SAFETY INSURANCE GROUP INC
Form 10-Q
August 08, 2008
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2008

OR

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

For the transition period from to

Commission File Number: 000-50070

SAFETY INSURANCE GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**13-4181699**
(State or other jurisdiction of incorporation or organization)	(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)

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 x No o

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 o Accelerated filer x Non-accelerated filer o Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

As of August 4, 2008, there were 16,287,003 shares of common stock with a par value of $0.01 per share outstanding.

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Safety Insurance Group, Inc. and Subsidiaries

Consolidated Balance Sheets

(Unaudited)

(Dollars in thousands, except share data)

	June 30, 2008	December 31, 2007
Assets		
Investment securities available for sale:		
Fixed maturities, at fair value (amortized cost: $984,596 and $995,360)	**$ 979,271**	$ 1,002,028
Equity securities, at fair value (cost: $8,728 and $6,794)	**8,603**	6,977
Total investment securities	**987,874**	1,009,005
Cash and cash equivalents	**64,115**	46,311
Accounts receivable, net of allowance for doubtful accounts	**163,843**	156,343
Accrued investment income	**10,404**	10,972
Receivable from reinsurers related to paid loss and loss adjustment expenses	**24,283**	13,047
Receivable from reinsurers related to unpaid loss and loss adjustment expenses	**78,396**	84,290
Ceded unearned premiums	**27,447**	28,818
Deferred policy acquisition costs	**52,185**	48,652
Deferred income taxes	**19,029**	13,388
Equity and deposits in pools	**24,245**	26,235
Other assets	**12,458**	9,931
Total assets	**$ 1,464,279**	$ 1,446,992
Liabilities		
Loss and loss adjustment expense reserves	**$ 468,992**	$ 477,720
Unearned premium reserves	**333,944**	320,545
Accounts payable and accrued liabilities	**34,926**	50,023
Taxes payable	**1,385**	120
Outstanding claims drafts	**17,144**	17,922
Payable to reinsurers	**18,810**	10,662
Total liabilities	**875,201**	876,992
Commitments and contingencies (Note 7)		
Shareholders equity		
Common stock: $0.01 par value; 30,000,000 shares authorized; 16,399,106 and 16,242,213 shares issued	**164**	162
Additional paid-in capital	**136,748**	134,224
Accumulated other comprehensive (loss) income, net of taxes	**(3,543)**	4,453
Retained earnings	**459,738**	432,746
Treasury stock, at cost; 122,324 and 48,124 shares	**(4,029)**	(1,585)
Total shareholders equity	**589,078**	570,000
Total liabilities and shareholders equity	**$ 1,464,279**	$ 1,446,992

The accompanying notes are an integral part of these financial statements

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Safety Insurance Group, Inc. and Subsidiaries

Consolidated Statements of Operations

(Unaudited)

(Dollars in thousands, except per share and share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
Net earned premiums	**$ 147,002**	$ 153,925	**$ 297,750**	$ 307,515
Net investment income	**11,207**	10,780	**22,735**	21,819
Net realized gains (losses) on investments	**2,072**	(162)	**2,103**	(91)
Finance and other service income	**4,515**	3,995	**9,013**	7,988
Total revenue	**164,796**	168,538	**331,601**	337,231
Losses and loss adjustment expenses	**91,078**	92,769	**186,948**	185,327
Underwriting, operating and related expenses	**44,474**	43,021	**88,939**	83,719
Interest expenses	**18**	19	**37**	41
Total expenses	**135,570**	135,809	**275,924**	269,087
Income before income taxes	**29,226**	32,729	**55,677**	68,144
Income tax expense	**8,295**	9,813	**15,701**	20,580
Net income	**$ 20,931**	$ 22,916	**$ 39,976**	$ 47,564
Earnings per weighted average common share:				
Basic	**$ 1.31**	$ 1.43	**$ 2.49**	$ 2.97
Diluted	**$ 1.30**	$ 1.42	**$ 2.48**	$ 2.95
Cash dividends paid per common share	**$ 0.40**	$ 0.25	**$ 0.80**	$ 0.50
Weighted average number of common shares outstanding:				
Basic	**16,033,785**	16,052,236	**16,029,290**	16,022,487
Diluted	**16,103,949**	16,127,154	**16,090,388**	16,096,412

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/(Loss), Net of Taxes	Retained Earnings	Treasury Stock	Total Shareholders Equity
Balance at December 31, 2006	$ 161	$ 129,785	$ 21	$ 366,381	$	$ 496,348
Net income, January 1 to June 30, 2007				47,564		47,564
Other comprehensive loss, net of deferred federal income taxes			(8,172)			(8,172)
Exercise of options and unearned compensation on restricted stock, net of deferred federal income taxes	1	2,512				2,513
Dividends paid				(8,100)		(8,100)
Balance at June 30, 2007	$ 162	$ 132,297	$ (8,151)	$ 405,845	$	$ 530,153

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income/(Loss), Net of Taxes	Retained Earnings	Treasury Stock	Total Shareholders Equity
Balance at December 31, 2007	**$ 162**	**$ 134,224**	**$ 4,453**	**$ 432,746**	**$ (1,585)**	**$ 570,000**
Net income, January 1 to June 30, 2008				**39,976**		**39,976**
Other comprehensive loss, net of deferred federal income taxes			**(7,996)**			**(7,996)**
Exercise of options and unearned compensation on restricted stock, net of deferred federal income taxes	**2**	**2,524**				**2,526**
Dividends paid				**(12,984)**		**(12,984)**
Acquisition of treasury stock					**(2,444)**	**(2,444)**
Balance at June 30, 2008	**$ 164**	**$ 136,748**	**$ (3,543)**	**$ 459,738**	**$ (4,029)**	**$ 589,078**

The accompanying notes are an integral part of these financial statements

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Safety Insurance Group, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income

(Unaudited)

(Dollars in thousands)

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Net income	**$ 20,931**	$ 22,916	**$ 39,976**	$ 47,564
Other comprehensive income, net of tax:				
Unrealized holding losses during the period, net of tax benefit of $(5,703), $(5,079), $(3,569) and $(4,433)	**(10,592)**	(9,432)	**(6,629)**	(8,231)
Reclassification adjustment for (gains) losses included in net income, net of tax (benefit) expense of $(725), $57, $(736) and $32	**(1,347)**	105	**(1,367)**	59
Unrealized losses on securities available for sale	**(11,939)**	(9,327)	**(7,996)**	(8,172)
Comprehensive income	**$ 8,992**	$ 13,589	**$ 31,980**	$ 39,392

