we analyzed the general market condition of each issuer's industry, particularly the financial services sector, as well as the geographic area of the issuer given the current economic environment. In addition, we looked for evidence of significant deterioration in the issuer's credit worthiness. We have determined that the unrealized losses above related to corporate debt securities at September 30, 2009 are attributed to the current volatile market conditions and not to the creditworthiness of any individual issuer.

We do not have the intent to sell these debt securities and do not believe we will be required to sell these securities before recovery and, as such, we do not consider the unrealized losses above to contain other-than-temporary credit impairments as of September 30, 2009.

In performing our OTTI analysis for equity securities, we give consideration to, among many factors, the financial position and future prospects of the issuer, general market conditions, the length of time that the security has been in an unrealized loss position, and our intent to hold the security in the near term. We have determined that the unrealized losses above are attributable to reduced asset values globally and not a reflection of the financial condition of any issuer. The $1.2 million of equity securities with unrealized losses of 12 months or greater is comprised of investments in four financially sound companies whose average market value is approximately 87% of their related cost. It is likely that these investments will recover their value in the near term.

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

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

($ in thousands)	Carrying Value	Fair Value
Due in one year or less	$ 257,341	259,434
Due after one year through five years	846,932	864,482
Due after five years through ten years	661,259	674,844
Due after ten years through fifteen years	38,708	41,133
Total HTM fixed maturity securities	$ 1,804,240	1,839,893

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

($ in thousands)	Fair Value
Due in one year or less	$ 125,151
Due after one year through five years	810,086
Due after five years through ten years	528,600
Due after ten years through fifteen years	24,349
Total AFS fixed maturity securities	$ 1,488,186

(f) The following table outlines a summary of our other investment portfolio by strategy and the remaining commitment amount associated with each strategy:

Other Investments	Carrying Value		2009
($ in millions)	September 30, 2009	December 31, 2008	Remaining Commitment
Alternative Investments			
Energy/Power Generation	$ 32.5	35.8	10.9
Distressed Debt	30.1	29.8	4.6
Private Equity	20.1	22.8	18.6
Secondary Private Equity	20.0	24.1	25.7
Real Estate	18.6	23.4	13.6
Mezzanine Financing	18.3	23.2	28.6
Venture Capital	5.6	5.9	2.0
Total Alternative Investments	145.2	165.0	104.0
Other Securities	2.3	7.1	-
Total Other Investments	$ 147.5	172.1	104.0

The decrease in Other Investments of $24.6 million for 2009 compared to 2008 was primarily due to the $26.8 million decrease in the fair value of our alternative investments partially offset by $7.0 million in net contributions. In addition, we sold $4.8 million in Other securities during the second quarter of 2009.

The following is a description of our alternative investment strategies:

Energy / Power Generation
This strategy invests primarily in cash flow generating assets in the coal, natural gas, power generation, and electric and gas transmission and distribution industries.

Distressed Debt
This strategy makes direct and indirect investments in debt and equity securities of companies that are experiencing financial and/or operational distress. Investments include buying indebtedness of bankrupt or financially-troubled companies, small balance loan portfolios, special situations and capital structure arbitrage trades, commercial real estate mortgages and similar non-U.S. securities and debt obligations. This strategy also includes a fund of funds component.

Private Equity
This strategy makes private equity investments primarily in established large and middle market companies across diverse industries in North America, Europe and Asia.

Secondary Private Equity
This strategy purchases seasoned private equity funds from investors desiring liquidity prior to normal fund termination. Investments are made across all sectors of the private equity market, including leveraged buyouts, venture capital, distressed securities, mezzanine financing, real estate, and infrastructure.

Real Estate
This strategy invests opportunistically in real estate in North America, Europe, and Asia via direct property ownership, joint ventures, mortgages, and investments in equity and debt instruments.

Mezzanine Financing
This strategy provides privately negotiated fixed income securities, generally with an equity component, to leveraged buyout (“LBO”) firms and private and publicly traded large, mid and small-cap companies to finance LBOs, recapitalizations, and acquisitions.

Venture Capital
In general, these investments are venture capital investments made principally by investing in equity securities of privately held corporations, for long-term capital appreciation. This strategy also makes private equity investments in growth equity and buyout partnerships.

