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AMERICAN SAFETY INSURANCE GROUP LTD  
Form 10-K  
April 01, 2002

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
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FORM 10-K

ANNUAL REPORT PURSUANT TO SECTIONS 13 OR 15 (d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For The Fiscal Year Ended December 31, 2001                      Commission File Number 1-14795

AMERICAN SAFETY INSURANCE GROUP, LTD.  
(Exact name of Registrant as specified in its charter)

Bermuda  
(State of incorporation  
or organization)

Not applicable  
(I.R.S. Employer  
Identification No.)

44 Church Street  
P.O. Box HM 2064  
Hamilton, Bermuda  
(Address of principal  
executive offices)

HM HX  
(Zip Code)

Registrant's telephone number: (441) 296-8560

Securities registered pursuant to Section 12(b) of the Act:

Title of each class -----	Name of each exchange on which ----- registered -----
Common Stock, \$0.01 par value	New York Stock Exchange, Inc.

Securities to be registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether 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 Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

The aggregate market value of Registrant's voting common stock held by non-affiliates on March 22, 2002 was \$24,507,613. For the purposes of this computation shares held by directors (and shares held by entities in which they serve as officers) and executive officers of the Registrant have been excluded. Such exclusion is not intended, nor shall it be deemed to be an admission that such persons are affiliates of Registrant.

The number of outstanding shares of Registrant's common stock on March 22, 2002 was 4,750,117.

Documents Incorporated by Reference: Part III of this Form 10-K incorporates by reference certain information from the Registrant's Proxy Statement for the 2002 Annual General Meeting of the Shareholders (the "2002 Proxy Statement").

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## AMERICAN SAFETY INSURANCE GROUP, LTD.

## Table of Contents

Page ----

PART I		
Item 1.	Business	1
Item 2.	Properties	31
Item 3.	Legal Proceedings	31
Item 4.	Submission of Matters to a Vote of Security Holders	32
PART II		
Item 5.	Market for the Registrant's Common Equity and Related Stockholder Matters	36
Item 6.	Selected Financial Data	37
Item 7.	Management's Discussion and Analysis of Results of Operations and Financial Condition	39
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	49
Item 8.	Financial Statements and Supplementary Data	50
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	50
PART III		
Item 10.	Directors and Executive Officers of the Registrant	51
Item 11.	Executive Compensation	51
Item 12.	Security Ownership of Certain Beneficial Owners and Management	51
Item 13.	Certain Relationships and Related Transactions	51
PART IV		
Item 14.	Exhibits, Financial Statements Schedules, and Reports on Form 8-K	52

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**PART I**
**Item 1. Business**

## General

American Safety Insurance Group, Ltd. (the "Company" or "American Safety") is a specialty insurance holding company organized under the laws of Bermuda which, through its subsidiaries, develops, underwrites, manages and markets primary casualty insurance and reinsurance programs in the alternative insurance market in all 50 states for environmental remediation risks, contracting and other specialty risks. The Company is also the owner/developer of a residential condominium, marina, par 3 golf course and beach club development in Ponce Inlet, Florida. Unless the context indicates otherwise, all references to the "Company" or "American Safety" refer to American Safety Insurance Group, Ltd. and its subsidiaries.

American Safety was formed in Bermuda as a group captive insurance company in 1986 to provide stable, long term insurance protection for the asbestos abatement and environmental remediation industry in the United States, which had suffered from disruptive market cycles in the standard insurance market. The Company now provides specialty insurance coverages and services in all 50 states and markets its insurance programs through approximately 190 independent insurance agency and brokerage firms.

The Company develops specialty insurance coverages and custom designed risk management programs not generally available in the standard insurance market. The Company's specialty insurance programs include coverages for general liability, pollution liability, professional

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liability, workers' compensation, surety, as well as custom designed risk management programs (including captive and rent-a-captive programs), for contractors, consultants and other businesses and property owners who are involved with environmental remediation, contracting and other specialty risks.

The Company insures and places risks through its two U.S. insurance subsidiaries, American Safety Casualty Insurance Company ("American Safety Casualty") and American Safety Indemnity Company ("American Safety Indemnity"), as well as its U.S. non-subsiary risk retention group affiliate, American Safety Risk Retention Group, Inc. ("American Safety RRG") and unaffiliated insurance companies. The Company also reinsures and places, through the Company's Bermuda reinsurance subsidiary, American Safety Reinsurance, Ltd. ("American Safety Re"), and unaffiliated reinsurers, a portion of the risks underwritten directly by its two U.S. insurance subsidiaries, its risk retention group affiliate and other insurers. Substantially all of the reinsurance business that the Company currently assumes is for primary insurance programs that the Company has developed and underwritten.

-1-

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The Company also provides specialized insurance program development, underwriting, risk placement, reinsurance, program management, brokerage, loss control, claims administration and marketing services through American Safety Insurance Services, Inc. ("ASI Services"), its principal U.S. program development, underwriting, brokerage and administrative services subsidiary. The Company selects its roles as program developer, primary underwriter, reinsurer, program manager and broker based on its assessment of each risk profile. After determining its roles, the Company utilizes its insurance and reinsurance subsidiaries, its insurance brokerage and management services subsidiaries, and its risk retention group affiliate to generate risk premium revenues, program management fees, insurance and reinsurance commissions and investment income.

### Industry Ratings

In August, 2001, A.M. Best Company ("A.M. Best"), an independent, nationally recognized insurance industry rating service and publisher, reaffirmed a rating of "A (Excellent)" on a group basis to American Safety, as well as its U.S. insurance subsidiary, American Safety Casualty Insurance Company ("American Safety Casualty"), its U.S. property and casualty excess and surplus lines insurance company, American Safety Indemnity Company ("American Safety Indemnity") its Bermuda reinsurance subsidiary, American Safety Reinsurance, Ltd. ("American Safety Re"), and its non-subsiary risk retention group affiliate, American Safety Risk Retention Group, Inc. ("American Safety RRG"). The rating of "A (Excellent)" is the third highest of A.M. Best's 16 letter ratings. A.M. Best's ratings represent an independent opinion of an insurer's ability to meet its obligations to policyholders, which opinion is of concern primarily to policyholders, insurance agents and brokers and should not be considered an investment recommendation. A.M. Best assigned a financial size rating (VII) on a group basis to American Safety representing capital and surplus in excess of \$50 million as a result of the Company's completion of its initial public offering in February 1998.

### Alternative Insurance Market

The alternative insurance market has developed over the past two decades to serve insureds whose insurance needs have not been adequately met by the standard insurance market. According to A.M. Best, the alternative insurance market has grown to approximately 48% of the total U.S. commercial property and casualty insurance market.

-2-

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Alternative insurance programs generally involve (i) the underwriting of risks which are characterized by the standard insurance market as difficult or which generate too little premium for standard insurance companies; and/or (ii) the design of specialized insurance programs, such as deductible or risk retention programs, and captive or rent-a-captive programs, which enable insureds to assume a portion of their own risks and share in the underwriting profitability or losses of the program. Originally developed to respond to the needs of insureds for adequate insurance coverage and affordable premium rates, the alternative insurance market also responds to strategic needs of insureds for better financial management, improved claims handling, more effective risk management, customized insurance programs, direct access to the worldwide reinsurance market and greater control over loss prevention. The benefits of such alternative insurance market techniques typically include lower and more stable costs, greater control by the client of its risk management program and an increased emphasis within the client's organization on loss prevention and loss control.

### Business Strategy

The Company's business strategy is to develop insurance programs for the environmental remediation industry and other specialty industries and risks. The Company targets niche insurance markets and opportunities where its expertise is required and where competition is limited. The Company seeks to generate underwriting profits, program management fees and brokerage commissions through such insurance programs. The Company utilizes a flexible approach to accomplish its strategy by combining (i) intensive underwriting, (ii) value-added services, including quality coverage enhancements, professional risk management, dedicated loss control and claims management, and (iii)

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superior service to insurance agents, brokers and insureds. Further, the Company differentiates itself by its ability to select its roles as program developer, primary underwriter, reinsurer, program manager and broker based on its assessment of each specialty risk profile.

The Company's real estate development subsidiary, Ponce Lighthouse Properties, Inc., is the owner/developer of a residential condominium, marina, par 3 golf course and beach club development known as the Harbour Village Golf and Yacht Club ("Harbour Village") in Ponce Inlet, Florida. The Company organized Rivermar Contracting Company, a subsidiary, to be the general contractor for the construction of the Harbour Village project. The Company acquired the property that is being developed as Harbour Village through foreclosure in April 1999. Management believes the development of Harbour Village will provide significant value to the Company's shareholders over the anticipated development period.

-3-

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### Insurance Program Development, Management and Administrative Operations

The Company's U.S. brokerage and management subsidiaries, in combination with the Company's primary insurance and reinsurance companies, provide a broad range of dedicated services in connection with the development and implementation of specialty risk insurance programs.

**Insurance Services.** American Safety Insurance Services, Inc. ("ASI Services") provides insurance program development, underwriting, risk placement, reinsurance placement, program management, brokerage, loss control, claims administration, marketing and administrative services to the Company's U.S. insurance operations, its risk retention group affiliate, and unaffiliated insurers and reinsurers.

ASI Services identifies and evaluates potential new program business and also receives submissions for new programs from insurance brokers and other intermediaries throughout the United States. When a submission for a new program is received, ASI Services identifies the resources needed to evaluate and develop the program. In evaluating and developing a new program, ASI Services considers the following factors: whether the submitting party will bear risk and the collateral security required therefor; the analysis of historic loss data; the integrity and experience of the submitting party; the availability of reinsurance; and the potential profitability of the program to the Company. If the prospects for a new program appear favorable, ASI Services designs the structure for the new program and determines what additional services, such as program management, brokerage, reinsurance, loss control, claims administration, marketing, or other services will be required. ASI Services determines which entities, both affiliated and unaffiliated, are best able to provide such services in a cost-effective manner and implements the program.

ASI Services has developed many of the Company's primary insurance and reinsurance programs. ASI Services also has served since 1990 as the program manager for the Company's risk retention group affiliate, providing it with program management, underwriting, loss control, brokerage, marketing and financial services pursuant to guidelines and procedures established by the board of directors of the risk retention group.

**Management and Administrative Services.** In the development and implementation of programs, ASI Services provides a number of fee and commission-based services. ASI Services provides (i) program management services for the overall management and administration of a program; (ii) underwriting services for evaluating individual risks or classes of risk; (iii) risk placement services for

-4-

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determining the most effective means of providing particular coverages; (iv) brokerage services for placing risks with affiliated or unaffiliated insurers; (v) reinsurance intermediary services for placing ceded reinsurance for a program; (vi) loss control services for evaluating the risks posed by a particular class of risk, as well as the ability of insureds to control their losses; (vii) claims administration services for the prompt reporting and handling of claims, and the supervision of claims adjusters and third party administrators; (viii) marketing services for designing and placing advertisements and other marketing materials, as well as marketing insurance programs to independent agents and brokers; and (ix) administrative services, including billing, collecting and reporting primary and reinsurance premiums, producing financial reports on programs and paying claims.