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, 2008	2007
Cash flows from operating activities:		
Net income	**$ 39,976**	$ 47,564
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization, net	**5,729**	4,673
(Benefit) provision for deferred income taxes	**(1,336)**	136
Net realized (gains) losses on investments	**(2,103)**	91
Changes in assets and liabilities:		
Accounts receivable	**(7,500)**	(17,285)
Accrued investment income	**568**	11
Receivable from reinsurers	**(5,342)**	(1,687)
Ceded unearned premiums	**1,371**	(93)
Deferred policy acquisition costs	**(3,533)**	(4,963)
Other assets	**1,578**	(12,272)
Loss and loss adjustment expense reserves	**(8,728)**	8,790
Unearned premium reserves	**13,399**	23,105
Accounts payable and accrued liabilities	**(15,097)**	(18,497)
Payable to reinsurers	**8,148**	12,002
Other liabilities	**366**	2,023
Net cash provided by operating activities	**27,496**	43,598
Cash flows from investing activities:		
Fixed maturities purchased	**(93,251)**	(125,306)
Equity securities purchased	**(3,494)**	(3,329)
Proceeds from sales of fixed maturities	**85,756**	152,385
Proceeds from maturities of fixed maturities	**17,675**	11,000
Proceed from sales of equity securities	**1,560**	979
Fixed assets purchased	**(3,143)**	(5,488)
Net cash provided by investing activities	**5,103**	30,241
Cash flows from financing activities:		
Proceeds and excess tax benefits from exercise of stock options	**633**	429
Dividends paid to shareholders	**(12,984)**	(8,100)
Acquisition of treasury stock	**(2,444)**	
Net cash used for financing activities	**(14,795)**	(7,671)
Net increase in cash and cash equivalents	**17,804**	66,168
Cash and cash equivalents at beginning of year	**46,311**	26,283
Cash and cash equivalents at end of period	**$ 64,115**	$ 92,451

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, 2008 and for the three and six months ended June 30, 2008 and 2007 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, 2008.

The Company is a leading provider of personal lines property and casualty insurance focused exclusively on the Massachusetts market. The Company s principal product line is private passenger automobile insurance, which accounted for 74.6% of its direct written premiums in 2007. The Company operates through its insurance company subsidiaries, Safety Insurance Company, Safety Indemnity Insurance Company and Safety Property and Casualty Company (together referred to as the Insurance Subsidiaries).

On June 20, 2007, the Company applied for admission in the State of New Hampshire for a Certificate of Authority to transact insurance business. On October 16, 2007, the State of New Hampshire Insurance Department issued a Certificate of Authority for property and casualty insurance to each of the Company s insurance company subsidiaries. To date, the Company has not commenced writing business in New Hampshire.

2. Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No.157, Fair Value Measurements (FAS 157). FAS 157 defines fair value, sets out a framework for measuring fair value and requires additional disclosures about fair value measurements. This standard applies to fair value measurements already required or permitted by existing standards and is effective for financial statements issued for fiscal years beginning after November 15, 2007. See Note 5 for further information regarding the Company s investments and fair value measurements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115, which is effective for fiscal years beginning after November 15, 2007. This statement permits an entity to choose to measure many financial instruments and certain other items at fair value at specified election dates. Subsequent unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. The Company has chosen not to elect the fair value option permitted by this statement.

3. Earnings per Weighted Average Common Share

Basic earnings per weighted average common share (EPS) are calculated by dividing net income by the weighted average number of basic common shares outstanding during the period. Diluted EPS are calculated by dividing net income by the weighted average number of basic common shares outstanding and the net effect of potentially dilutive common shares. At June 30, 2008 and 2007, the Company s potentially dilutive instruments were common shares under options of 304,290, and 356,268, respectively, and common shares under restriction of 230,325, and 176,781, respectively.

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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)

Basic and diluted EPS were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
Earnings per weighted average common share:				
Basic	**$ 1.31**	$ 1.43	**$ 2.49**	$ 2.97
Diluted	**$ 1.30**	$ 1.42	**$ 2.48**	$ 2.95
Weighted average number of common shares outstanding:				
Basic	**16,033,785**	16,052,236	**16,029,290**	16,022,487
Effect of dilutive securities:				
Stock options	**52,593**	62,909	**54,954**	65,644
Restricted stock	**17,571**	12,009	**6,144**	8,281
Diluted	**16,103,949**	16,127,154	**16,090,388**	16,096,412

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 174,925 anti-dilutive stock options for both the three and six months ended June 30, 2008. There were 185,825 anti-dilutive stock options for both the three and six months ended June 30, 2007.

Diluted EPS also excludes common shares under restriction with a fair value on the grant date greater than the average market price of the Company s common stock during the period because their inclusion would be anti-dilutive. There were 46,035 and 65,760 anti-dilutive shares under restriction for the three months ended June 30, 2008 and 2007, respectively. There were 107,730 and 65,760 anti-dilutive shares under restriction for the six months ended June 30, 2008 and 2007, respectively.

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, 2008, there were 1,056,595 shares available for future grant. The Board 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, 2008 is as follows:

Type of Equity Awarded	Effective Date	Number of Awards Granted	Fair Value per Share (1)	Vesting Terms
RS	**March 10, 2008**	**76,816**	**$ 35.80**	**3 years, 30%-30%-40%**
RS	**March 10, 2008**	**4,000**	**$ 35.80**	**No vesting period (2)**
RS	**March 20, 2008**	**45,779**	**$ 34.37**	**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.

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(Dollars in thousands except per share and share data)

Accounting and Reporting for Stock-Based Awards

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards 123R (revised 2004), Share-Based Payment (FAS 123R), which requires the Company to measure and recognize the cost of employee services received in exchange for an award of equity instruments. Under the provisions of FAS 123R, 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 FAS 123R, 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 FAS 123 as adjusted to incorporate forfeiture assumptions under FAS 123R, 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 FAS 123R.

Stock Options

The fair value of stock options used to compute net income and earnings per share for the three and six month periods ended June 30, 2008 and 2007 is the estimated fair value at grant date using the Black-Scholes option-pricing model with the following assumptions:

	Three and Six Months Ended June 30,	
	2008	**2007**
Expected dividend yield	**1.36% - 2.52%**	1.36% - 2.52%
Expected volatility	**0.20 - 0.36**	0.20 - 0.36
Risk-free interest rate	**3.23% - 4.76%**	3.23% - 4.76%
Expected holding period	**6.5 - 7 years**	6.5 - 7 years

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, 2008 and 2007.

The following table summarizes stock option activity under the Incentive Plan for the six months ended June 30, 2008.

	Shares Under Option	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at beginning of year	**334,588**	**$ 28.25**		
Exercised	**(30,298)**	**$ 13.73**		
Outstanding at end of period	**304,290**	**$ 29.70**	**6.4 years**	**$ 2,681**
Exercisable at end of period	**182,055**	**$ 25.18**	**5.9 years**	**$ 2,255**

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based upon the Company s closing stock price of $35.65 on June 30, 2008, which would have been received by the option holders had all option holders

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exercised their options as of that date. The range of exercise prices on stock options outstanding under the Incentive Plan was $12.00 to $42.85 at June 30, 2008 and 2007. The total intrinsic value of options exercised during the six months ended June 30, 2008 and 2007 was $664, and $448, respectively.