Our seven alternative investment strategies employ low or moderate levels of leverage and generally use hedging only to reduce foreign exchange or interest rate volatility. At this time, our alternative investment strategies do not include hedge funds. At September 30, 2009, we have contractual obligations that expire at various dates through 2023 to further invest up to $104.0 million in alternative investments. There is no certainty that any such additional investment will be required.

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

		Quarter ended September 30,		Nine Months ended September 30,	
($ in thousands)		2009	2008	2009	2008
Fixed maturity securities	$	34,747	36,851	106,980	109,681
Equity securities, dividend income		551	1,004	1,562	3,683

Trading securities, change in fair value		-	(4,817)	262	(6,448)
Short-term investments		237	976	1,161	3,703
Other investments		2,713	3,295	(26,451)	5,595
Investment expenses		(1,663)	(1,175)	(4,844)	(3,699)
Net investment income earned	$	36,585	36,134	78,670	112,515

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

Third Quarter 2009 ($ in thousands)		Gross	Included in OCI	Recognized in earnings
Fixed maturity securities				
Corporate securities	$	-	-	-
ABS		68	-	68
CMBS		-	-	-
RMBS		5,473	1,591	3,882
Total fixed maturity securities		5,541	1,591	3,950
Equity securities		292	-	292
OTTI losses	$	5,833	1,591	4,242

Third Quarter 2008 ($ in thousands)		Gross	Included in OCI	Recognized in earnings
Fixed maturity securities				
Corporate securities	$	8,590	-	8,590
ABS		7,367	-	7,367
CMBS		6,338	-	6,338
RMBS		2,951	-	2,951
Total fixed maturity securities		25,246	-	25,246
Equity securities		4,823	-	4,823
Other		4,785	-	4,785
OTTI losses	$	34,854	-	34,854

Nine Months 2009 ($ in thousands)		Gross	Included in OCI	Recognized in earnings
Fixed maturity securities				
Corporate securities	$	1,270	-	1,270
ABS		1,595	(826)	2,421
CMBS		1,417	706	711
RMBS		39,447	1,770	37,677
Total fixed maturity securities		43,729	1,650	42,079
Equity securities		1,738	-	1,738
OTTI losses	$	45,467	1,650	43,817

Nine Months 2008 ($ in thousands)		Gross	Included in OCI	Recognized in earnings
Fixed maturity securities				
Corporate securities	$	10,201	-	10,201
ABS		14,679	-	14,679
CMBS		6,338	-	6,338
RMBS		3,812	-	3,812
Total fixed maturity securities		35,030	-	35,030
Equity securities		4,823	-	4,823
Other		4,785	-	4,785
OTTI losses	$	44,638	-	44,638

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

($ in thousands)		
Balance, June 30, 2009	$	11,391
Credit losses remaining in retained earnings after adoption of OTTI accounting guidance		-
Addition for the amount related to credit loss for which an OTTI was not previously recognized		-
Reductions for securities sold during the period		-
Reductions for securities for which the amount previously recognized in OCI was recognized in earnings		-
because of intention or potential requirement to sell before recovery of amortized cost		-
Additional increases to the amount related to credit loss for which an OTTI was previously recognized		72
Accretion of credit loss impairments previously recognized due to an increase in cash flows expected		-
to be collected		-
Balance, September 30, 2009	$	11,463

($ in thousands)		
Balance, March 31, 2009	$	-
Credit losses remaining in retained earnings after adoption of OTTI accounting guidance		9,395
Addition for the amount related to credit loss for which an OTTI was not previously recognized		-
Reductions for securities sold during the period		-
Reductions for securities for which the amount previously recognized in OCI was recognized in earnings		-
because of intention or potential requirement to sell before recovery of amortized cost		-
Additional increases to the amount related to credit loss for which an OTTI was previously recognized		2,068
Accretion of credit loss impairments previously recognized due to an increase in cash flows expected		-
to be collected		-
Balance, September 30, 2009	$	11,463

In addition to our discussion in Note 2. “Summary of Significant Accounting Policies” in Item 8. “Financial Statements and Supplementary Data” in our 2008 Annual Report, below is additional information regarding the methodology and significant inputs that we used to measure the amount of OTTI recognized in earnings in Third Quarter and Nine Months 2009:

- For structured securities, we utilized underlying data for each security, including information from credit agencies, to determine projected future cash flows. These projections included base case and stress testing scenarios that modify expected default rates, loss severities, and prepayment assumptions based on type and vintage. Generally the range of the conditional default rates used in the scenarios are:

o	CMBS:	1.00 – 2.50
o	Alternative-A securities (“Alt-A”) fixed structured securities:	0.50 – 6.00
o	Alt-A hybrid structured securities:	1.00 – 7.00
o	All other fixed structured securities:	0.07 – 1.00
o	All other hybrid structured securities:	0.33 – 1.50

In determining the loss severity used within the scenarios, we used a current, or estimated, loan-to-value ratio multiplied by an estimated 60% loss on that exposure. Based on these projections, we determined expected recovery values for each security, incorporating both base case and stress testing case scenarios. The amortized cost bases of the securities were adjusted down, if required, to the projected discounted cash flow value calculated in the OTTI review process. These downward adjustments are considered credit impairments and are charged through earnings and included:

- $3.9 million and $37.7 million of RMBS credit OTTI charges in Third Quarter and Nine Months 2009, respectively. As of September 30, 2009, we had the intention to sell one security in a loss position and, as a result, recorded an OTTI charge in Third Quarter 2009 for the related $3.8 million unrealized loss position on this security. Additional charges taken during the year related to securities that experienced declines in the cash flows of their underlying collateral. Based on our assumptions within the ranges of the conditional default rates and loss severities outlined above, we do not believe it is probable that we will receive all contractual cash flows for these securities.

- o There were no CMBS credit OTTI charges in Third Quarter 2009 and $0.7 million for Nine Months 2009. These charges related to declines in the related cash flows of the collateral. For these securities, based on our assumptions within the ranges of the conditional default rates and loss severities outlined above, we do not believe it is probable that we will receive all contractual cash flows for these securities.

- o $0.1 million and $2.4 million of ABS credit OTTI charges in Third Quarter and Nine Months 2009, respectively. These charges related primarily to two bonds from the same issuer, who is currently in technical default, that were previously written down. These charges also include additional credit impairment losses on another security that was previously written down in 2008 which, based on our current assumptions of the conditional default rates and loss severities, indicate that it is probable that we will not receive all contractual cash flows for this security.

- $1.3 million for Nine Months 2009 of corporate debt credit OTTI charges. In assessing corporate debt securities for OTTI, we evaluate, among other things, the issuer's ability to meet its debt obligations, the value of the company, and, if applicable, the value of specific collateral securing the position. This second quarter of 2009 charge was primarily related to a financial institution issuer that was on the verge of bankruptcy. This security was sold in Third Quarter 2009 at an additional loss of $1.1 million.

To determine the credit loss, we discount the expected cash flows at the effective interest rate implicit in the security at the date of acquisition for those structured securities that were not of high-credit quality at acquisition. For all other securities, we use a discount rate that equals the current yield, excluding the impact of previous OTTI charges, used to accrete the beneficial interest.

- $0.3 million and $1.7 million of equity charges in Third Quarter and Nine Months 2009, respectively, related to two banks, one bank exchange traded fund, one energy company, and a membership warehouse chain of stores. We believe the share price weakness of these securities is more reflective of general overall financial market conditions, as we are not aware of any significant deterioration in the fundamentals of these four companies. However, the length of time these securities have been in an unrealized loss position, and the overall distressed trading levels of many coal stocks in the energy sector, banking stocks in the financial services sector, and retail/wholesale store stocks make a recovery to our cost basis unlikely in the near term.

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

	Quarter ended September 30,		Nine Months ended September 30,	
($ in thousands)	2009	2008	2009	2008
HTM fixed maturity securities				
Gains	$ 81	17	219	27
Losses	(236)	(1)	(530)	(1)
AFS fixed maturity securities				
Gains	4,154	26	17,752	1,084
Losses	(4,441)	(2,337)	(13,400)	(6,851)
AFS equity securities				
Gains	551	14,087	29,257	31,784
Losses	-	(871)	(27,744)	(1,900)
Other investments				
Gains	-	1,356	-	1,356
Losses	(850)	-	(2,039)	-
Total other net realized investment gains (losses)	(741)	12,277	3,515	25,499

Total OTTI charges recognized in earnings		(4,242)	(34,854)	(43,817)	(44,638)
Total net realized losses	$	(4,983)	(22,577)	(40,302)	(19,139)

Realized gains and losses on the sale of investments are determined on the basis of the cost of the specific investments sold.