**Other Insurance Service Subsidiaries.** The Company has three other U.S. subsidiaries engaged, under the direction of ASI Services, which provide various administrative and insurance agency services. Environmental Claims Services, Inc. operates as a specialized claims administration facility engaged in the administration and analysis of environmental and other specialty program claims. Sureco Bond Services, Inc. is a surety bond agency authorized to write contract performance and payment bonds for unaffiliated insurers. American Safety Purchasing Group, Inc. was formed to facilitate the provision of certain insurance coverages through a purchasing group (as defined by the Risk Retention Act) by licensed insurance companies.

### Primary Insurance Operations

## Item 1. Business

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The Company, through its two U.S. insurance subsidiaries and its risk retention group affiliate, provides primary casualty insurance in the alternative insurance market in all 50 states for environmental remediation risks, general contracting, and other specialty risks. The Company's specialty insurance programs include coverages for general liability, pollution liability, professional liability, workers' compensation, surety, commercial automobile and property, as well as custom designed risk management programs (including captive and rent-a-captive programs), for contractors, consultants and other businesses and property owners who are involved with environmental remediation, contracting and other specialty risks.

*Environmental Insurance Programs.* The Company has developed specialty insurance programs for a broad range of environmental concerns and believes that its intensive underwriting, dedicated loss control and claims management, and superior service orientation will enable it to expand its insurance program base to other environmental coverages not currently being provided. Since 1986, the Company's insurance programs have helped asbestos abatement and other environmental remediation contractors and consultants, as well as property owners, perform remediation work in schools, hospitals, commercial, industrial and other facilities.

-5-

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The Company's in-house underwriting department consists of trained environmental and other specialty risk underwriters. The underwriting staff analyzes loss histories of prospective insureds, as well as the insureds' technical capabilities and experience with similar projects to those for which insurance is being requested. The underwriting staff may also request references and financial information. Some of the underwriters have technical backgrounds and experience in various environmental fields. The Company's in-house loss control department also is involved in the underwriting process, in reviewing technical work guidelines provided by applicants, such as safety and health practices and procedures, as well as inspecting contractor insureds' environmental remediation project sites and recordkeeping throughout the United States.

The Company's general and pollution liability policies for environmental risks cover bodily injury and property damage to third parties arising out of the operations of insureds, which may include losses arising from exposure to specific hazardous substances that are released during a remediation project. Coverages provided for professional liability protect insureds against claims arising out of bodily injury or property damage and/or negligent acts, errors or omissions which occur as a result of the performance of professional consulting, testing, laboratory and similar services, such as the failure to detect hazardous materials in connection with assessments for same, or the failure to properly design or monitor performance on remediation projects in accordance with contracts entered into by such insureds. The Company also provides workers' compensation coverage for contractors involved in environmental remediation, which may include risks such as occupational diseases from exposure to hazardous substances.

The Company provides insurance coverage for a broad range of environmental risks, including:

*Asbestos Abatement.* Asbestos is a fibrous mineral which has been commercially produced for, among other things, insulation and reduction of fire and heat in buildings and products. In spite of the usefulness of asbestos, health problems have arisen with its use. In response to the need for detection, abatement and removal of asbestos, the asbestos abatement industry developed in the mid-1980's and sought insurance for risks involved with its business. Since 1986, the Company has provided general, pollution and professional liability coverages as well as workers' compensation coverage for contractors, consultants, other businesses and property owners involved with asbestos abatement.

*Lead Abatement.* The Company provides general, pollution and professional liability coverages and workers' compensation coverage for lead paint abatement contractors, consultants and property owners in connection with the abatement of lead paint from both public and private facilities, including housing authority complexes.

-6-

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*Underground Storage Tank Removal.* The Company provides general, pollution and professional liability coverages as well as workers' compensation coverage to contractors and consultants for the removal and replacement of underground storage tanks, including associated soil remediation activities attributed to leaking underground storage tanks.

*Other Hazardous Substances.* The Company provides general, pollution and professional liability coverages, and workers' compensation coverage in connection with the removal and remediation of other hazardous substances, including hazardous waste, polychlorinated biphenyls (PCBs) and various petroleum products.

*Other Environmental Risks.* The Company provides environmental insurance coverages that offer protection against environmental exposures arising from general business or fixed site operations. Environmental impairment liability insurance is offered for varied purposes such as facilitating the financing of real estate transactions, transferring real estate and protecting against the release of hazardous substances from treatment and disposal sites.

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*Surety.* The Company's U.S. insurance subsidiary, American Safety Casualty, is licensed to write surety bonds in 47 states and the District of Columbia primarily providing contract performance and payment bonds to environmental and general construction contractors. American Safety Casualty is listed as an acceptable surety on federal bonds, commonly known as a "Treasury Listed" or "T-listed" surety, enabling it to issue surety bonds for federal projects, as well as state and private projects that utilize such designation as a reference in determining the acceptability of surety companies. American Safety Casualty's underwriting limitation, as determined by the Department of the Treasury as of July 1, 2001, was \$1,203,000 on a per-bond basis; however, this limitation does not constrain the amount of a bond that can be written, provided that the excess exposure is protected with approved reinsurance or other methods prescribed by the Department of the Treasury. During 2001, the Company's U.S. insurance subsidiary, American Safety Casualty, substantially reduced writing contract surety business as a result of adverse loss experience and the lack of affordable reinsurance.

The Company also provides insurance coverage for a broad range of specialty risks, including:

-7-

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*Excess and Surplus Lines.* The Company's U.S. insurance subsidiary, American Safety Indemnity, writes excess and surplus lines insurance. These risks are generally of a specialized or unique nature which are not served by the standard insurance market. The Company's excess and surplus lines insurance typically covers construction and products liability.

*Program Business.* The Company, through its U.S. brokerage and management services subsidiaries, works with brokers and program administrators to develop and design tailor-made programs for a wide range of specialty industries, including environmental, construction, pest control, bail bond, transportation and professional liability. The Company can serve as the policy-issuing insurer, place reinsurance, coordinate claims handling, implement loss control services, and complete regulatory filings as may be required by the program.

*Commercial Lines.* During 2001, the Company's U.S. insurance subsidiary, American Safety Casualty, discontinued writing commercial lines insurance for insureds, including retail stores, strip shopping centers, office buildings and hotel/motel franchisees.

*Employee Leasing and Staffing Industry.* During 2001, the Company's U.S. insurance subsidiary, American Safety Casualty, discontinued writing workers' compensation and general liability insurance for employee leasing companies (also known as professional employer organizations) and staffing industry companies as a result of adverse loss experience.

*Underwriting.* ASI Services's underwriting staff handles all insurance underwriting functions for programs business, with specific underwriting authority related to the experience and knowledge level of each underwriter. Risks that are perceived to be more difficult and complex are underwritten by experienced staff and reviewed by management. ASI Services uses management information reports to measure risk selection and pricing in order to control underwriting performance. The principal underwriting factors used by ASI Services for underwriting liability, workers' compensation and surety coverages, are a financially stable business, an established operating history, favorable loss histories and a demonstrated commitment to loss control practices.

*Claims.* Claims arising under the policies and treaties issued or reinsured by the Company are reviewed and managed by ASI Services's internal claims department. When ASI Services receives notice of a loss, its claims personnel open a claim file and establish a reserve with respect to the loss. For programs business, ASI Services retains claims settlement authority, delegating only limited settlement authority to certain third party administrators. ASI Services emphasizes prompt and fair settlement of meritorious claims, maintenance of adequate loss reserves and careful control of claims adjustment and legal expenses.

-8-

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### Reinsurance Assumed

Reinsurance is a contractual arrangement under which one insurer (the ceding company) transfers to another insurer (the reinsurer) all or a portion of the risk(s) that the ceding company has assumed under the insurance policy or policies it has issued. A ceding company may purchase reinsurance for any number of reasons, including to obtain, through the transfer of a portion of its liabilities, greater underwriting capacity than its own capital resources would support, to stabilize its underwriting results, to protect against catastrophic loss, and to enter into or withdraw from a line of business. Reinsurance can be written on either a quota share or excess of loss basis, under either a treaty or facultative reinsurance agreement.

Substantially all of the reinsurance business that the Company currently assumes is for primary insurance coverages that the Company has developed and underwritten. The Company, through its Bermuda reinsurance subsidiary, enters into treaties with its U.S. insurance subsidiaries, its risk retention group affiliate and unaffiliated insurers with whom the Company has developed insurance programs. The Company reinsures, generally on an excess of loss basis, the general liability, pollution liability, professional liability and workers' compensation risks for contractors, consultants and other businesses and property owners who are involved with environmental remediation, general contracting and

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other specialty risks.

For the year ended December 31, 2000, of the \$22.6 million of gross reinsurance premiums written by the Company, approximately \$7.9 million was assumed from its risk retention group affiliate, with the balance of approximately \$14.7 million assumed from unaffiliated insurers. For the year ended December 31, 2001, of the \$26.8 million of gross reinsurance premiums written by the Company, approximately \$10.9 million was assumed from its risk retention group affiliate, with the balance of approximately \$15.9 million assumed from unaffiliated reinsurers.

The Company's assumed reinsurance business for general liability, pollution liability, and professional liability is written under excess of loss treaties primarily with its risk retention group affiliate. In the layer of the first \$350,000 of loss per occurrence, the Company assumes 75% of the losses arising from claims covered under the policies written after the reinsured pays the first \$100,000 of claims in the aggregate on an annual basis; and the reinsured retains 25% of the risk after payment of the aggregate amount.

The Company's two U.S. insurance subsidiaries cede certain risks on a quota share basis to the Company's Bermuda reinsurance subsidiary in order to provide for a spread of risk among the respective companies as well as to increase the capacity of the Company's U.S. insurance subsidiaries to write insurance business.

-9-

Management's reinsurance underwriting strategy is to utilize the underwriting expertise of ASI Services, the Company's principal U.S. program development, underwriting and administrative services subsidiary, to practice discipline in selecting and retaining risks and structuring insurance programs which the Company reinsures. The Company utilizes ASI Services to provide direct contact with reinsureds, either by underwriting or claim audits or periodic loss control visits to the insureds and the producing brokers, both to enhance the quality of the underwriting process and to develop and retain business relationships.