A summary of the status of non-vested options as of June 30, 2008, is presented below.

	Number of Shares		Weighted Average Grant Date Exercise Price
Non-vested at beginning of year	**192,580**	**$**	**33.62**
Vested	**(70,345)**	**$**	**28.75**
Non-vested at end of period	**122,235**	**$**	**36.43**

As of June 30, 2008, there was $1,194 of unrecognized compensation expense related to non-vested option awards that is expected to be recognized over a weighted average period of 1.6 years.

Cash received from options exercised was $416, and $286 for the six months ended June 30, 2008, and 2007, 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.

The following table summarizes restricted stock activity under the Incentive Plan during the six months ended June 30, 2008.

	Shares Under Restriction		Weighted Average Fair Value
Outstanding at beginning of the year	**186,751**	**$**	**41.85**
Granted	**126,595**	**$**	**35.28**

Vested and unrestricted	**(67,021)**	**$**	**40.79**
Outstanding at end of period	**246,325**	**$**	**38.77**

As of June 30, 2008, there was $7,847 of unrecognized compensation expense related to non-vested restricted stock awards that is expected to be recognized over a weighted average period of 1.9 years. The total fair value of the shares that were vested and unrestricted during the six months ended June 30, 2008 and 2007 was $2,733 and $1,996, respectively. For the six months ended June 30, 2008 and 2007, the Company recorded compensation expense related to restricted stock of $1,118 and $914 net of income tax benefits of $602 and $492, respectively.

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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)

5. Investments

The gross unrealized appreciation (depreciation) of investments in fixed maturity securities and equity securities was as follows:

	As of June 30, 2008			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities and obligations of U.S. Government agencies (1)	$ 308,075	$ 1,293	$ (2,384)	$ 306,984
Obligations of states and political subdivisions	519,252	4,230	(3,414)	520,068
Asset-backed securities (1)	86,394	7	(3,886)	82,515
Corporate and other securities	70,875	485	(1,656)	69,704
Subtotal, fixed maturity securities	984,596	6,015	(11,340)	979,271
Equity securities (2)	8,728	17	(142)	8,603
Totals	$ 993,324	$ 6,032	$ (11,482)	$ 987,874

(1) Obligations of U.S. Government agencies include 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 Small Business Administration (SBA). The total of these fixed maturity securities was $305,577 at amortized cost and $304,358 at fair value as of June 30, 2008. As such, the asset-backed securities presented exclude such issuers already presented under U.S. Treasury securities and obligations of U.S. Government Agencies.

(2) Equity securities consist solely of interests in mutual funds held to fund the Company s executive deferred compensation plan.

The amortized cost and the estimated fair value of fixed maturity securities, by maturity, are shown below. 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, 2008	
	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 14,435	$ 14,492
Due after one year through five years	241,456	243,704
Due after five years through ten years	156,852	156,587
Due after ten years through twenty years	165,662	163,643
Due after twenty years	14,220	13,972
Asset-backed securities	391,971	386,873

Totals	**$**	**984,596**	**$**	**979,271**

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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)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
Gross realized gains				
Fixed maturity securities	**$ 2,072**	$ 9	**$ 2,128**	$ 852
Equity securities				93
Gross realized losses				
Fixed maturity securities		(171)	**(25)**	(1,036)
Net realized gains (losses) on investments	**$ 2,072**	$ (162)	**$ 2,103**	$ (91)

Proceeds from fixed maturities maturing were $11,000 and $6,000 for the three months ended June 30, 2008 and 2007, respectively. Proceeds from fixed maturities maturing were $17,675 and $11,000 for the six months ended June 30, 2008 and 2007, respectively.

The following table illustrates the gross unrealized losses included in the Company s investment portfolio and the fair value of those securities aggregated by investment category. The table also illustrates the length of time that they have been in a continuous unrealized loss position.

	As of June 30, 2008					
	Less than 12 Months		**12 Months or More**		**Total**	
	Estimated Fair Value	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**
U.S. Treasury securities and obligations of U.S. Government agencies	**$ 164,779**	**$ 1,838**	**$ 21,735**	**$ 546**	**$ 186,514**	**$ 2,384**
Obligations of states and political subdivisions	**184,908**	**2,268**	**49,184**	**1,146**	**234,092**	**3,414**
Asset-backed securities	**34,938**	**2,157**	**43,918**	**1,729**	**78,856**	**3,886**
Corporate and other securities	**17,461**	**243**	**18,607**	**1,413**	**36,068**	**1,656**
Subtotal, fixed maturity securities	**402,086**	**6,506**	**133,444**	**4,834**	**535,530**	**11,340**
Equity securities	**3,622**	**142**			**3,622**	**142**
Total temporarily impaired securities	**$ 405,708**	**$ 6,648**	**$ 133,444**	**$ 4,834**	**$ 539,152**	**$ 11,482**

The Company s investment portfolio included 201 securities in an unrealized loss position at June 30, 2008. The Company s methodology of assessing other-than-temporary impairment is based upon analysis of each security as of the balance sheet date and considers various factors including the length of time and the extent to which fair value has been less than the cost, the financial condition and the near term prospects of the issuer, whether the debtor is current on its contractually obligated interest and principal payments, and the Company s intent to hold the investment for a period of time sufficient to allow for recovery of its costs.

As of June 30, 2008, the Company s fixed income securities portfolio was comprised entirely of investment grade corporate fixed maturity securities, U.S. Government and Agency securities, states and political subdivision securities, and asset-backed securities (i.e., all securities received a rating assigned by Moody s Investors Service, Inc. of Baa or higher, except the few securities not rated by Moody s which received Standard &Poor s ratings of A- or higher, as well as a rating assigned by the Securities Valuation Office of the National Association of Insurance Commissioners of 1 or 2). 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 Aaa/AAA. Management continues to expect the recent subprime mortgage market deterioration to have little or no effect on the Company s portfolio. The unrealized losses recorded on the fixed maturity investment portfolio at June 30, 2008 resulted from fluctuations in market interest rates as opposed to fundamental changes in the credit quality of the issuers of such securities. Therefore, these decreases in values are viewed as being temporary as the Company has the intent and ability to retain such investments for a period of time sufficient to allow for recovery in fair value.

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During the three and six months ended June 30, 2008, and 2007, there was no significant deterioration in the credit quality of any of the Company s holdings and no other-than-temporary impairment charges were recorded related to the Company s portfolio of investment securities.

Net Investment Income

The components of net investment income were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	**2008**	2007
Interest and dividends on fixed maturities	**$ 11,178**	$ 10,240	**$ 22,701**	$ 21,111
Dividends on equity securities	**71**	79	**122**	105
Interest on cash and cash equivalents	**291**	785	**580**	1,253
Total investment income	**11,540**	11,104	**23,403**	22,469
Investment expenses	**333**	324	**668**	650
Net investment income	**$ 11,207**	$ 10,780	**$ 22,735**	$ 21,819

Fair Value Measurements

On January 1, 2008, the Company adopted FAS 157. FAS 157 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 FAS 157, 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). The Statement 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 FAS 157 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

Level 3 Valuations based on unobservable inputs.

