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## Research Update:

# Selective Insurance Group Inc. And Operating Companies Ratings Affirmed; Outlook Revised To Negative

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# Selective Insurance Group Inc. And Operating Companies Ratings Affirmed; Outlook Revised To Negative

## Overview

- The capital position of Selective Insurance Group Inc.'s operating subsidiaries has significantly weakened, in our view, due to a modest decline in statutory surplus and increased risk charges for underwriting risk, asset risk, and property catastrophe exposure.
- As a result, we are revising the outlook to negative from stable. At the same time, we are affirming our ratings on Selective Insurance Group and its operating companies.
- We expect capital adequacy to improve to a level commensurate with the rating.

## Rating Action

On Sept. 18, 2012, Standard & Poor's Ratings Services affirmed its 'A' financial strength rating on Branchville, N.J.-based Selective Insurance Co. of America and its affiliates (Selective) and the 'BBB' counterparty credit rating on Selective Insurance Group Inc. (SIGI). At the same time, we revised the outlook to negative from stable.

## Rationale

Our ratings on Selective and SIGI reflect the group's strong competitive position in some Mid-Atlantic states, strong relationships with independent agents, and strong financial flexibility.

The negative outlook reflects our view of the group's significantly weakened capital position stemming from both a modest decline in statutory surplus and the increased charges for underwriting risk, asset risk, and property catastrophe exposure as measured by Standard & Poor's capital adequacy model. Currently, the company's capital is redundant at the 'BBB' level.

Selective maintains a strong competitive position in the small to midsize commercial insurance markets in certain Mid-Atlantic states. The company is an attractive regional carrier to its independent agents because of the ease and speed of business flow through its efficient technology and the seamless integration of policy-level transactions into its underwriting systems. The personal lines business, however, continues to produce underwriting losses and is a weakness to the group's overall operating profitability. Selective has a

substantial business concentration in the Mid-Atlantic region, particularly in New Jersey, which generated about 25% of total 2011 net premiums written (NPW), increasing the company's vulnerability to regulatory, competition, and natural catastrophes.

Operating performance improved in the first half of 2012 due to lower catastrophe losses. As of June 30, 2012, Selective's statutory combined ratio was 102.7%--it was 106.7% for full-year 2011. SIGI employs a modest amount of financial leverage in its capital structure. As of June 30, 2012, financial leverage was 22.2% and fixed-charge coverage was 4.2%.

## Outlook

We believe that Selective will sustain its strong competitive advantage and boost its NPW by roughly 12% for 2012, with a more modest increase for 2013 primarily on growth in NPW from the recently acquired surplus lines business. We expect the company to continue gradually reducing its concentration in the Mid-Atlantic states. Assuming no further catastrophe losses this year, we expect Selective's statutory combined ratio for full-year 2012 to be 102%-103% (including three to four percentage points of catastrophe losses) and its statutory return on revenue to be 5%-6%. As a result of significant catastrophe losses in the past few years for many regional property/casualty insurers, including Selective, we believe the company's operating earnings profile will remain volatile in the coming months. We also expect capital adequacy to improve to a level commensurate with the rating. If the company performs materially below these expectations, we could lower the rating in the next 12 to 24 months.

## Related Criteria And Research

Interactive Ratings Methodology, April 22, 2009

## Ratings List

Ratings Affirmed; Outlook Action

	To	From
Selective Insurance Group Inc.		
Counterparty Credit Rating		
Local Currency	BBB/Negative/--	BBB/Stable/--

Selective Insurance Co. of America  
 Selective Way Insurance Co.  
 Selective Insurance Co. of the Southeast  
 Selective Insurance Co. of South Carolina  
 Selective Insurance Co. of NY  
 Counterparty Credit Rating

*Research Update: Selective Insurance Group Inc. And Operating Companies Ratings Affirmed; Outlook Revised To Negative*

Local Currency	A/Negative/--	A/Stable/--
Financial Strength Rating		
Local Currency	A/Negative/--	A/Stable/--

Ratings Affirmed

Selective Insurance Group Inc.

Senior Unsecured	BBB
Junior Subordinated	BB+

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