### Selected Operating Information

*Gross Premiums Written and Produced.* As a result of the Company's roles in connection with insurance program development, risk bearing on a primary and reinsurance basis, insurance and reinsurance brokerage, and production and administration, the Company is involved in a number of insurance and reinsurance premium and fee-generating activities. The Company places insurance and reinsurance with its insurance and reinsurance subsidiaries and its risk retention group affiliate, and also acts as an agency and broker for its risk retention group affiliate, unaffiliated insurers and reinsurers for which the Company receives brokerage commissions of approximately 10% of gross premiums written and produced. For the year ended December 31, 2001, the Company was involved with the placement of approximately \$176.3 million of gross premiums through its various programs and subsidiaries.

The following table sets forth the Company's premiums written and produced for the years ended December 31, 2000 and December 31, 2001:

-10-

	December 31, 2000			Decemb
	Gross	Ceded	Net	Gross
	-----	-----	---	-----
	(Dollars in thousands)			
The Company	\$86,872	\$44,872	\$42,000	\$158,017
American Safety RRG (1)	18,683			15,863
Other Insurers and Reinsurers (2)	12,594			13,256
Less: Ceded from American Safety RRG to the Company (3)	(7,923)			(10,864)
	\$110,226			\$176,272

1. Represents premiums written by American Safety RRG, the Company's non-subsiidiary affiliate.
2. Represents premiums produced by the Company, as an agency and broker, for unaffiliated insurers and reinsurers.
3. Represents premiums ceded to the Company from American Safety RRG.

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Net Premiums Written. The following table sets forth the Company's net premiums written by principal lines of insurance and reinsurance for the years ended December 31, 2000 and December 31, 2001:

Net Premiums Written	December 31, 2000		December 31, 2001	
	(Dollars in thousands)			
General Liability	\$ 11,731	27.9%	\$45,664	57.8%
Workers' Compensation	13,318	31.7	21,371	27.0
Surety	8,387	20.0	1,562	2.0
Commercial Lines	4,293	10.2	3,120	3.9
Program Business	4,271	10.2	7,351	9.3
Total	\$42,000	100.0%	\$79,068	100%

-11-

The following table sets forth the Company's net premiums written by specialty industry for the years ended December 31, 2000 and December 31, 2001:

	December 31, 2000		December 31, 2001	
	(Dollars in thousands)			
Environmental	\$17,545	41.8%	\$22,624	28.6%
Employee Leasing	9,226	22.0	7,809	9.9
Program Business and Other	6,602	15.7	9,765	12.4
Commercial Lines	4,292	10.2	3,120	3.9
Excess & Surplus Lines	4,335	10.3	35,750	45.2
Total	\$42,000	100.0%	\$79,068	100.0%

*Commissions and Fees.* The Company generates fee and commission income in connection with the Company's program development and management, insurance and reinsurance brokerage services, and production and other insurance related services. Fee and commission income was \$4.7 million for the year ended December 31, 2000, and \$3.9 million for the year ended December 31, 2001.

*Combined Ratio.* The combined ratio is a standard measure of a property and casualty insurer's performance in managing its losses and expenses. Underwriting results are generally considered profitable when the combined ratio is less than 100%. The following table compares the statutory combined ratios of the Company with the property and casualty industry over the past three years.

### Combined Ratio (Statutory Basis)

	1999	2000	2001
	----	----	----
The Company (1) (2) .....	70.9%	80.9%	91.5%
Property and casualty industry (3) ..	107.5	110.3	117.0

- 
1. Data has been derived from the consolidated financial statements of the Company.
  2. Payments by American Safety Casualty and American Safety Indemnity to ASI Services for management services are included in the combined ratio.
  3. The statutory industry data was obtained from A.M. Best.

Although the combined ratio is the generally accepted measure for comparing results within the property and casualty insurance industry, the combined ratio does not distinguish between property and casualty companies based upon their mix of business. The Company focuses primarily on long-tail liability coverages and writes a very limited amount of short-tail liability coverages. Long-tail liability insurance coverages often produce greater underwriting losses than short-tail liability insurance. Long-tail liability coverages also produce more investable cash flow for an insurance company because claims may not be reported for many years. Therefore, the companies writing long-tail insurance coverages may be able to mitigate their higher underwriting losses by deriving investment income. Accordingly, a higher combined ratio (on a



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statutory basis) for a company writing long-tail liability insurance does not necessarily mean lower profitability.

Premium and Loss Summary. The Company is engaged in the development of programs and underwriting of coverages as both a primary casualty insurer and a reinsurer. The following table provides selected historical information based on generally accepted accounting principles in the United States of America ("GAAP") concerning the business written by the Company and the associated underwriting risks. This data should be read in conjunction with the consolidated financial statements and notes thereto and the Selected Financial Data included elsewhere in this Report.

-12-

	1999 ----	2000 ----	2001 ----
	(In thousands, except ratio data)		
Reinsurance :			
Gross Premiums Written	\$ 12,584	\$22,646	\$26,764
Net Premiums Written	11,647	20,448	24,971
Net Premiums Earned	10,609	16,706	22,364
Loss & Loss Adjustment Expense Ratio	54.3%	73.7%	64.1%
Primary:			
Gross Premiums Written	\$ 10,821	\$64,226	\$131,253
Net Premiums Written	2,894	21,552	54,097
Net Premiums Earned	1,516	10,099	42,423
Loss & Loss Adjustment Expense Ratio	35.2%	58.0%	69.7%
Combined:			
Gross Premiums Written	\$ 23,405	\$86,872	\$158,017
Net Premiums Written	14,541	42,000	79,068
Net Premiums Earned	12,125	26,805	64,787
Loss & Loss Adjustment Expense Ratio	56.9%	69.0%	67.9%
Expense Ratio	16.7%	18.6%	24.9%
	-----	-----	-----
Combined	73.6%	87.6%	92.8%
	=====	=====	=====

Significant fluctuations in demand for and supply of various casualty insurance and reinsurance lines of business have led to substantial price fluctuations over time. The Company's management seeks to expand and contract various lines of business based on the relative favorability of the pricing environment for its products. As a writer of both primary insurance and reinsurance, the Company has additional flexibility to adjust its business mix in response to price differences in these markets and to utilize its knowledge of primary insurance markets to guide its assumption of insurance and reinsurance risks. During the past decade, the Company has operated in a soft market cycle which was characterized by excess insurance capacity and declining insurance premium rates; however, commencing in fiscal year 2000 the Company has operated in a hardening market with increased insurance premium rates for workers' compensation and excess and surplus lines.

### Reinsurance Ceded

The Company obtains reinsurance for its primary insurance and reinsurance operations from unaffiliated reinsurers to protect and mitigate the exposures of the Company. The Company's reinsurance program for general, pollution and professional liability, and excess and surplus lines risks operates on an excess of loss basis, with the Company's maximum exposure, on a per occurrence basis, limited to \$262,500 for general and pollution liability risks and \$350,000 for excess and surplus lines risks. For workers' compensation reinsurance business assumed by the Company, the Company's maximum exposure is \$350,000 per occurrence. Some of the reinsurance treaties maintained by the Company for its protection have certain aggregate limits of liability.

-13-

The Company purchases reinsurance for its primary insurance business lines and its reinsurance business. Gross reinsurance premiums ceded in 2000 were \$44.9 million, which constituted 52% of the gross premiums written, and in 2001 were \$78.9 million, which constituted 50% of the gross premiums written. The amount of reinsurance obtained by the Company varies with the line of business insured or reinsured. The Company experienced increased reinsurance costs in 2001, and expects such increased reinsurance costs to continue in 2002, as a result of a hardening reinsurance market.

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The Company evaluates the credit quality of the U.S. reinsurers and retrocessionaires to which it cedes business. The following table sets forth certain information relating to the Company's unaffiliated reinsurers and retrocessionaires as of December 31, 2001 with recoverables in excess of 5% of the Company's total shareholders' equity:

Reinsurers -----	A.M. Best Rating (1) -----	for Year Ended December 31, 2001 -----	for Year Ended December 31, 2000 -----
Berkley Insurance Company	A	32,382	2,453
Louisiana Pest Control Insurance Company	B+	9,095	9,117
Zurich International (UK) Ltd.	NR-5	8,430	8,466
Alea London Ltd.	A-	8,107	7,887
American Constantine Insurance Company Limited	N/A	6,053	8,783
Various Lloyd's Syndicates	N/A	6,688	208
Everest Re	A+	3,534	-
Dorinco Re	A	3,236	-

-----  
(1) A.M. Best rating currently assigned.

During the fourth quarter of 2001, one of the Company's former reinsurers, Berkley Insurance Company (formerly known as Signet Star Reinsurance Company), disputed its obligations under several reinsurance treaties entered into during the "soft reinsurance market" that existed in 1998 and 1999. As a result of adverse loss experience to the reinsurer from certain lines of business, Berkley has stopped reimbursing the Company for amounts due under such treaties and has requested that the Company retroactively consider taking a greater portion of the losses than is required under the treaties. As of December 31, 2001, unreimbursed paid claims under the treaties totaled \$6.5 million and additional ceded case reserves and reserves for incurred but not reported losses totaled approximately \$25.8 million. The Company is discussing resolution of this matter with Berkley, although the Company believes the reinsurer's request has no merit and was made in bad faith. If this dispute cannot be resolved, the Company will institute legal and arbitration proceedings against the reinsurer. Berkley is a subsidiary of W.R. Berkley Corp. (NYSE:BER). The Company does not believe this dispute will have a material adverse effect on the overall financial condition or liquidity of the Company as management believes the Company has sufficient current cash flows and other invested assets to meet its insurance obligations.

-14-

### Loss and Loss Adjustment Expense Reserves

The Company is required to maintain reserves to cover its estimated ultimate liability for losses and loss adjustment expenses with respect to reported and unreported claims incurred. The Company engages an independent internationally recognized actuarial consulting firm to provide reserve studies, rate studies and opinions. Reserves are estimates at a given time, which are established from actuarial and statistical projections by the Company of the ultimate settlement and administration costs of claims occurring on or prior to such time, including claims that have not yet been reported to the insurer. The establishment of appropriate loss reserves is an inherently uncertain process, and there can be no assurance that ultimate payments will not materially exceed the Company's reserves.

With respect to reported claims, reserves are established on a case-by-case basis. The reserve amounts on each reported claim are determined by taking into account the circumstances surrounding each claim and policy provisions relating to the type of loss. Loss reserves are reviewed on a regular basis, and as new data becomes available, appropriate adjustments are made to reserves.

Approximately 16% of the Company's net reserves relate to liability associated with asbestos abatement and other environmental general liability insurance programs, 28% of such reserves are attributable to the workers' compensation insurance, 26% of such reserves relate to excess and surplus lines, and the balance of 30% of such reserves is allocated among surety and other lines of insurance business.

-15-

In establishing reserves for its general liability insurance program, the Company uses paid and reported Bornhuetter-Ferguson methods which are based in part on developing paid and reported losses and an initial expected loss level. Initial expected losses reflect an expected loss ratio estimated from the ten year experience of the Company and a loss cost model applied to premium by coverage year. This loss indication and paid/reported losses are assigned respective weights to obtain estimates of ultimate losses which are considered in establishing ultimate loss levels.