The Company uses observable inputs for the vast majority of its investment portfolio. Fair value measurements for securities for which quoted prices are unavailable are estimated based upon reference to observable inputs, such as benchmark interest rates, market comparables, broker quotes and other relevant inputs. In circumstances where quoted prices or observable inputs are adjusted to reflect management s best estimate of fair value, such fair value measurements are considered a lower level measurement in the FAS 157 fair value hierarchy.

The following table presents the Company s fair value measurements for investments by level.

	As of June 30, 2008			
	Total	**Level 1 Inputs**	**Level 2 Inputs**	**Level 3 Inputs**
Fixed maturity securities	**$ 979,271**	**$**	**$ 975,600**	**$ 3,671**
Equity securities	**8,603**	**8,603**		
Total investment securities	**$ 987,874**	**$ 8,603**	**$ 975,600**	**$ 3,671**

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The following table summarizes the changes in the Company s Level 3 fair value measurements for the three months ended June 30, 2008.

	Fixed Maturity Securities	Equity Securities	Total
Balance at April 1, 2008	$ 3,669	$	$ 3,669
Net gains and losses included in earnings			
Net gains included in other comprehensive income	2		2
Purchases and sales			
Transfers in (out) of Level 3			
Balance at June 30, 2008	$ 3,671	$	$ 3,671
Amount of total losses included in earnings attributable to the change in unrealized losses related to assets still held at June 30, 2008	$	$	$

The following table summarizes the changes in the Company s Level 3 fair value measurements for the six months ended June 30, 2008.

	Fixed Maturity Securities	Equity Securities	Total
Balance at January 1, 2008	$ 3,758	$	$ 3,758
Net gains and losses included in earnings			
Net losses included in other comprehensive income	(87)		(87)
Purchases and sales			
Transfers in (out) of Level 3			
Balance at June 30, 2008	$ 3,671	$	$ 3,671
Amount of total losses included in earnings attributable to the change in unrealized losses related to assets still held at June 30, 2008	$	$	$

On January 1 and June 30, 2008, one fixed maturity security was manually priced solely using broker quotes. This was deemed to render the fair value measurements as based upon unobservable inputs and accordingly, it was classified within Level 3. Transfers in and out of Level 3 would be attributable to changes in the ability to observe significant inputs in determining fair value exit pricing. As noted in the table above, no transfers were made in or out of Level 3 inputs during the three and six months ended June 30, 2008.

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6. Loss and Loss Adjustment Expense (LAE) Reserves

The following table sets forth a reconciliation of beginning and ending reserves for losses and LAE, as shown in the Company s consolidated financial statements for the periods indicated:

	Six Months Ended June 30,			
		2008		**2007**
Reserves for losses and LAE at beginning of year	**$**	**477,720**	$	449,444
Less reinsurance recoverable on unpaid losses and LAE		**(84,290)**		(78,464)
Net reserves for losses and LAE at beginning of year		**393,430**		370,980
Incurred losses and LAE, related to:				
Current year		**201,641**		200,048
Prior years		**(14,693)**		(14,721)
Total incurred losses and LAE		**186,948**		185,327
Paid losses and LAE related to:				
Current year		**94,503**		93,315
Prior years		**95,279**		84,215
Total paid losses and LAE		**189,782**		177,530
Net reserves for losses and LAE at end of period		**390,596**		378,777
Plus reinsurance recoverables on unpaid losses and LAE		**78,396**		79,457
Reserves for losses and LAE at end of period	**$**	**468,992**	$	458,234

At the end of each period, the reserves were re-estimated for all prior accident years. The Company s prior year reserves decreased by $14,693, and $14,721 for the six months ended June 30, 2008 and 2007, respectively. The decreases in prior year reserves during the six months ended June 30, 2008 resulted from re-estimations of prior years ultimate loss and LAE liabilities and is primarily composed of reductions of $9,588 in our retained automobile reserves and $4,294 in reserves assumed from Commonwealth Automobile Reinsurers (CAR). The decrease in prior year reserves during the 2007 period is primarily composed of reductions of $7,813 in CAR assumed reserves and $6,028 in our retained automobile reserves.

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 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

The Company has a $30,000 revolving credit facility with Citizens Bank of Massachusetts. Loans under the credit facility bear interest at the Company s option at either (i) the LIBOR rate plus 1.5% per annum or (ii) the higher of Citizens Bank of Massachusetts prime rate or 0.5% above the federal funds rate plus 1.5% per annum. Interest only is payable prior to maturity. The obligations of the Company under the credit facility are secured by pledges of the Company s assets and the capital stock of its operating subsidiaries. The credit facility is guaranteed by the non-insurance company subsidiaries of the Company.

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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, dividends, and other matters. As of June 30, 2008, the Company was in compliance with all such covenants.

The Company had no amounts outstanding on its credit facility at June 30, 2008 and at December 31, 2007. 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, 2008 and 2007.

The credit facility was scheduled to expire on June 17, 2008. However, the expiration date was extended to August 17, 2008. The Company expects that the credit facility will be renewed prior to expiration.

9. Income Taxes

Federal income tax expense for the three and six months ended June 30, 2008 and 2007 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.

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement 109 (FIN 48) on January 1, 2007. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 requires that the Company determine whether the benefits of its tax positions have a more likely than not chance of being sustained upon audit based upon the technical merits of the tax position. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. As a result of the implementation of FIN 48, the Company recognized no adjustment to its consolidated balance sheet or statement of operations. The Company believes that the positions taken on its income tax returns for open tax years will be sustained upon examination by the IRS. Therefore, the Company has not recorded a liability under FIN 48.

During the three and six months ended June 30, 2008, there were no material changes to the amount of the Company s unrecognized tax benefits or to any assumptions regarding the amount of its FIN 48 liability.

As of June 30, 2008 and December 31, 2007, the Company was no longer subject to examination of its U.S. federal tax returns for years prior to 2004.

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. 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, at management s discretion. The timing of such repurchases and actual number of shares repurchased 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 may be modified, suspended or terminated at any time without prior notice.

During the six months ended June 30, 2008, the Company purchased 74,200 of its common shares on the open market under the program at a cost of $2,444. During the twelve months ended December 31, 2007, the Company purchased 48,124 of its common shares on the open market under the program at a cost of $1,585.