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Proceeds from the sale of AFS securities were $100.5 million in Third Quarter 2009 and $595.4 million in Nine Months 2009. Of the $4.4 million of realized losses incurred from sales of AFS fixed maturity securities during Third Quarter 2009, $4.2 million was attributable to four securities on which we had taken previous OTTI charges as we had the intention to sell these securities. Additional sales of AFS fixed maturity securities that resulted in realized losses were driven by further declines in the issuers' creditworthiness and liquidity.

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

NOTE 7. Fair Value Measurements

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

	September 30, 2009		December 31, 2008	
($ in thousands)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Fixed maturity securities:				
HTM	$ 1,804,240	1,839,893	1,163	1,178
AFS	1,488,186	1,488,186	3,034,278	3,034,278
Equity securities:				
AFS	89,892	89,892	132,131	132,131
Trading	-	-	2,569	2,569
Short-term investments	236,896	236,896	198,111	198,111
Other securities	2,246	2,246	7,040	7,040
Financial liabilities				
Notes payable:1				
8.87% Senior Notes Series B	12,300	12,689	24,600	25,592
7.25% Senior Notes	49,899	48,535	49,895	42,221
6.70% Senior Notes	99,400	78,525	99,383	72,000
7.50% Junior Notes	100,000	84,200	100,000	59,680
Total notes payable	261,599	223,949	273,878	199,493

1 Our notes payable are subject to certain debt covenants that were met in their entirety in 2008 and Nine Months 2009. For further discussion regarding the debt covenants, refer to Note 9. "Indebtedness" in the 2008 Annual Report.

The fair values of our investment portfolio are generated using various valuation techniques, which are as follows:

a. For valuations of securities in our equity portfolio and U.S. Treasury notes held in our fixed maturity portfolio, we utilize a market approach, wherein we use quoted prices in an active market for identical assets. The source of these prices is one primary external pricing service, which we validate against a second external pricing service. Significant variances between pricing from the two pricing services are challenged with the respective pricing service, the resolution of which determines the price utilized. These securities are classified as Level 1 in the fair value hierarchy.

b. For the majority of our fixed maturity portfolio, approximately 99%, we also utilize a market approach, using primarily matrix pricing models prepared by external pricing services. Matrix pricing models use mathematical techniques to value debt securities by relying on the securities relationship to other benchmark quoted securities, and not relying exclusively on quoted prices for specific securities, as the specific securities are not always frequently traded. We utilize up to two pricing services in order to obtain prices on our fixed maturity portfolio. As a matter of policy, we consistently use one of the pricing services as our primary source and we use the second pricing service in certain circumstances where prices were not available from the primary pricing service. In order to validate the prices utilized for reasonableness, we validate them in one of two ways: (i) randomly sampling the population and verifying the price to a separate third party source; or (ii) analytically validating the entire portfolio against a third pricing service. Historically, we have not experienced significant variances in prices and therefore we have consistently used either our primary or secondary pricing service. These prices are typically Level 2 in the fair value hierarchy.

For approximately 1% of our fixed maturity portfolio, we are unable to obtain a price from either our primary or secondary pricing service; therefore, we obtain non-binding broker quotes for such securities. These quotes are reviewed for reasonableness by internal investment professionals and are generally classified as Level 2 in the fair value hierarchy as the brokers are generally using market information to determine the quotes.

c. Short-term investments are carried at cost, which approximates fair value. Given the liquid nature of our short-term investments, we generally validate their fair value by way of active trades within approximately a week of the financial statement close. These securities are Level 1 in the fair value hierarchy. Our investments in other miscellaneous securities are generally accounted for at fair value based on net asset value and included in Level 2 in the fair value hierarchy.