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In establishing reserves for its workers' compensation insurance program, several methods are employed in determining ultimate losses: a pure premium method; two Bornhuetter-Ferguson methods - paid and reported; and two loss development methods - paid and incurred. The first three methods use industry expected losses adjusted for the Company's experience while the last two methods rely on industry payment and reporting patterns to develop the Company's actual losses. The Company reviews all methods each coverage year in determining ultimate losses.

In establishing reserves for its surety and other coverages, the Company uses an expected loss ratio method due to the limited amount of exposure assumed and the lack of historical Company specific information available.

All the methods used are generally accepted actuarial methods and, with the exception of the pure premium method, rely in part on loss reporting and payment patterns while considering the long tail nature of the coverages and inherent variability in projection results from year-to-year. The patterns used are generally based on industry data with supplemental consideration given to Company experience as deemed warranted.

The Company's independent actuarial consulting firm also relies on industry data to provide the basis for reserve analysis on newer lines of business. Provisions for inflation are implicitly considered in the reserving process. For GAAP purposes, the Company's reserves are carried at the total estimate for ultimate expected loss, without any discount to reflect the time value of money. Reserve calculations are reviewed regularly by management and periodically by regulators. The Company's independent actuarial consulting firm annually expresses an opinion on the adequacy of statutory reserves established by management, which is filed with the various jurisdictions in which the Company's insurance and reinsurance subsidiaries and its risk retention group affiliate are licensed. Based upon practices and procedures employed by the Company, without regard to independent actuarial opinions, management believes that the Company's reserves are adequate.

The following table provides a reconciliation of beginning and ending liability balances on a GAAP basis for the years indicated:

-16-

	1999 ----	2000 ----	2001 ----
		(In thousands)	
Gross losses and loss adjustment expense reserves at beginning of year	\$14,701	\$20,413	\$50,509
Ceded reserves at beginning of year	1,841	6,065	27,189
	-----	-----	-----
Net losses and loss adjustment expense reserves at beginning of year	12,860	14,348	23,320
	-----	-----	-----
Add:			
Incurred losses related to:			
Current accident year	7,449	17,356	42,469
Prior accident years	(553)	1,150	1,517
	-----	-----	-----
Total incurred losses	6,896	18,506	43,986
	-----	-----	-----
Less:			
Claims payments related to:			
Current accident year	1,707	4,291	12,952
Prior accident years	3,701	5,243	10,514
	-----	-----	-----
Total claims paid	5,408	9,534	23,466
	-----	-----	-----
Net losses and loss adjustment expense reserves at end of year	14,348	23,320	43,840
Ceded reserves at end of year	6,065	27,189	77,583
	-----	-----	-----
Gross losses and loss adjustment expense reserves at end of year	\$20,413	\$50,509	\$121,423

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The following table shows the development of the reserves for unpaid losses and loss adjustment expenses from 1991 through 2001 for the Company's primary insurance and reinsurance subsidiaries on a GAAP basis. The top line of the table shows the liabilities at the balance sheet date for each of the indicated years and reflects the estimated amounts for losses and loss adjustment expenses for claims arising in that year and all prior years that are unpaid at the balance sheet date, including losses incurred but not yet reported to the Company. The upper portion of the table shows the re-estimated amount of previously recorded liability based on experience as of the end of each succeeding year. The lower portion of the table shows the cumulative amounts subsequently paid as of successive years with respect to the liability. The estimates change as more information becomes known about the frequency and severity of claims for individual years. A redundancy (deficiency) exists when the re-estimated liability at each December 31 is less (greater) than the prior liability estimate. The "cumulative redundancy" or deficiency depicted in the table, for any particular calendar year, represents the aggregate change in the initial estimates over all subsequent calendar years.

-17-

	1991	1992	1993	1994	1995	1996	1997	1998
	----	----	----	----	----	----	----	----
	(In thousands)							
Reserves for unpaid losses and loss adjustment expense	\$4,552	\$4,135	\$4,798	\$6,048	\$8,288	\$8,869	\$10,793	\$12,860
Reserves re-estimated at December 31:								
1 year later	3,264	4,266	4,653	5,854	7,482	9,850	11,587	12,307
2 years later	3,057	4,100	4,584	5,381	7,518	9,926	12,253	12,967
3 years later	2,956	4,148	3,920	4,823	7,398	9,606	12,550	12,677
4 years later	2,933	3,644	3,063	4,373	7,027	9,767	11,556	
5 years later	2,607	2,987	2,740	3,941	7,251	8,677	-	
6 years later	1,953	2,765	2,535	4,062	6,261	-	-	
7 years later	1,693	2,504	2,641	3,324	-	-	-	
8 years later	1,422	2,630	2,002	-	-	-	-	
9 years later	1,456	2,070	-	-	-	-	-	
10 years later	1,066	-	-	-	-	-	-	
Cumulative redundancy (deficiency)	3,486	2,065	2,796	2,724	2,027	192	(763)	18
Cumulative amount of liability paid through December 31:								
1 year later	99	524	152	501	931	1,827	3,007	3,700
2 years later	308	651	382	997	2,056	3,506	5,707	6,560
3 years later	380	872	621	1,552	2,906	4,918	7,443	9,050
4 years later	531	1,095	776	1,899	3,656	6,034	8,991	
5 years later	697	1,235	1,064	2,162	4,619	6,638	-	
6 years later	701	1,511	1,252	2,428	4,906	-	-	
7 years later	699	1,516	1,500	2,617	-	-	-	
8 years later	700	1,733	1,500	-	-	-	-	
9 years later	820	1,733	-	-	-	-	-	
10 years later	820	-	-	-	-	-	-	
Net reserve December 31								14,300
Ceded Reserves								6,000
Gross Reserve								20,400

### Investments

The Company has an Investment Services Agreement with Invesco Capital Management, Inc. ("Invesco") whereby Invesco provides investment advisory services to the Company, subject to the investment policies and guidelines established by the Company's Board of Directors. The Company has consistently invested primarily in investment grade fixed income securities, with the objective of providing reasonable returns while limiting liquidity risk and credit risk. The Company's investment strategy has been to increase its investments in high quality bonds, as opposed to equity securities, in order to avoid market fluctuations. The investment portfolio consists primarily of government

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and governmental agency securities and high quality marketable corporate securities which are rated at investment grade level.

At December 31, 2001, the Company's total assets of \$297 million consisted of the following: cash, investments and notes receivable 47%; premiums receivable and agent's balances 9%; reinsurance recoverables 36%; and other assets 8%. At December 31, 2001, the Company held investment grade fixed income debt securities valued at \$62 million and secured notes receivable valued at \$8.1 million which represented secured loans to unaffiliated parties, at or above market rates, secured by corporate and personal guarantees, real estate and other collateral.

-18-

The Company's cash and investments at December 31, 2001 totaled approximately \$130.4 million, and were classified as follows:

Type of Investment	Book Value ----- (In thousands)	Percent of Portfolio -----
Cash and short-term investments	\$ 32,056	24.5%
United States government securities	28,618	21.9
Mortgage-backed securities	7,914	6.1
Corporate bonds	23,153	17.8
Foreign investments	1,004	0.8
Real estate	37,663	28.9
	-----	----
Total	\$130,408	100.0%
	=====	=====

The statement and fair values of the bond portfolio, classified by rating, as of December 31, 2001 were as follows:

S&P's/Moody's Rating (1) -----	Fair Value -----	Amount Reflected on Balance Sheet ----- (In thousands)	Percent of Total -----
AAA/Aaa (including United States Treasuries of \$29,607)	\$ 39,455	\$ 39,455	63.8%
AA/Aa	4,684	4,684	7.6
A/A	10,390	10,390	16.8
BBB/Baa	7,307	7,307	11.8
	-----	-----	-----
Total	\$ 61,836	\$ 61,836	100.0%
	=====	=====	=====

(1) Ratings are assigned by Standard & Poor's ("S&P") or, if no S&P rating is available, by Moody's Investors Service Inc. ("Moody's").

The National Association of Insurance Commissioners ("NAIC") has a bond rating system by which it assigns securities to classes called "NAIC designations" that are used by insurers when preparing their annual financial statements. The NAIC assigns designations to publicly traded as well as privately placed securities. The designations assigned by the NAIC range from class 1 to class 6, with a rating in class 1 being the highest quality. As of December 31, 2001, all of the Company's bond portfolio, measured on a statutory carrying value basis, was invested in securities rated in class 1 or class 2 by the NAIC, which are considered investment grade.

-19-

The weighted average maturity of the Company's bond portfolio at December 31, 2001 was 7.90 years. The composition of the Company's bond portfolio, classified by maturity, as of December 31, 2001 was as follows:

Amortized	Market
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Maturity (1) -----	Cost -----	Value -----
(In thousands)		
Due in one year or less.....	\$ 550	\$ 563
Due from one to five years.....	22,933	23,883
Due from five to ten years.....	21,759	21,934
Due after ten years.....	7,534	7,618
Mortgage-backed securities.....	7,914	7,838
	-----	-----
Total .....	\$ 60,690	\$ 61,836
	=====	=====

(1) Based on stated maturity dates with no prepayment assumptions.

The Company's investment grade fixed maturity securities included mortgage backed bonds of \$7.8 million, which are subject to risks associated with the variable prepayments of the underlying mortgage loans.

At December 31, 2001, the Company had two secured notes receivable from an unrelated party totaling \$8.1 million, whose maturity dates (July 15 and October 2, 2001) were extended until March 1, 2002. These notes carry an interest rate of 12% and are collateralized with various forms of real estate, and personal and corporate guarantees. The Company ceased accruing interest on these loans after the original maturity dates. These notes are currently in default and the Company is discussing resolution of this matter with the borrower.

American Safety Risk Retention Group, Inc.

*Organization History.* Following the enactment of the Risk Retention Act, American Safety, in order to establish a U.S. insurance company to market and underwrite specialty environmental coverages, provided financial and technical assistance in connection with the organization of American Safety RRG in 1988. American Safety RRG is not owned by the Company but is managed by ASI Services, the Company's principal U.S. program development, underwriting and administrative services subsidiary, on a fee-for-service basis. American Safety RRG is authorized to write liability insurance in all 50 states as a result of the Risk Retention Act, its license from the Vermont Department of Banking, Insurance, Securities and Health Care Administration (the "Vermont Department") under the Vermont Captive Act as a stock captive insurance company, and other state insurance filings. Presently, four of the directors of American Safety RRG are also directors of the Company. The directors of American Safety RRG are elected annually by the insureds/shareholders of American Safety RRG.