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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 i 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 74.6% of our direct written premiums in 2007), we offer a portfolio of other insurance products, including commercial automobile (13.3% of 2007 direct written premiums), homeowners (9.3% of 2007 direct written premiums), dwelling fire, umbrella and business owner policies (totaling 2.8% of 2007 direct written premiums). Operating exclusively in Massachusetts 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 814 independent insurance agents in 916 locations throughout Massachusetts. We have used these relationships and our extensive knowledge of the Massachusetts market to become the second largest private passenger automobile and third largest commercial automobile insurance carrier in Massachusetts, capturing an approximate 11.4% and 11.1% share, respectively, of the Massachusetts private passenger and commercial automobile markets in 2007, according to the Commonwealth Automobile Reinsurers (CAR) Cession Volume Analysis Report of February 15, 2008, 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 discussion as automobile exposures.

On June 20, 2007, we applied for admission in the State of New Hampshire for a Certificate of Authority to transact insurance business. On October 16, 2007, the State of New Hampshire Insurance Department issued a Certificate of Authority for property and casualty insurance to each of our Insurance Subsidiaries. We anticipate that we will begin writing business in New Hampshire late in 2008.

Massachusetts Automobile Insurance Market

We have been subject to extensive regulation in the private passenger automobile insurance industry in Massachusetts, which represented 74.6% of our direct written premiums in 2007. 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. CAR operates at an underwriting deficit. This deficit is allocated among every Massachusetts automobile insurance company, including us, based on a complex formula that takes into consideration a company s voluntary market share, the rate at which it cedes business to CAR, and the company s utilization of a credit system CAR has designed to encourage carriers to reduce their use of CAR. In addition, based on our market share, we have been assigned certain licensed producers by CAR that have been unable to obtain a voluntary contract with another insurer. We call these agents Exclusive Representative Producers, or ERPs.

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On July 16, 2007, the Commissioner issued two decisions that significantly changed how private passenger automobile insurance is regulated in Massachusetts. In the first decision, the Commissioner announced that she 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, she would institute a system that introduces competitive pricing to the Massachusetts private passenger automobile insurance market, which the Commissioner has described as managed competition (Managed Competition). On October 5, 2007, the Commissioner issued a Competitive Rating Regulation; 211 CMR 79.00: Private Passenger Motor Vehicle Insurance Rates that describes the technical details of Managed Competition (the Regulation). The Regulation governs the rate filing that an insurer can file. Safety filed its rate filing on November 19, 2007 and amended it on November 27, 2007.

In addition, the Regulation prohibits the following rating and underwriting factors:

- *Rating Factors:* Insurers are prohibited from using credit information, sex, marital status, race, creed, national origin, religion, occupation, income, education, home ownership and age (except to produce the reduction in rates for insureds age 65 and over).

- *Underwriting Factors:* Insurers are prohibited from refusing to issue or renew a private passenger auto insurance policy based on credit information, sex, marital status, race, creed, national origin, religion, age, occupation, income, principal place of garaging, education and home ownership.

We are not able at this time to determine what effect the Regulation will have on our business over the long term.

The Commissioner has also issued a number of Regulatory Review Standards Applicable to Private Passenger Motor Vehicle Insurance (the Rating Bulletins). Rating Bulletins 2007-07 and 2007-08 limit rates to not more than 110% of what the 2007 premium rate level would have been for each risk. Rating Bulletin 2007-10 sets standards for filing policy forms and application for insurance. Rating Bulletin 2007-11 offers guidance on required and optional discounts, and Rating Bulletin 2007-12 limits the ability of companies to offer different rate levels within companies of the same insurance group.

In the second decision, the Commissioner approved and set a time table for the implementation of new CAR rules pursuant to which the current reinsurance program run by CAR will be replaced with an assigned risk plan, the Massachusetts Automobile Insurance Plan (MAIP). Under these new rules, we will no longer be assigned ERPs whose business we must insure (subject to the option of ceding it to CAR) and instead, we will be assigned individual policies by CAR. The MAIP will begin with business effective on or after April 1, 2008 for new business and those risks that have 10 or more Safe Driver Points. The last policy effective date on which any risk can be ceded to CAR in accordance with the current reinsurance program is March 31, 2009. We are not able at this time to determine what effect these new CAR rules will have on our business.

The Commissioner s decision to implement an assigned risk plan brought to a close a lengthy period of regulatory and judicial consideration of the Massachusetts private passenger residual market.

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 is spread equitably among the six servicing carriers. Each Massachusetts commercial automobile insurer must bear a portion of the losses of the commercial reinsurance pool that is serviced by the six servicing carriers in the LSC program. Subject to Commissioner 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 submitted through a Request for Proposal a bid to process a portion of the Taxi/Limo Program. CAR approved Safety as one of the two servicing carriers for this program beginning January 1, 2008. Based on CAR data, Safety would process approximately half of the $18,000 in ceded Taxi/Limo business.

As noted above, in 2007 and previous years, the Commissioner set the maximum premium rates that could be charged and minimum commissions that had to be paid to agents for private passenger automobile insurance. Beginning in 2007, the effective date of the Commissioner s rate decision was April 1st as compared to January 1st of 2006 and prior rate decisions. The 2006 rates were in effect from January 1, 2006 until March 31, 2007. The Commissioner announced on December 15, 2006, an 11.7% statewide average private passenger automobile insurance rate decrease for 2007, compared to an 8.7% decrease for 2006.

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Coinciding with the 2007 rate decision, the Commissioner also approved a 13.0% commission rate which agents receive for selling private passenger automobile insurance, as a percentage of premiums, compared to a commission rate of 11.8% in 2006.

Under Managed Competition, we decreased our rates an average 6.3% effective April 1, 2008. We decreased our rates an additional average 0.2% effective May 1, 2008. Our rates include a 13.0% commission rate for agents.

Our direct written premiums increased by 20.0% between 2002 and 2007, from $516,556 to $619,848. However, our direct written premiums decreased by 1.5% between 2006 and 2007 as a result of the state-mandated private passenger automobile rate decrease effective April 1, 2007. We anticipate a further reduction in private passenger automobile direct written premiums for 2008 as a result of Managed Competition rate decreases effective April 1, 2008.

For the six months ended June 30, 2008, our average private passenger automobile premium per exposure decreased by 7.5% from the six months ended June 30, 2007. The table below shows average Massachusetts private passenger automobile premium rate changes and changes in our average premium per automobile exposure.

Massachusetts Private Passenger Automobile Rates

Year	Average Rate Change (1)	Safety Change in Average Premium per Automobile Exposure (2)
2008	(6.5)%	(7.5)%
2007	(11.7)%	(5.5)%
2006	(8.7)%	(6.8)%
2005	(1.7)%	0.1%
2004	2.5%	6.1%
2003	2.7%	6.9%
2002	0.0%	5.2%
2001	(8.3)%	0.0%
2000	0.7%	7.4%
1999	0.7%	10.9%
1998	(4.0)%	2.8%

(1) Source: Commissioner rate decisions for 1998 2007, and Safety Insurance for 2008. The 11.7% average rate decrease in 2007 was in effect for the period April 1, 2007 through March 31, 2008. The 6.5% average rate decrease in 2008 is effective for the period April 1, 2008 through March 31, 2009.

(2) Source: Safety Insurance.

