MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms Selective Insurance Group's ratings; outlook changed to negative

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New York, February 04, 2013 -- Moody's Investors Service has affirmed the Baa2 senior debt rating of Selective Insurance Group (NASDAQ: SIGI; "Selective") and the A2 insurance financial strength (IFS) ratings of its principal insurance operating subsidiaries. In the same action, Moody's has changed the outlook on the ratings to negative from stable reflecting a trend of weak underwriting profitability and lower interest coverage metrics.

RATINGS RATIONALE

According to Pano Karambelas, Moody's lead analyst for Selective, "The negative outlook reflects our view that Selective's underwriting results have lagged similarly rated peers, with combined ratios (101.4%, 107.2%, and 104.0% in 2010-2012, respectively) consistently at or above the higher end of our expectations (at 103%). Although, underwriting earnings on an ex-catastrophe basis have begun to improve in both the company's standard commercial lines business and in its personal lines portfolio, meaningfully enhanced profitability levels have failed to materialize.

The company has taken 15 consecutive quarters of rate increases (including over 6% in 2012), and utilizes a technologically oriented risk-segmentation strategy to identify sub-par business. However, concentrations in challenging classes of business, such as independent contractors, while reduced continue to weigh on profitability. Selective's pre-tax earnings coverage of interest - 2.28x in 2012 and 2.46x on five-year average basis - reflecting adjusted financial leverage of 29% at year-end 2012, is meaningfully below our ratings expectations. Other challenges include the low interest rate environment which continues to pressure investment portfolio yields and operating income, partially offsetting improvements in underwriting margins.

According to Moody's, the A2 IFS ratings of Selective's operating subsidiaries reflect its solid regional franchise with established independent agency support, solid risk adjusted capitalization, and strong invested asset quality. The company also makes good use of technological tools to service agents, increase efficiency and monitor performance. These strengths are offset by weak underwriting profitability in its standard commercial lines portfolio (82% of premium volume), limited scale and weak profitability in its personal lines portfolio (18% of premium volume) and exposure to Northeast Hurricanes as approximately 45% of the group's business is concentrated in NJ, NY, and PA. Despite the NY/NJ concentration, the company's $52 million net pre-tax loss from Hurricane Sandy (which is partially offset by $16 million in fee income reflecting Selective's participation as servicing carrier in the National Flood Insurance Program) is manageable for the company, reflecting the company's avoidance of coastal and urban concentrations, though the storm highlights the large loss potential from more powerful Northeast hurricanes.

Moody's noted that the following factors could lead to an affirmation of the ratings with a stable outlook: 1) improved underwriting performance with combined ratios below 101%; 2) maintaining pre-tax interest coverage above 6x; 3) gross underwriting leverage less than 4x; and 4) adjusted debt-to-capital at or under 30%.

Conversely factors that could lead to a downgrade include: 1) weak underwriting profitability with combined ratios at or above 103%); 2) interest coverage below 4x; 3) increased underwriting leverage (4.5x or higher); 4) decline in shareholders' equity by more than 10%; and 5) increased adjusted financial leverage over 35%.

The following ratings have been affirmed with a negative outlook:

Selective Insurance Group, Inc. -- senior unsecured debt at Baa2, junior subordinate debt at Baa3 (hyb)

Selective Insurance Company of America -- insurance financial strength at A2;

Selective Way Insurance Company -- insurance financial strength at A2;

Selective Insurance Company of South Carolina -- insurance financial strength at A2;

Selective Insurance Company of the Southeast -- insurance financial strength at A2;

Selective Insurance Company of New York -- insurance financial strength at A2;

Selective Insurance Company of New England -- insurance financial strength at A2; and

Selective Auto Insurance Company of New Jersey -- insurance financial strength at A2.

Selective is a New Jersey based holding company for seven insurance subsidiaries. Commercial lines insurance, consisting primarily of general liability, workers' compensation and commercial auto, comprises approximately 82% of the company's total net written premiums, while personal lines constitute the remaining 18%. For 2012, Selective reported total revenue of $1.7 billion and net income of $38 million. Shareholders' equity at year-end 2012 was approximately $1.1 billion.

The principal methodology used in this rating was Moody's Global Rating Methodology for Property and Casualty Insurers published in May 2010. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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