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

The following tables provide quantitative disclosures of our financial assets that were measured at fair value at September 30, 2009 and December 31, 2008:

($ in thousands)	Assets Measured at Fair Value at 9/30/09	Fair Value Measurements at 9/30/09 Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Description				
Measured on a recurring basis:				
U.S. government and government agencies1	$ 352,870	31,582	321,288	-
Obligations of states and political subdivisions	407,057	-	407,057	-
Corporate securities	318,079	-	318,079	-
ABS	23,819	-	23,819	-
CMBS	84,667	-	84,667	-
RMBS	301,694	-	301,694	-
Total fixed maturity securities	1,488,186	31,582	1,456,604	-

Equity securities	89,892	89,892	-	-
Short-term investments	236,896	236,896	-	-
Other investments	2,246	-	2,246	-
Measured on a non-recurring basis:				
Goodwill	9,573	-	-	9,573
Total assets	$ 1,826,793	358,370	1,458,850	9,573

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

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($ in thousands)	Assets Measured at Fair Value at 12/31/08	Fair Value Measurements at 12/31/08 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Description				
Measured on a recurring basis:				
Trading securities:				
Equity securities	$ 2,569	2,569	-	-
AFS securities:				
Fixed maturity securities	3,034,278	94,811	2,939,467	-
Equity securities	132,131	132,131	-	-
Short-term investments	198,111	198,111	-	-
Other investments	7,040	-	7,040	-
Measured on a non-recurring basis:				
Goodwill	21,788	-	-	21,788
Total assets	$ 3,395,917	427,622	2,946,507	21,788

Certain assets are measured at fair value on a nonrecurring basis. Due to the economic deterioration that occurred during 2008 and 2009 in the U.S., our near-term financial projections for our HR Outsourcing reporting unit were not sufficient to support its carrying value. As a result, in Third Quarter 2009, a pre-tax goodwill impairment loss of $12.2 million was recognized for this reporting unit, which is included in "(Loss)/Income from discontinued operations, net of tax" in our Consolidated Statement of Income. In addition, during the fourth quarter of 2008, also due to near-term financial projections not sufficient to support our HR Outsourcing reporting unit's carrying value, a pre-tax goodwill impairment loss of $4.0 million was recognized. Fair value was determined using various inputs including, but not limited to: expected present value of future cash flows, comparison to similar companies, market multiples, and other factors. Estimated cash flows may extend far into the future and by their nature are difficult to determine over an extended time frame. Factors that may significantly affect the estimates include specific industry or market sector conditions, changes in revenue growth trends, competitive forces, cost structures, and changes in discount rates.

NOTE 8. Reinsurance

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

	Unaudited, Quarter ended September 30,		Unaudited, Nine Months ended September 30,	
($ in thousands)	2009	2008	2009	2008
Premiums written:				
Direct	$ 435,169	458,952	1,294,019	1,343,072
Assumed	11,250	11,541	18,611	19,198
Ceded	(69,701)	(67,754)	(194,866)	(178,183)
Net	$ 376,718	402,739	1,117,764	1,184,087
Premiums earned:				
Direct	$ 413,007	424,928	1,244,840	1,273,647
Assumed	5,944	6,570	16,677	22,125

Ceded	(63,045)	(56,790)	(183,427)	(160,423)
Net	$ 355,906	374,708	1,078,090	1,135,349
Losses and loss expenses incurred:				
Direct	$ 264,650	286,390	793,995	847,434
Assumed	4,134	4,718	11,207	15,031
Ceded	(26,752)	(36,560)	(71,927)	(102,037)
Net	$ 242,032	254,548	733,275	760,428

Ceded losses and loss expenses incurred, excluding Flood losses, increased by $15.2 million in Third Quarter 2009 compared to Third Quarter 2008 and $35.1 million in Nine Months 2009 compared to Nine Months 2008 due to normal volatility in losses that are ceded to our reinsurers under our casualty excess of loss treaty.

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

National Flood Insurance Program	Unaudited, Quarter ended September 30,		Unaudited, Nine Months ended September 30,	
($ in thousands)	2009	2008	2009	2008
Ceded premiums written	$ (48,375)	(48,083)	(137,205)	(129,446)
Ceded premiums earned	(43,432)	(39,144)	(127,858)	(113,209)
Ceded losses and loss expenses incurred	(8,729)	(33,739)	(19,829)	(85,058)

NOTE 9. Segment Information

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

- Insurance Operations, which is evaluated based on statutory underwriting results (net premiums earned ("NPE"), incurred losses and loss expenses, policyholders dividends, policy acquisition costs, and other underwriting expenses), and statutory combined ratios; and
- Investments, which is evaluated based on net investment income and net realized gains and losses.