Statutory Accounting Principles

Our results are reported in accordance with GAAP, which differ from amounts reported in accordance with statutory accounting principles (SAP) as prescribed by insurance regulatory authorities. Specifically, under GAAP:

- Policy acquisition costs such as commissions, premium taxes and other variable costs incurred in connection with writing new and renewal business are capitalized and amortized on a pro rata basis over the period in which the related premiums are earned, rather than expensed as incurred, as required by SAP.

- Certain assets are included in the consolidated balance sheets whereas, under SAP, such assets are designated as non admitted assets, and charged directly against statutory surplus. These assets consist primarily of premium receivables that are outstanding over ninety days, federal deferred tax assets in excess of statutory limitations, furniture, equipment, leasehold improvements and prepaid expenses.

- Amounts related to ceded reinsurance are shown gross of ceded unearned premiums and reinsurance recoverables, rather than netted against unearned premium reserves and loss and loss adjustment expense reserves, respectively, as required by SAP.

- Fixed maturities securities, which are classified as available-for-sale, are reported at current fair values, rather than at amortized cost, or the lower of amortized cost or market, depending on the specific type of security, as required by SAP.

- The differing treatment of income and expense items results in a corresponding difference in federal income tax expense. Changes in deferred income taxes are reflected as an item of income tax benefit or expense, rather than recorded directly to surplus as regards policyholders, as required by SAP. Admittance testing may result in a charge to unassigned surplus for

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non-admitted portions of deferred tax assets. Under GAAP reporting, a valuation allowance may be recorded against the deferred tax asset and reflected as an expense.

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 expenses as a percent of net written premiums, if calculated on a SAP basis, or net earned premiums, if 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 statutory insurance ratios are outlined in the following table:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
Statutory Ratios:				
Loss Ratio	**62.0%**	60.3%	**62.8%**	60.3%
Expense Ratio	**30.4%**	28.3%	**29.3%**	26.5%
Combined Ratio	**92.4%**	88.6%	**92.1%**	86.8%

Under GAAP, the loss ratio is computed in the same manner as under SAP, but the expense ratio is determined by matching underwriting expenses to the period over which net premiums were earned, rather than to the period that net premiums were written.

Our GAAP insurance ratios are outlined in the following table:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
GAAP Ratios:				
Loss Ratio	**62.0%**	60.3%	**62.8%**	60.3%
Expense Ratio	**30.3%**	27.9%	**29.9%**	27.2%
Combined Ratio	**92.3%**	88.2%	**92.7%**	87.5%

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, 2008, there were 1,056,595 shares available for future grant. The Board and the Compensation Committee intend to issue more awards under the Incentive Plan in the future.

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A summary of stock based awards granted under the Incentive Plan during the six months ended June 30, 2008 is as follows:

Type of Equity Awarded	Effective Date	Number of Awards Granted		Fair Value per Share (1)	Vesting Terms
RS	**March 10, 2008**	**76,816**	**$**	**35.80**	**3 years, 30%-30%-40%**
RS	**March 10, 2008**	**4,000**	**$**	**35.80**	**No vesting period (2)**
RS	**March 20, 2008**	**45,779**	**$**	**34.37**	**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 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 July 1 2008, our catastrophe reinsurance provides gross per occurrence reinsurance coverage up to $330,000. As a result of the changes to the models, and our revised reinsurance program, our catastrophe reinsurance protects us in the event of a 245-year storm (that is, a storm of a severity expected to occur once in a 245-year period). Swiss Re, our primary reinsurer, maintains an A.M. Best rating of A+ (Superior). All of our other reinsurers have an A.M. Best rating of A (Excellent) or better except for Folksamerica, Montpelier, New Castle and PARIS RE which are rated A- (Excellent). 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 has increased and as a result the FAIR Plan has decided to buy reinsurance to reduce their exposure to catastrophe losses. On July 1, 2008, the FAIR Plan purchased $1,100,000 of catastrophe reinsurance for property losses in excess of $180,000. At June 30, 2008, we had no material amounts recoverable from any reinsurer, excluding the residual markets described above.

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.

Critical Accounting Policies and Estimates

Loss and Loss Adjustment Expense Reserves.

Significant periods of time can elapse between the occurrence of an insured loss, the reporting to us of that loss and our final payment of that loss. To recognize liabilities for unpaid losses, we establish reserves as balance sheet liabilities. Our reserves represent estimates of amounts needed to pay reported and unreported losses and the expenses of investigating and paying those losses, or loss adjustment expenses. Every quarter, we review our previously established reserves and adjust them, if necessary.

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When a claim is reported, claims personnel establish a case reserve for the estimated amount of the ultimate payment. The amount of the reserve is primarily based upon an evaluation of the type of claim involved, the circumstances surrounding each claim and the policy provisions relating to the loss. The estimate reflects the informed judgment of such personnel based on general insurance reserving practices and on the experience and knowledge of the claims person. During the loss adjustment period, these estimates are revised as deemed necessary by our claims department based on subsequent developments and periodic reviews of the cases.

In accordance with industry practice, we also maintain reserves for estimated losses incurred but not yet reported (IBNR). IBNR reserves are determined in accordance with commonly accepted actuarial reserving techniques on the basis of our historical information and experience. We review and make adjustments to incurred but not yet reported reserves quarterly.

When reviewing reserves, we analyze historical data and estimate the impact of various loss development factors, such as our historical loss experience and that of the industry, trends in claims frequency and severity, our mix of business, our claims processing procedures, legislative enactments, judicial decisions, legal developments in imposition of damages, and changes and trends in general economic conditions, including the effects of inflation. A change in any of these factors from the assumption implicit in our estimate can cause our actual loss experience to be better or worse than our reserves, and the difference can be material. There is no precise method, however, for evaluating the impact of any specific factor on the adequacy of reserves, because the eventual development of reserves is affected by many factors.

Management determines our loss and LAE reserves estimate based upon the analysis of our actuaries. A reasonable estimate is derived by selecting a point estimate within a range of indications as calculated by our actuaries using generally accepted actuarial techniques. The key assumption in most actuarial analysis is that past patterns of frequency and severity will repeat in the future, unless a significant change in the factors described above takes place. Our key factors and resulting assumptions are the ultimate frequency and severity of claims, based upon the most recent ten years of claims reported to the Company, and the data CAR reports to us to calculate our share of the residual market, as of the date of the applicable balance sheet. For each accident year and each coverage within a line of business our actuaries calculate the ultimate losses incurred. Our total reserves are the difference between the ultimate losses incurred and the cumulative loss and loss adjustment payments made to date. Our IBNR reserves are calculated as the difference between our total reserves and the outstanding case reserves at the end of the accounting period. To determine ultimate losses, our actuaries calculate a range of indications and select a point estimation using such actuarial techniques as:

- *Paid Loss Indications:* This method projects ultimate loss estimates based upon extrapolations of historic paid loss trends. This method tends to be used on short tail lines such as automobile physical damage.