-20-

American Safety transferred its book of primary insurance business to American Safety RRG in 1988 and American Safety RRG replaced American Safety as the policy issuing carrier insuring general, pollution and professional liability risks for contractors, consultants and other businesses and property owners who are involved with environmental remediation. American Safety then became the quota share reinsurer of the risks transferred and subsequently underwritten by American Safety RRG. All reinsurers of American Safety RRG are required to be approved as reinsurers by the Vermont Department, and American Safety has been an authorized reinsurer of American Safety RRG since 1988. The Company, through its insurance subsidiaries, participates in the business of American Safety RRG as its primary reinsurer under an excess of loss/quota share reinsurance arrangement. For policies written by American Safety RRG, the Company receives 45% of the premium and assumes 75% of the risk in the layer of the first \$350,000 of loss per occurrence, subject to American Safety RRG's retention of the first \$100,000 of loss in the aggregate each year. American Safety RRG also cedes 100% of the risk in the layer of \$650,000 in excess of \$350,000 per occurrence, 100% of the risk in the layer of \$4 million in excess of \$1 million, and 100% of the risk in the layer of \$5 million in excess of \$5 million, to unaffiliated reinsurers.

*Regulation.* The Risk Retention Act facilitates the establishment of risk retention groups to insure certain liability risks of its members. The statute applies only to "liability" insurance and does not permit coverage of personal risk liability or workers' compensation. Membership in a risk retention group is limited to persons engaged in businesses or activities that are similar or related with respect to the liability to which the members are exposed by virtue of any related, similar, or common business, trade, products, services (including professional services), premises or operations. Ownership in a risk retention group is limited to persons who are members of the group and who are provided insurance by the group.

The Risk Retention Act and the Vermont Captive Act require that each insured of American Safety RRG be a shareholder. Each insured is required to purchase one share of the American Safety RRG's common stock upon the acceptance of the applicant as an insured. There

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is no trading market for the shares of common stock of American Safety RRG and each share is restricted as to transfer. If and when a holder of American Safety RRG common stock ceases to be an insured, whether voluntarily or involuntarily, such person's share of common stock is automatically canceled and such person is no longer a shareholder of American Safety RRG. The ownership interests of members in a risk retention group are considered to be exempt securities for purposes of the registration provisions of the Securities Act and the Securities and Exchange Act and are likewise not considered securities for purposes of any state securities law.

-21-

Congress intended under the Risk Retention Act that the primary responsibility for regulating the financial condition of a risk retention group would rest on the state in which the group is licensed or chartered. American Safety RRG is subject to regulation as a captive insurer under the insurance laws of Vermont and, to a lesser extent, under the laws of each state in which it is doing business. The Risk Retention Act requires a risk retention group to provide a notice on each insurance policy which it issues to the effect that (i) the policy is issued by a risk retention group; (ii) the risk retention group may not be subject to all of the insurance laws and regulations of the state in which the policy is being issued; and (iii) no state insurance insolvency guaranty fund is available to the policies issued by the risk retention group.

*Management.* Since 1990, ASI Services has managed the nationwide operations of American Safety RRG from its offices in Atlanta, Georgia pursuant to a program management agreement with a three year term. American Safety RRG has also entered into local management services agreements since 1988 with captive management companies of national insurance brokerage or insurance companies with offices located in Burlington, Vermont to provide local administrative services.

ASI Services acts as the program manager for American Safety RRG pursuant to the program's management agreement and is authorized to solicit and accept applications for insurance and to issue insurance policies on behalf of American Safety RRG subject to guidelines and procedures established by the board of directors of American Safety RRG. For 2001, the program management agreement between American Safety RRG and ASI Services provided for payment of a monthly program management fee of \$114,000 and a managing general agency commission of 10-15% of premium paid by insureds. The Company's recognized revenues from American Safety RRG for the years ended December 31, 2000 and December 31, 2001 are as follows:

-22-

	December 31, 2000	December 31, 2001
	-----	-----
	(In thousands)	
Assumed earned premiums from American Safety RRG.....	\$5,761	\$10,964
Ceded earned premiums to American Safety RRG .....	4,469	7,005
	-----	-----
Net premiums earned .....	1,292	3,959
Management fees.....	1,424	1,496
Brokerage commission income.....	2,515	1,490

In the table above, assumed earned premiums represent the assumption of a portion of liability risks by the Company from American Safety RRG, and ceded earned premiums represent the transfer of a portion of liability risks from the Company to American Safety RRG. Management fees include administrative services, underwriting services, claims administration services, financial, accounting, billing and collection services and consulting services.

The Company derived approximately 14.5% (\$5.2 million) of its revenues in 2000 and 6.8% (\$6.9 million) of its revenue in 2001 from American Safety RRG for administrative and management fees, managing agent commissions, loss control fees, reinsurance intermediary fees and reinsurance premiums.

### Insurance Regulation

The Company's primary insurance and reinsurance operations are subject to regulation under applicable insurance statutes of the jurisdictions or states in which each subsidiary is domiciled and writes insurance. Insurance regulations are intended to provide safeguards for the policyholders rather than to protect shareholders of insurance companies or their holding companies.

The nature and extent of state regulation varies from jurisdiction to jurisdiction, but typically involves prior approval of the acquisition of control of an insurance company or of any company controlling an insurance company, regulation of certain transactions entered into by an

insurance company with an affiliate, approval of premium rates for lines of insurance, standards of solvency and minimum amounts of capital and surplus which must be maintained, limitations on types and amounts of investments, restrictions on the size of risks which may be insured by a single company, deposits of securities for the benefit of policyholders, and reports with respect to financial condition and other matters. In addition, state regulatory examiners perform periodic examinations of insurance companies.

-23-

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Although the federal government does not directly regulate the business of insurance in the United States, federal initiatives often affect the insurance business in a variety of ways. The insurance regulatory structure has also been subject to scrutiny in recent years by the National Association of Insurance Commissioners ("NAIC"), federal and state legislative bodies and state regulatory authorities. Various new regulatory standards have been adopted and proposed in recent years. The development of standards to ensure the maintenance of appropriate levels of statutory surplus by insurers has been a matter of particular concern to insurance regulatory authorities.

#### Bermuda Regulation

American Safety, as a licensed Bermuda insurance company, and its Bermuda reinsurance subsidiary, American Safety Re, are subject to regulation under The Insurance Act 1978, as amended, and related regulations (the "Bermuda Act"), which provides that no person shall conduct insurance business (including reinsurance) in or from Bermuda unless registered as an insurer under the Bermuda Act by the Supervisor of Insurance (the "Supervisor").

The Bermuda Act requires, among other things, Bermuda insurance companies to meet and maintain certain standards of solvency, to file periodic reports in accordance with the Bermuda Statutory Accounting Rules, to produce annual audited financial statements and to maintain a minimum level of statutory capital and surplus. In general, the regulation of insurers in Bermuda relies heavily upon the auditors, directors and managers of the Bermuda insurer, each of which must certify that the insurer meets the solvency capital requirements of the Bermuda Act. Furthermore, the Supervisor is granted powers to supervise, investigate and intervene in the affairs of insurance companies.

Neither American Safety nor American Safety Re is registered or licensed as an insurance company in any state or jurisdiction in the United States.

#### U.S. Regulation

American Safety, as a specialty insurance holding company, does not itself do business in the United States. The Company, through its U.S. subsidiaries, does business in the United States. The Company's two U.S. insurance subsidiary's operations are subject to state regulation where each is domiciled and where each writes insurance.

-24-

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American Safety Casualty, a U.S. insurance subsidiary domiciled in Delaware, was acquired by the Company in 1993. American Safety Casualty is currently licensed as a property and casualty insurer in 48 states and the District of Columbia. The insurer is subject to regulation and examination by the Delaware Insurance Department and the other states in which it is an admitted insurer. The Delaware Insurance Department examines American Safety Casualty on a triennial basis. No other state has examined American Safety Casualty since it was acquired by the Company. The insurance laws of Delaware place restrictions on a change of control of American Safety as result of its ownership of American Safety Casualty. Under Delaware law no person may obtain 10% or more of the voting securities of American Safety without the prior approval of the Delaware Insurance Department.

American Safety Casualty, as a licensed insurer, is subject to state regulation of rates and policy forms in the various states in which direct premiums are written for its general liability and workers' compensation lines of business. Under such regulations, a licensed carrier may be required to file and obtain prior approval of its policy form and the rates that are charged to insureds. American Safety Casualty is also required to participate in state insolvency funds, or shared markets, which are designed to protect insureds of insurance carriers which become unable to pay claims due to an insurer's insolvency. Assessments made against insurers participating in such funds are based on direct premiums written by participating insurers, as a percentage of total direct written premiums of all participating insurers.

American Safety Indemnity, a U.S. insurance subsidiary domiciled in Oklahoma was acquired by the Company in 2000. American Safety Indemnity is currently licensed or approved as an excess and surplus lines insurer in 36 states and the District of Columbia. The insurer is subject to regulation examination by the Oklahoma Insurance Department and the other states in which it is approved as an excess and surplus lines insurer. The Oklahoma Insurance Department examines American Safety Indemnity on a triennial basis. No other state has examined American Safety Indemnity since it was acquired by the Company. The insurance laws of Oklahoma place restrictions on a change of control of American Safety as a percentage of its ownership of American Safety Indemnity. Under Oklahoma law no person may obtain 10% or more of the voting securities of American Safety without the prior approval of the Oklahoma Insurance Department.



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American Safety Indemnity, a licensed insurer in the State of Oklahoma and an approved excess and surplus lines insurer in other states, is subject to state regulation. As an excess and surplus lines insurer, premium rates are not filed and approved with the various state insurance departments, but certain restrictions regarding the types of insurance written by excess and surplus lines insurers must be met. Generally, excess and surplus lines insurers may only write coverage that is not available in the "admitted" market and strict guidelines regarding the coverages are set forth in various state statutes. Surplus lines brokers are the licensed individuals or entities placing coverage with excess and surplus lines insurers, and in most states, the broker is responsible for the payment of surplus lines taxes which are payable to the state in which the surplus lines risk is located. Surplus lines insurers are exempt from participation in state insolvency funds which are designed to protect insureds if "admitted" insurers become insolvent and are unable to pay claims. While American Safety Indemnity is exempt from the majority of state regulatory requirements, it must be "approved" to write the type of insurance in the states where its surplus lines insurance is written. The Oklahoma Insurance Department retains primary regulatory authority over American Safety Indemnity, as a licensed and admitted insurance company in Oklahoma.

-25-

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### Competition

The casualty insurance and reinsurance business is highly competitive with respect to a number of factors, including overall financial strength of the insurer or reinsurer, ratings by rating agencies, premium rates, policy terms and conditions, services offered, reputation and commission rates. The Company faces competition from a number of insurers who have greater financial and marketing resources and greater name recognition than the Company. Although the Company's business strategy is to develop insurance programs for the environmental remediation industry, the contracting industry, as well as other specialty industries and risks by targeting niche markets where its expertise is required and where competition is limited, the Company nevertheless encounters competition from other insurance companies engaged in insuring risks in broader lines of business which encompass the Company's niche markets and specialty programs, and such competition is expected to increase as the Company expands its operations.