As discussed in Note 1, we revised our segments as follows in 2009:

- During the first quarter of 2009, we realigned our Flood operations to be part of our Insurance Operations segment, which reflects how senior management evaluates our results.
- During Third Quarter 2009, we entered into a plan to dispose of Selective HR, which comprised our HR Outsourcing segment. The results of Selective HR operations are included in "(Loss) income from discontinued operations, net of tax" in our Consolidated Statements of Income. See Note 15. "Discontinued Operations" for additional information on this planned disposal.

We do not aggregate any of our operating segments. All historical data presented has been restated to reflect our current operating segments. Our goodwill balance for our operating segments was $7.8 million at September 30, 2009 and December 31, 2008 and related to our Insurance Operations segment. The remaining goodwill balance for our discontinued operation was $9.6 million at September 30, 2009 and $21.8 million at December 31, 2008. These balances are reflected in "Assets from discontinued operations" on the Consolidated Balance Sheets. See Note 15. "Discontinued Operations" for information regarding the goodwill impairment charge recognized in Nine Months 2009.

Our subsidiaries provide services to each other in the normal course of business. These transactions totaled $2.3 million in Third Quarter 2009 and $6.9 million in Nine Months 2009 compared to $3.6 million in Third Quarter 2008 and $10.5 million in Nine Months 2008. These transactions were eliminated in all consolidated statements herein. In computing the results of each segment, we do not make adjustments for interest expense, net general corporate expenses, or federal income taxes. We do not maintain separate investment portfolios for the segments and, therefore, do not allocate assets to the segments.

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

Revenue from continuing operations by segment	Unaudited, Quarter ended September 30,		Unaudited, Nine Months ended September 30,	
($ in thousands)	2009	2008	2009	2008
Insurance Operations:				
Net premiums earned:				
Commercial automobile	$ 75,513	75,411	226,698	232,393
Workers compensation	64,742	78,383	201,709	234,351
General liability	88,280	97,861	274,357	301,062
Commercial property	49,880	48,742	147,735	147,253
Business owners' policy	15,804	14,389	46,565	42,914
Bonds	4,634	4,732	13,817	14,225
Other	2,426	2,331	7,188	6,939
Total commercial lines	301,279	321,849	918,069	979,137
Personal automobile	33,319	33,280	99,205	98,827
Homeowners	18,613	17,230	53,337	50,776
Other	2,695	2,349	7,479	6,609
Total personal lines	54,627	52,859	160,021	156,212
Total net premiums earned	355,906	374,708	1,078,090	1,135,349
Miscellaneous income	2,657	569	7,720	3,035
Total Insurance Operations revenues	358,563	375,277	1,085,810	1,138,384
Investments:				
Net investment income	36,585	36,134	78,670	112,515
Net realized loss on investments	(4,983)	(22,577)	(40,302)	(19,139)
Total investment revenues	31,602	13,557	38,368	93,376
Total all segments	390,165	388,834	1,124,178	1,231,760
Other income	10	377	38	1,235
Total revenues from continuing operations	$ 390,175	389,211	1,124,216	1,232,995

Income from continuing operations, before federal income tax	Unaudited, Quarter ended September 30,		Unaudited, Nine Months ended September 30,	
($ in thousands)	2009	2008	2009	2008
Insurance Operations:				
Commercial lines underwriting	$ 2,171	1,741	10,185	8,421
Personal lines underwriting	(2,313)	(2,935)	(7,258)	(6,882)
Underwriting (loss) income, before federal income tax	(142)	(1,194)	2,927	1,539
GAAP combined ratio	100.0%	100.3	99.7%	99.9
Statutory combined ratio	99.8%	97.6	99.6%	98.2
Investments:				
Net investment income	36,585	36,134	78,670	112,515
Net realized loss on investments	(4,983)	(22,577)	(40,302)	(19,139)
Total investment income, before federal income tax	31,602	13,557		