- *Incurred Loss Indications:* This method projects ultimate loss estimates based upon extrapolations of historic incurred loss trends. This method tends to be used on long tail lines of business such as automobile liability and homeowner s liability.

- *Bornhuetter-Ferguson Indications:* This method projects ultimate loss estimates based upon extrapolations of an expected amount of IBNR, which is added to current incurred losses or paid losses. This method tends to be used on small, immature, or volatile lines of business, such as our BOP and umbrella lines of business.

- *Bodily Injury Code Indications:* This method projects ultimate loss estimates for our private passenger and commercial automobile bodily injury coverage based upon extrapolations of the historic number of accidents and the historic number of bodily injury claims per accident. Projected ultimate bodily injury claims are then segregated into expected claims by type of injury (e.g. soft tissue injury vs. hard tissue injury) based on past experience. An ultimate severity, or average paid loss amounts, is estimated based upon extrapolating historic trends. Projected ultimate loss estimates using this method are the aggregate of estimated losses by injury type.

Such techniques assume that past experience, adjusted for the effects of current developments and anticipated trends, are an appropriate basis for predicting our ultimate losses, total reserves and resulting IBNR reserves. It is possible that the final outcome may fall above or below these amounts as a result of a number of factors, including immature data, sparse data, or significant growth in a line of business. Using these methodologies our actuaries established a range of reasonably possible estimations for net reserves of approximately $348,160 to $394,318 as of June 30, 2008. In general, the low and high values of the ranges represent reasonable minimum and maximum values of the indications based on the techniques described above. The Company s selected point estimate of net loss and LAE reserves based upon the analysis of our actuaries was $390,596 as of June 30, 2008.

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The following table presents the point estimation of the recorded reserves and the range of estimations by line of business for net loss and LAE reserves as of June 30, 2008.

Line of Business	Low	Recorded	High
Private passenger automobile	$ 243,074	$ 272,993	$ 273,884
Commercial automobile	54,725	61,182	62,308
Homeowners	33,264	36,038	36,780
All other	17,097	20,383	21,346
Total	$ 348,160	$ 390,596	$ 394,318

The following table presents our total net reserves and the corresponding case reserves and IBNR reserves for each line of business as of June 30, 2008.

Line of Business	Case	IBNR	Total
Private passenger automobile	$ 203,691	$ 23,476	$ 227,167
CAR assumed private passenger auto	24,703	21,123	45,826
Commercial automobile	31,534	10,403	41,937
CAR assumed commercial automobile	8,658	10,587	19,245
Homeowners	15,001	6,021	21,022
FAIR Plan assumed homeowners	6,002	9,014	15,016
All other	9,007	11,376	20,383
Total net reserves for losses and LAE	$ 298,596	$ 92,000	$ 390,596

For our private passenger automobile, commercial automobile and homeowners lines of business as of June 30, 2008, due to the relatively long time we have been writing these lines of insurance and our stable long-term trends in frequency and severity, the range of reserves is relatively narrow.

For our all other lines of business as of June 30, 2008 due to the relatively short time we have been writing these lines of business, the sparse amount of data and the resulting immature history available for our analysis, the range of reserves is relatively wide. In all business lines, we have recorded reserves closer to the high in the ranges of our projections.

Our IBNR reserves for CAR assumed private passenger and assumed commercial automobile business are 46.1% and 55.0%, respectively, of our total reserves for CAR assumed private passenger and assumed commercial automobile business as of June 30, 2008 due to the reporting lags in the information we receive from CAR, as described further in the section entitled *CAR Loss and Loss Adjustment Expense Reserves*.

The following table presents information by line of business for our total net reserves and the corresponding retained (i.e., direct less ceded) reserves and assumed reserves as of June 30, 2008.

Line of Business	Retained	Assumed	Net

Private passenger automobile	$ 227,167		
CAR assumed private passenger automobile		$ 45,826	
Net private passenger automobile			$ 272,993
Commercial automobile	41,937		
CAR assumed commercial automobile		19,245	
Net commercial automobile			61,182
Homeowners	21,022		
FAIR Plan assumed homeowners		15,016	
Net homeowners			36,038
All other	20,383		20,383
Total net reserves for losses and LAE	$ 310,509	$ 80,087	$ 390,596

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CAR Loss and Loss Adjustment Expense Reserves

We are a participant in CAR and assume a significant portion of losses and LAE on business ceded by the industry participants to CAR. We estimate reserves for assumed losses and LAE that have not yet been reported to us by CAR. Our estimations are based upon the same factors we use for our own reserves, plus additional factors due to the nature of and the information we receive from CAR.

The CAR deficit, which consists of premium ceded to CAR less CAR losses and LAE, is allocated among every automobile insurance company writing business in Massachusetts based on a complex formula (the Participation Ratio) that takes into consideration a company s voluntary market share, the amount of business it cedes to CAR and credits the company earns under a system CAR has designed to encourage carriers to voluntarily write business in selected under-priced classes and territories.

We receive a Settlement of Balances report from CAR that reports our share of CAR premium, losses and LAE, on a lagged basis, seventy-five days after the end of every quarter. CAR-published financial data is always at least one quarter behind the financial data we report. For example, when we reported our financial results for the year ended December 31, 2007, we had nine months of reported 2007 CAR financial data, and we had to estimate and record as IBNR reserves what CAR would report to us for the last three months of the year.

We receive our final calendar year Participation Ratio report from CAR eight months after the end of that year, and thus we have to estimate for six quarters our share of the CAR deficit. For example, for the year ended December 31, 2006 we had to estimate our 2006 policy year CAR Participation Ratio beginning with the first quarter of 2006 through the second quarter of 2007.

Because of the lag in CAR estimates, and in order to try to validate to the extent possible the information CAR does provide, we must try to estimate the effects of the actions of our competitors in order to establish our Participation Ratio. Before final Participation Ratios are available, we estimate the size of CAR and the resulting deficit based on historical analysis of CAR results, and estimations of our competitors current cession strategies. Even after our final Participation Ratio is available from CAR, we must continue to estimate the size of CAR, and the resulting deficit based upon data published by CAR and our own continuing analysis. As a result, changes in our reserves for CAR may continue to occur until all claims are finally settled. The Loss Reserving Committee at CAR meets 70 days after the end of each quarter to estimate the CAR deficit for all active policy years and publishes estimations, which we use to estimate our share of the deficit. The estimation that CAR calculates is based on data it collects from 19 servicing carriers which settle, reserve and report claims using a variety of methods. Any delays or errors in the collection of this data could have a significant impact on the accuracy of CAR s estimations.

Although we rely to a significant extent in setting our reserves on the information CAR provides, we are cautious in our use of that information, both because of the delays described above and because the CAR estimates incorporate data CAR receives from all other CAR servicing carriers in Massachusetts. We do not have direct access to that data or firsthand knowledge of how those carriers are currently conducting their operations. As a result, we are cautious in recording CAR reserves for the calendar years that we have to estimate our Participation Ratio and these reserves are subject to significant judgments and estimates.