### Employees

At December 31, 2001, the Company employed 130 persons, none of whom was represented by a labor union. ASI Services employs all but one of the Company's employees and manages the Company's U.S. business operations. The Company employs a senior financial officer in Bermuda.

### Certain Risk Factors

The Company's insurance operations are subject to the following risk factors in addition to the information (including disclosures relating to forward-looking statements) set forth elsewhere in this Report:

#### Industry Cyclicity; Potential Fluctuations in Financial Results

The financial results of casualty insurance companies historically have been subject to significant fluctuations and may vary significantly in the future. Results of operations may fluctuate due to a variety of factors, including competitive conditions in the industry, levels of new and renewal insurance business, unpredictable developments in loss trends, adequacy and changes in loss reserves, collectibility of reinsurance receivables, market acceptance of new coverages or enhancements, changes in operating expenses, fluctuations in interest rates and other changes in investment markets which affect market prices of investments and income from such investments, and changes in levels of general business activity and economic conditions. The Company has experienced increased competitive pricing pressures in its lines of business in recent years. In addition, insureds are eligible for renewal of their policies on different anniversary dates, subject to underwriting and loss control criteria applied by the Company. If a large number of insureds were to decline to renew their policies or if their policies were not renewed in a given calendar quarter, the Company's results of operations could be materially adversely affected in the renewal quarter and subsequent quarters.

#### Significant Industry Concentration; Specialty Industry Risks

Due to the Company's focus on insuring specialty risks, such as the environmental remediation industry and the contracting industry, its operations could be more exposed than its more diversified competitors to the effects of changes in economic conditions, regulations and legal precedents affecting such specialty industries. These changes may include economic downturns that may adversely impact the building and real estate development industry, and the degree of enactment and enforcement of federal and state environmental regulations that encourage or require environmental remediation efforts.

-27-

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## Dependence and Availability of Reinsurance

The availability, amount and cost of reinsurance are subject to prevailing market conditions that are beyond the control of the Company and that affect the Company's business, financial condition and results of operations. The Company's business depends significantly upon the Company's ability to limit its risk exposure by ceding (i.e., transferring to others) significant amounts of the potential liability arising from risks insured or reinsured by the Company. Although the Company since 1990 has been able to obtain appropriate and affordable reinsurance and anticipates that it will continue to be able to obtain such reinsurance, there can be no assurance that such reinsurance will be available. If the Company were unable to maintain or replace its reinsurance treaties upon their expiration, either its exposures would increase or, if it were unwilling to bear such increase in exposures, the Company would be required to reduce the level of its underwriting commitments. Furthermore, the Company is subject to credit risk with respect to its reinsurers, as the ceding of risk to its reinsurers does not relieve the Company of its primary liability to its insureds. Although the Company places its reinsurance with reinsurers it believes to be financially stable, a significant reinsurer's inability to make payment under the terms of a reinsurance treaty could have a material adverse effect on the Company's business, financial condition and results of operations.

## Possible Inadequacy of Loss Reserves

The establishment of appropriate loss reserves is an inherently uncertain process, particularly in the environmental remediation industry where claims that have occurred may not be reported to an insurance company until future periods of time, and there can be no assurance that ultimate losses will not materially exceed the Company's loss reserves. Insurance companies are required to maintain reserves to cover their estimated ultimate liability for losses and loss adjustment expenses with respect to reported and unreported claims incurred. Reserves are estimates at a given time involving actuarial and statistical projections of what the Company expects to be the cost of the ultimate settlement and administration of claims. These estimates are based on facts and circumstances then known, predictions of future events, estimates of future trends, claims frequency and severity, potential judicial expansion of liability precedents, legislative activity and other factors, such as inflation. The Company engages an internationally recognized actuarial consulting firm to provide reserve studies and rate studies. To the extent that loss reserves prove to be inadequate in the future, the Company would have to increase its reserves and incur charges to earnings in the periods such reserves are increased, which would cause fluctuations in operating results and could have a material adverse effect on the Company's business, financial condition and results of operations.

-28-

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## Reliance on Independent Insurance Agencies and Brokers

The failure or inability of independent insurance agencies and brokers to market the Company's insurance programs successfully could have a material adverse effect on the Company's business, financial condition and results of operations. The Company markets its insurance programs primarily through approximately 190 independent insurance agencies and insurance brokerage firms. Agencies and brokers are not obligated to promote the Company's insurance programs and may sell competitors' insurance programs. As a result, the Company's business depends in part on the marketing efforts of these agencies and brokers and on the Company's ability to offer insurance programs and services that meet the requirements of the clients and customers of these agencies and brokers.

## Risks Associated with Growth Strategy

The Company's growth strategy includes potential strategic acquisitions, as well as continued internal growth, particularly of its specialty insurance program business, and development of new insurance programs. If the Company is unable to implement its growth strategy effectively, the Company's business, financial condition and results of operations could be materially adversely affected. Although the Company is not engaged in negotiations with respect to any acquisition, any future acquisition would be accompanied by risks commonly encountered in acquisitions of companies. Such risks include, among other things, the difficulty in assimilating the operations and personnel of an acquired company; potential disruption of the Company's ongoing business; inability to successfully integrate acquired systems and insurance programs into the Company's operations; maintenance of uniform standards, controls and procedures; and possible impairment of relationships with employees and insureds of an acquired business as a result of changes in management. In addition, there can be no assurance that the Company will be able to successfully implement its strategy for continued internal growth. There can be no assurance that the Company would be successful in overcoming the risks or any other problems customarily encountered in connection with an acquisition, or achieving internal growth or development of new insurance programs.

## Importance of Industry Ratings

Increased public and regulatory scrutiny of the financial stability of insurance companies have resulted in greater emphasis by policyholders upon insurance company ratings, with a resultant potential competitive advantage for insurance companies with higher ratings. A.M. Best, an independent nationally recognized insurance industry rating service and publisher, reaffirmed a rating of A (Excellent) on a group basis to American Safety, as well as its U.S. insurance subsidiary, American Safety Casualty, its U.S. property and casualty excess and surplus line insurance subsidiary, American Safety Indemnity, and its non-subsiary risk retention group affiliate, American Safety RRG. No assurance can

be given that the group will maintain this rating, and any downgrade of such rating could adversely affect the Company's business, financial condition and results of operations. A.M. Best's ratings represent an independent opinion of an insurer's ability to meet its obligations to policyholders which opinion is of concern primarily to policyholders, insurance agents and brokers and should not be considered an investment recommendation.

-29-

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## Regulation

**Insurance Regulation.** The Company's primary insurance and reinsurance subsidiaries, as well as its non-subsidiary risk retention group affiliate, are subject to regulation under applicable insurance statutes of the jurisdictions in which they are domiciled or licensed and write insurance. Such regulation may limit the ability or the speed of the Company to respond to market opportunities and may require the Company to incur significant annual regulatory compliance expenditures. Insurance regulation is intended to provide safeguards for policyholders rather than to protect shareholders of insurance companies or insurance holding companies. Such regulation relates to authorized lines of business, capital and surplus requirements, types and amounts of investments, underwriting limitations, trade practices, policy forms, claims practices, mandated participation in shared markets, reserve adequacy, insurer solvency, transactions with related parties, changes in control, payment of dividends and a variety of other financial and nonfinancial components of an insurance company's business. Any changes in insurance laws and regulations could materially adversely affect the Company's business, financial conditions and results of operations. The Company is unable to predict what additional laws and regulations, if any, affecting its business may be promulgated in the future or how they might be interpreted.

**Environmental Regulation.** Environmental remediation activities and other environmental risks are highly regulated by both federal and state governments. Environmental regulation is evolving and changes in the regulatory patterns at federal and state levels may have a significant effect upon potential claims against the Company. Such changes may also affect the demand for the types of insurance offered by and through the Company and the availability or cost of reinsurance. The Company is unable to predict what additional laws and regulations, if any, affecting environmental remediation activities and other environmental risks may be promulgated in the future or how they might be interpreted.

-30-

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## Potential Risk of United States Taxation of Bermuda Operations

Bermuda's tax laws are more favorable to American Safety, a Bermuda company, and its Bermuda reinsurance subsidiary, American Safety Re, than the United States' tax laws because these Bermuda companies are not obligated to pay any taxes in Bermuda based upon income or capital gains. If the Company's Bermuda-based operations were determined to be subject to United States taxation, the Company's results of operations could be materially adversely affected. The United States Internal Revenue Code of 1986, as amended (the Code), does not contain a definitive identification of activities that constitute being engaged in a United States trade or business, and there can be no assurance that the Internal Revenue Service (the Service) will not contend that the Company's Bermuda-based operations are engaged in a United States trade or business and therefore are subject to United States income taxation. The Company, exclusive of its U.S. subsidiaries, does not consider itself to be engaged in a trade or business in the United States and accordingly does not expect to be subject to United States income taxation. The Company's U.S. subsidiaries are subject to United States taxation.

## Item 2. Properties

The Company's Bermuda offices are located at 44 Church Street, Hamilton, Bermuda, and the telephone number is (441) 296-8560. The principal offices of the Company's U.S. subsidiaries are located at 1845 The Exchange, Suite 200, Atlanta, Georgia 30339, and the telephone number is (770) 916-1908.

## Item 3. Legal Proceedings

The Company, through its subsidiaries, is routinely a party to pending or threatened litigation in the normal course of or related to its business. Based upon information presently available, in view of legal and other defenses available to the Company's subsidiaries, management does not believe that any pending or threatened litigation or disputes will have any material adverse effect on the Company's financial condition.

On January 6, 2000, the Company acquired (i) the stock of L&W Holdings, Inc. and its wholly-owned subsidiary, RCA Syndicate #1, Ltd., an Illinois licensed insurance carrier operating on the INEX (formerly the Illinois Insurance Exchange), (ii) the stock of Principal Management, Inc., an insurance program development and management company headquartered in Okemos, Michigan, and in a related transaction, the Company also acquired (iii) the stock of Pegasus Insurance, a Cayman Islands licensed insurance carrier. The transactions were structured as stock acquisitions, with the purchase price payable by the Company consisting of \$3,500,000 plus 200,000 American Safety common shares and earnout provisions for up to an additional 254,000 American Safety common shares over a five-year period. Of the purchase price, \$1,000,000 of cash and 109,086 shares of stock are held in escrow to secure the obligations of the sellers.