Sensitivity Analysis

Establishment of appropriate reserves is an inherently uncertain process. There can be no certainty that currently established reserves based on our key assumptions regarding frequency and severity in our lines of business, or our assumptions regarding our share of the CAR loss will prove adequate in light of subsequent actual experience. To the extent that reserves are inadequate and are strengthened, the amount of such increase is treated as a charge to earnings in the period that the deficiency is recognized. To the extent that reserves are redundant and are released, the amount of the release is a credit to earnings in the period the redundancy is recognized. For the six months ended June 30, 2008, a 1 percentage-point change in the loss and LAE ratio would result in a change in reserves of $2,978. Each 1 percentage-point change in the loss and loss expense ratio would have a $1,935 effect on net income, or $0.12 per diluted share.

Our assumptions consider that past experience, adjusted for the effects of current developments and anticipated trends, are an appropriate basis for establishing our reserves. Our individual key assumptions could each have a reasonable possible range of plus or minus 5 percentage-points for each estimation, although there is no guarantee that our assumptions will not have more than a 5 percentage point variation. The following sensitivity tables present information for each of our primary lines of business on the effect each 1 percentage-point change in each of our key assumptions on unpaid frequency and severity could have on our retained (i.e., direct minus ceded) loss and LAE reserves and net income for the six months ended June 30, 2008. In

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evaluating the information in the table, it should be noted that a 1 percentage-point change in a single assumption would change estimated reserves by 1 percentage-point. A 1 percentage-point change in both our key assumptions would change estimated reserves within a range of plus or minus 2 percentage-points.

	-1 Percent Change in Frequency	No Change in Frequency	+1 Percent Change in Frequency
Private passenger automobile retained loss and LAE reserves			
-1 Percent Change in Severity			
Estimated decrease in reserves	$ (4,543)	$ (2,272)	$
Estimated increase in net income	2,953	1,477	
No Change in Severity			
Estimated (decrease) increase in reserves	(2,272)		2,272
Estimated increase (decrease) in net income	1,477		(1,477)
+1 Percent Change in Severity			
Estimated increase in reserves		2,272	4,543
Estimated decrease in net income		(1,477)	(2,953)
Commercial automobile retained loss and LAE reserves			
-1 Percent Change in Severity			
Estimated decrease in reserves	(839)	(419)	
Estimated increase in net income	545	272	
No Change in Severity			
Estimated (decrease) increase in reserves	(419)		419
Estimated increase (decrease) in net income	272		(272)
+1 Percent Change in Severity			
Estimated increase in reserves		419	839
Estimated decrease in net income		(272)	(545)
Homeowners retained loss and LAE reserves			
-1 Percent Change in Severity			
Estimated decrease in reserves	(420)	(210)	
Estimated increase in net income	273	137	
No Change in Severity			
Estimated (decrease) increase in reserves	(210)		210
Estimated increase (decrease) in net income	137		(137)
+1 Percent Change in Severity			
Estimated increase in reserves		210	420
Estimated decrease in net income		(137)	(273)
All other retained loss and LAE reserves			
-1 Percent Change in Severity			
Estimated decrease in reserves	(408)	(204)	
Estimated increase in net income	265	133	
No Change in Severity			
Estimated (decrease) increase in reserves	(204)		204
Estimated increase (decrease) in net income	133		(133)
+1 Percent Change in Severity			
Estimated increase in reserves		204	408
Estimated decrease in net income		(133)	(265)

Our estimated share of CAR loss and LAE reserves is based on assumptions about our Participation Ratio, the size of CAR, and the resulting deficit (similar assumptions apply with respect to the FAIR Plan). Our assumptions consider that past experience, adjusted for the effects of current developments and anticipated trends, are an appropriate basis for establishing our

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CAR reserves. Each of our assumptions could have a reasonably possible range of plus or minus 5 percentage-points for each estimation.

The following sensitivity table presents information of the effect each 1 percentage-point change in our assumptions on our share of reserves for CAR and other residual markets could have on our assumed loss and LAE reserves and net income for the six months ended June 30, 2008. In evaluating the information in the table, it should be noted that a 1 percentage-point change in our assumptions would change estimated reserves by 1 percentage-point.

	-1 Percent Change in Estimation	+1 Percent Change in Estimation
CAR assumed private passenger automobile		
Estimated (decrease) increase in reserves	**$ (458)**	**$ 458**
Estimated increase (decrease) in net income	**298**	**(298)**
CAR assumed commercial automobile		
Estimated (decrease) increase in reserves	**(192)**	**192**
Estimated increase (decrease) in net income	**125**	**(125)**
FAIR Plan assumed homeowners		
Estimated (decrease) increase in reserves	**(150)**	**150**
Estimated increase (decrease) in net income	**98**	**(98)**

Reserve Development Summary

The changes we have recorded in our reserves in the past illustrate the uncertainty of estimating reserves. The Company s prior year reserves decreased by $14,693, and $14,721 for the six months ended June 30, 2008 and 2007, respectively.

The following table presents a comparison of prior year development of our net reserves for losses and LAE for the six months ended June 30, 2008 and 2007. Each accident year represents all claims for an annual accounting period in which loss events occurred, regardless of when the losses are actually reported, booked or paid. Our financial statements reflect the aggregate results of the current and all prior accident years.

Accident Year	Six Months Ended June 30, 2008	2007
1998 & prior	**$ (60)**	$ (12)
1999	**(86)**	(84)
2000	**(310)**	(406)
2001	**(647)**	(69)
2002	**(1,334)**	110
2003	**(1,399)**	5
2004	**(2,775)**	(1,882)
2005	**(3,510)**	(4,416)
2006	**(2,442)**	(7,967)
2007	**(2,130)**	
All prior years	**$ (14,693)**	$ (14,721)

The decreases in prior years reserves during the six months ended June 30, 2008 and 2007 resulted from re-estimations of prior year ultimate loss and LAE liabilities. The 2008 decrease is primarily composed of reductions of $9,588 in our retained automobile reserves and $4,294 in CAR assumed reserves. The decrease in prior year reserves during the 2007 period resulted from re-estimations of prior year ultimate loss and LAE liabilities and is composed primarily of reductions of $7,813 in reserves assumed from CAR and $6,028 in our retained automobile reserves.

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The following table presents information by line of business for prior year development of our net reserves for losses and LAE for the six months ended June 30, 2008.

Accident Year	Private Passenger Automobile	Commercial Automobile	Homeowners	All Other	Total
1998 & prior	$ (60)	$	$	$	$ (60)
1999	(86)				(86)
2000	(231)	(8)	(71)		(310)
2001	(511)	(7)	(129)		(647)
2002	(1,307)	(23)	(4)		(1,334)
2003	(1,137)	(21)	(130)	(111)	(1,399)
2004					