When RCA Syndicate #1, Ltd. filed its 1999 Annual Statement with the Illinois Department of Insurance in March 2000, the Company first became aware that there had been a material adverse change in the business affairs and financial condition of the acquired companies from that represented by the sellers. The Company launched an investigation which disclosed that the insurance claims experience of the acquired companies had been misrepresented and that incurred losses from insurance claims were significantly in excess of the amounts reported in their claims records and their financial statements. As a result, the Company then made written demand upon the selling shareholders of the acquired companies for rescission of the acquisitions, including a return of the purchase price paid for the companies. The Company filed a lawsuit on April 21, 2000 in the United States District Court for the Northern District of Georgia to rescind the acquisitions based upon the sellers' breach of the representations and warranties made concerning the business affairs and financial condition of the acquired companies. The sellers' misrepresentations as to the business affairs and financial condition of the acquired companies, and the under-reserving for claims, relate only to the operations of the acquired companies. The lawsuit is in the final stages of pre-trial discovery.

During the fourth quarter of 2001, one of the Company's former reinsurers, Berkley Insurance Company, disputed its obligations under several reinsurance treaties entered into during the "soft reinsurance market" that existed in 1998 and 1999. As a result of adverse loss experience to the reinsurer from certain lines of business, Berkley has stopped reimbursing the Company for amounts due under such treaties and has requested that the Company retroactively consider taking a greater portion of the losses than is required under the treaties. As of December 31, 2001, unreimbursed paid claims under the treaties totaled \$6.5 million and additional ceded case reserves and reserves for incurred but not reported losses totaled approximately \$25.8 million. The Company is discussing resolution of this matter with Berkley, although the Company believes the reinsurer's request has no merit and was made in bad faith. If this dispute cannot be resolved, the Company will institute legal and arbitration proceedings against the reinsurer. Berkley is a subsidiary of W.R. Berkley Corp. (NYSE:BER). The Company does not believe this dispute will have a material adverse effect on the overall financial condition or liquidity of the Company as management believes the Company has sufficient current cash flows and invested assets to meet its insurance obligations.

#### Item 4. Submission of Matters to a Vote of Security Holders

No matter was submitted to a vote of the Company's security holders during the fourth quarter of the fiscal year ended December 31, 2001.

### Management of the Company

The following table provides information regarding the management of the Company. Biographical information for each of such persons is set forth immediately following the table.

Name ----	Age ---	Position -----
Lloyd A. Fox	56	President, Chief Executive Officer and Director
Stephen R. Crim.....	38	President and Director
Joseph D. Scollo, Jr.....	38	Senior Vice President - Operations
Fred J. Pinckney.....	54	General Counsel and Secretary
Steven B. Mathis.....	34	Chief Financial Officer
J. Jeffrey Hood.....	38	Senior Vice President-Technical Services
Gary J. Campbell.....	35	Vice President-Finance

Lloyd A. Fox has been a director of the Company since 1996 and is President and Chief Executive Officer of the Company. From 1990 through 2001, Mr. Fox headed the management of the Company's U.S. subsidiaries. He assisted as general legal counsel in the formation of American Safety in 1986. Previously, Mr. Fox was an attorney for 16 years in Atlanta, Georgia, where his practice centered on insurance, the environmental and construction industries, as well as corporate and taxation matters. He received a juris doctor degree from the University of Michigan Law School in 1974 and a bachelor of science degree in pharmacy from Brooklyn College of Pharmacy in 1968. Mr. Fox's employment agreement ends December 31, 2002.

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Stephen R. Crim is Executive Vice President of the Company and, effective January 1, 2002, he heads the management the Company's U.S. subsidiaries. Mr. Crim has been responsible for all underwriting functions since joining the Company in 1990. Previously, Mr. Crim was employed in the underwriting department of Aetna Casualty and Surety and The Hartford Insurance Co. between 1986 and 1990. Mr. Crim has 15 years experience in the insurance industry. Mr. Crim received a bachelors degree in mathematics from the Indiana University in 1986. Mr. Crim will become President of the Company effective January 1, 2003.

-33-

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Joseph D. Scollo, Jr. is Senior Vice President - Operations of the Company since November 1998. Previously, Mr. Scollo served as senior vice president -operations of United Coastal Insurance Company, New Britain, Connecticut since 1989. Mr. Scollo has 13 years experience in the insurance industry. Mr. Scollo received a bachelor of science degree in business from Western New England College in 1985 and is a certified public accountant. Mr. Scollo will become Executive Vice President of the Company effective January 1, 2003.

*Fred J. Pinckney* became General Counsel and Secretary of the Company in October 1997. Previously, Mr. Pinckney was an attorney for 25 years in Atlanta, Georgia, where his practice centered on securities and corporate matters. He was involved as special legal counsel in the formation of American Safety in 1986 and acted as outside legal counsel to the Company prior to joining the Company. Mr. Pinckney received a juris doctor degree from the University of Michigan Law School in 1973 and a bachelor of arts degree in political science from the University of Pittsburgh in 1969.

Steven B. Mathis became Chief Financial Officer of the Company in August 1998. Previously he was the Company's controller since 1992 and he is currently responsible for all accounting and treasury functions of the Company. Mr. Mathis has 12 years accounting experience in the insurance industry having held accounting positions with American Insurance Managers, Inc. and American Security Group. Mr. Mathis received a bachelor of business administration degree in accounting from the University of Georgia in 1989.

*J. Jeffrey Hood* is Senior Vice President-Technical Services of ASI Services and is responsible for loss control, claims and regulatory matters. Prior to joining the Company in 1990, Mr. Hood served as a consultant for a national technical engineering firm for four years. Mr. Hood received a bachelor of science degree in petroleum engineering from Mississippi State University in 1985. Mr. Hood has 15 years of experience relating torsk management in the environmental remediation industry.

-34-

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Gary J. Campbell became Vice President-Finance of the Company in 2001. Previously, Mr. Campbell was a Senior Account Executive for Mutual Risk Management Ltd. for four years in Bermuda. From 1991 to 1997, Mr. Campbell was an audit senior in the Chartered Accounting firm of Withy Addison in Mississauga, Canada. Previously, he worked for two years in audit with Ernst & Young in Mississauga, Canada. Mr. Campbell obtained his Chartered Accounting designation in 1996 and passed the CPA United States Reciprocity Exam in 2002. Mr. Campbell received a bachelor's degree in business from the University of Western Ontario in Canada in 1989.

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-35-

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### PART II

#### Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters

The Company's common shares commenced trading on the National Association of Security Dealers, Inc.'s National Market on February 13, 1998 as a result of the Company's completion of its initial public offering. On February 5, 1999, the Company's common shares were listed and traded on the New York Stock Exchange, Inc. under the symbol "ASI" and the Company's prior listing on the National Association of Security Dealers, Inc.'s National Market ceased. As of March 22, 2002, there were approximately 2,200 holders of the Company's common shares.

The following table sets forth the high and low prices per share of the Company's common shares for the periods indicated.

First Quarter	\$ 7.38	\$ 5.50
Second Quarter	5.94	3.75
Third Quarter	4.63	3.75
Fourth Quarter	6.94	3.25

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Fiscal Year Ended December 31, 2001	High	Low
First Quarter	\$ 9.10	\$ 5.75
Second Quarter	10.25	7.95
Third Quarter	10.35	8.80
Fourth Quarter	9.65	8.80

The Company issued a cash dividend of \$0.12 per common share on March 1, 2002 to shareholders of record on February 11, 2002. Future cash dividends will be reviewed by the Board of Directors on a quarter by quarter basis. As an insurance holding company, the Company's ability to pay cash dividends to its shareholders will depend, to a significant degree, on the ability of the Company's subsidiaries to generate earnings from which to pay cash dividends to American Safety. The jurisdictions in which American Safety and its insurance and reinsurance subsidiaries are domiciled place limitations on the amount of dividends or other distributions payable by insurance companies in order to protect the solvency of insurers. The Company's current plans are for its insurance and reinsurance subsidiaries to principally retain their capital for growth.

-36-

### Item 6. Selected Financial Data

The following table sets forth selected consolidated financial data with respect to the Company for the periods indicated. The balance sheet data and income statement have been derived from the audited financial statements of the Company. This information should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Company's consolidated financial statements and notes thereto included elsewhere in this Report.

	1997	1998	1999	2000	
					(In thousands, except per share and ra
Income Statement Data:					
Revenues:					
Direct and assumed premiums earned	\$ 10,590	\$ 13,114	\$ 18,140	\$54,079	\$
Ceded premiums earned	(2,243)	(3,994)	(6,015)	(27,274)	
Net premiums earned	8,347	9,120	12,125	26,805	
Net investment income	1,647	2,847	2,878	2,605	
Interest on notes receivable	798	2,409	2,614	1,531	
Brokerage commission income	2,589	1,183	1,389	3,291	
Management fees from affiliate	601	1,344	1,386	1,425	
Net realized gains (losses)	84	443	174	(518)	
Real estate income	-	-	-	-	
Other income	14	24	921	939	
Total revenues	14,080	17,370	21,487	36,078	
Expenses:					
Losses and loss adjustment expenses incurred	4,093	5,177	6,896	18,506	
Acquisition expenses	2,336	1,192	894	3,792	
Real estate expenses	-	-	-	-	
Other expenses	4,084	5,246	7,694	12,758	
Expenses due to rescission	-	-	-	3,542	
Total expenses	10,513	11,615	15,484	38,598	

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Earnings (loss) before income taxes	3,567	5,755	6,003	(2,520)
Income Taxes	356	(199)	83	(1,157)
Net earnings (loss)	\$ 3,211	\$ 5,954	\$ 5,920	\$ (1,363)
Net diluted earnings (loss) per share	\$ 1.08	\$ 1.04	\$ 0.98	\$ (0.25)
Common shares and common share equivalents used in computing net diluted earnings per share	2,964	5,738	6,032	5,497
<b>GAAP Ratios:</b>				
Loss and loss adjustment expense ratio	49.0%	56.8%	56.9%	69.0%
Expense Ratio	32.8	23.9	16.7	18.6
Combined ratio	81.8%	80.7%	73.6%	87.6%
Net premiums written to Equity	0.4x	0.2x	0.3x	0.7x
<b>Statutory Ratios:</b>				
Loss and loss adjustment expense ratio	49.0%	56.8%	56.9%	69.1%
Expense ratio	30.5	22.6	14.0	11.8
Combined ratio	79.5%	79.4%	70.9%	80.9%
<b>Balance Sheet Data (at end of period)</b>				
Total investments	\$ 29,341	\$ 51,048	\$59,648	\$ 91,247
Total assets	47,668	86,147	104,017	207,298
Unpaid losses and loss adjustment expenses	11,572	14,700	20,413	50,509
Total liabilities	25,827	26,878	42,978	149,495
Total shareholders' equity	21,841	59,269	61,039	57,803

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-38-

### Item 7. Management's Discussion and Analysis of Results of Operations and Financial Condition

The information in the following discussion is presented on the basis of accounting principles generally accepted in the United States of America ("GAAP") and should be read in conjunction with the Company's consolidated financial statements and notes thereto included elsewhere in this Report. All amounts and percentages are rounded:

#### Results of Operations

The following table sets forth the Company's consolidated revenues:

	Year Ended December 31,	
	1999	2000
	-----	-----
	(In thousands)	
Net Premiums earned:		
Reinsurance:		

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Workers' Compensation	\$ 7,384	\$11,151	\$
General Liability	3,149	5,479	
Auto Liability	30	-	
	-----	-----	-----
Total reinsurance	10,563	16,630	
	-----	-----	
Primary Insurance:			
Commercial Lines	39	2,638	
Workers' Compensation	-	249	
Surety	1,302	4,539	
General Liability	-	845	
Program Business	221	1,904	
	-----	-----	
Total primary insurance	1,562	10,175	
	-----	-----	
Total net premiums earned	12,125	26,805	
	-----	-----	
	2,878		
Net Investment Income		2,605	
Interest on notes receivable	2,614	1,531	
Commission and fee income:			
Brokerage commission income	1,389	3,291	
Management fees from affiliates	1,386	1,425	
	-----	-----	
Total commission and fee income	2,775	4,716	
	-----	-----	
Net realized gains (losses)	174	(518)	
Real estate income	-	-	
Other income	921	939	
	-----	-----	
Total Revenues	\$21,487	\$36,078	\$1
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-39-

The following table sets forth the components of the Company's statutory combined ratio for the period indicated:

	1999	2000	2001
	----	----	----
Insurance Operations			
Loss & Loss Adjustment Expense Ratio	56.9%	69.1%	67.9%
Expense Ratio	14.0	11.8	23.6
	-----	-----	-----
Combined Ratio	70.9%	80.9%	91.5%
	=====	=====	=====



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### Year Ended December 31, 2001 to Year ended December 31, 2000

*Net Premiums Earned.* Net premiums earned increased 141.7% from \$26.8 million in 2000 to \$64.8 million in 2001. The principal factors accounting for the increase were an increase of general liability reinsurance premiums by 77.2% or \$4.2 million, an increase in workers compensation primary premiums by \$6.1 million, an increase in general liability primary premiums by \$17.6 million, an increase in commercial lines premiums by \$2.6 million, and an increase in program business premiums by 294.5% or \$5.6 million.

*Net Investment Income.* Net investment income increased 40.1% from \$2.6 million in 2000 to \$3.7 million in 2001 as a result of higher levels of invested assets generated from increased cash flows from operations. The average annual pre-tax yield on investments was 4.8% in 2000 and 5.0% in 2001. The average annual after-tax yield on investments was 4.0% in 2000 and 3.7% in 2001.

*Interest from Notes Receivable.* Interest from notes receivable decreased 49.9% from \$1.5 million in 2000 to \$800,000 in 2001. One reason for the decrease relates to repayment of various loans. Average notes receivable have decreased to \$8.5 million from \$10.9 million. The average annual pretax yield on notes receivable was 14.1% and 9.0% in 2000 and 2001, respectively. The Company ceased accruing interest on two impaired loans with one borrower in accordance with its accounting policies. However, the appraised value of the collateral securing these loans is in excess of the balances owed.

*Brokerage Commission Income.* Income from insurance brokerage operations decreased 26.7% from \$3.3 million in 2000 to \$2.4 million in 2001 due to reduced levels of insurance premiums being produced through the Company's risk retention group affiliate, and increased levels of insurance premiums being produced by the Company's excess and surplus lines carrier insurance company (which are not recognized as brokerage commission income).

-40-

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*Management Fees.* Management fees received from the Company's risk retention group affiliate increased 5.0% from \$1.43 million in 2000 to \$1.5 million in 2001 and is consistent with the prior year.

*Net Realized Gains.* Net realized gains (losses) from the sale of investments increased from a loss of \$518,000 in 2000 to a gain of \$652,000 in 2001. These gains were primarily realized from the sale of bonds in the Company's investment portfolio.

*Real Estate Income.* Real estate sales at the Harbour Village project were \$27.6 million in 2001. These sales were realized from the closing of 102 condominium units and 59 boat slips for the year ended December 31, 2001. See Exhibit 99 included in this Report for further information regarding Harbour Village.

*Losses and Loss Adjustment Expenses.* Loss and loss adjustment expenses increased 137.7% from \$18.5 million in 2000 to \$44.0 million in 2001 due to an increase in net earned premiums and increases in surety and commercial lines reserves.

*Acquisition Expenses.* Acquisition expenses increased from \$3.8 million to \$12.2 million as a result of increased earned premiums. Premium tax expense also increased to \$3.7 million from \$948,000 due to higher volumes of direct premiums earned.

Payroll and other expenses increased 23.4% from \$12.2 million in 2000 to \$15.1 million in 2001 due to increases in payroll and litigation costs, write-off of certain workers' compensation receivables, and costs associated with the Company's financial service subsidiary.

*Real Estate Expenses.* Real estate expenses associated with Harbour Village increased from \$542,000 in 2000 to \$25.1 million in 2001. Of the costs recognized in 2001, \$20.7 million were previously capitalized variable costs related to the sale of the condominium units and boat slips, and the remaining \$721,000 of expenses were fixed costs of the project, including advertising and other administrative costs. See Exhibit 99 included in this Report for further information regarding Harbour Village.

*Expense Due to Rescission.* Expense for rescission was \$600,000 for 2001, as compared to \$3.5 million in 2000, which is associated with the rescission of the previously acquired Michigan agency and two related insurance companies.

*Income Taxes.* Federal and state income taxes increased from a benefit of \$1.2 million in 2000 to an expense of \$1.2 million in 2001 as a result of increased levels of income in the Company's U.S. insurance and real estate subsidiaries.

-41-

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### Year Ended December 31, 2000 to Year ended December 31, 1999

*Net Premiums Earned.* Net premiums earned increased 121.1% from \$12.1 million in 1999 to \$26.8 million in 2000. The principal factors accounting for the increase were an increase in workers' compensation premiums by 54.4% or \$4.0 million, an increase of general liability reinsurance premiums by 100.8% or \$3.2 million, an increase in surety premiums by 248.6% or \$3.2 million, an increase in commercial lines premiums by 6,664% or \$2.6 million, and an increase in program business premiums by 761.5% or \$1.7 million.

*Net Investment Income.* Net investment income decreased 9.5% from \$2.9 million in 1999 to \$2.6 million in 2000 as a result of higher levels of short term investments to enable the Company to fund its stock repurchase programs. The average annual pre-tax yield on investments was 5.8% in 1999 and 4.8% in 2000. The average annual after-tax yield on investments was 5.4% in 1999 and 4.0% in 2000.

*Interest from Notes Receivable.* Interest from notes receivable decreased 41.4% from \$2.6 million in 1999 to \$1.5 million in 2000. The main reason for the decrease relates to repayment of various loans. Average notes receivable has decreased to \$10.9 million from \$14.6 million. The average annual pretax yield on notes receivable was 18.0% and 12.2% in 1999 and 2000, respectively.

*Brokerage Commission Income.* Income from insurance brokerage operations increased 136.9% from \$1.4 million in 1999 to \$3.3 million in 2000 as a result of increased commissions derived from insurance premiums produced through the Company's risk retention group affiliate. However, commencing in late fiscal 2000 a portion of these insurance premiums are being written by the Company (rather than the Company's risk retention group affiliate), and revenues will be recognized as premiums earned over the life of the underlying policies and not recognized as brokerage commission income.

*Management Fees.* Management fees received from the Company's risk retention group affiliate increased 2.8% from \$1.39 million in 1999 to \$1.43 million in 2000 and is consistent with the prior year.

*Net Realized Gains.* Net realized gains (losses) from the sale of investments decreased from a gain of \$174,000 in 1999 to a loss of \$518,000 in 2000. These losses were realized from the sale of bonds in the Company's investment portfolio.

-42-

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*Losses and Loss Adjustment Expenses.* Loss and loss adjustment expenses increased 168.3% from \$6.9 million in 1999 to \$18.5 million in 2000 primarily due to an increase in net earned premiums and release of reserve redundancies in 1999. Increases in general liability, workers' compensation and surety business accounted for the largest portion of the increase in loss and loss adjustment expenses.

*Acquisition Expenses.* Acquisition expenses increased 324.3% to \$3.8 million from \$894,000 as a result of increased production of surety, commercial lines and powersports premiums, which are product lines that produce higher acquisition expenses. Premium tax expense has increased to \$1.0 million from \$341,000 due to higher volumes of direct premiums earned.

*Payroll and Other Expenses.* Payroll and other expenses increased 66.2% from \$7.7 million in 1999 to \$12.8 million in 2000. The principal factors accounting for the result were payroll and related expenses increased \$2.5 million in part due to increased staffing of the Company's newer business units; operating expenses associated with the Company's financial services subsidiary increased to \$430,000 for the year due to additional staff and related expenses; noncapitalized expenses associated with the Company's Harbour Village real estate development were \$542,000; and expenses for licenses and fees increased \$525,000 as the Company expanded its capability to direct write more lines of insurance business.

*Expense Due to Rescission.* Expense for rescission was \$3.5 million for 2000 as a result of the rescission of the previously acquired Michigan agency and two related insurance companies.

*Income Taxes.* Federal and state income taxes decreased from an expense of \$82,722 in 1999 to a benefit of \$1.2 million in 2000 due to decreased taxable income in the Company's U.S. subsidiaries and as a result of the acquisition rescission charge.

### Liquidity and Capital Resources

The Company historically has met its cash requirements and financed its growth principally through cash flows generated from operations. During the past decade, the Company has operated in a soft market cycle which was characterized by excess insurance capacity and declining insurance premium rates; however, commencing in fiscal year 2000 the Company has operated in a hardening market with increased insurance premium rates for workers' compensation and excess and surplus lines. The Company's primary sources of cash flow are proceeds from the sale or maturity of invested assets, premiums earned, investment income, income from real estate development sales commission income and management fees. The Company's short-term cash requirements are primarily for claims payments, reinsurance premiums, commissions, salaries, employee benefits, real estate development expenses, and other operating expenses, and the purchase of investment securities, which

have historically been satisfied

-43-

from operating cash flows. Due to the uncertainty regarding settlement of unpaid claims, the long-term liquidity requirements of the Company may vary, and the Company has attempted to structure its investment portfolio to take into account the historical payout patterns. Notwithstanding the Company's dispute with one of its former reinsurers, Berkley Insurance Company, as disclosed elsewhere in this Report, management believes that the Company's current cash flows are sufficient for the short-term needs of its insurance business and the Company's invested assets are sufficient for the long-term needs of its insurance business. The Company also purchases reinsurance to mitigate the effect of large claims and to help stabilize demands on its liquidity.

On a consolidated basis, net cash provided from operations was \$5.5 million for 1999, \$24.4 million for 2000 and \$28.1 million for 2001. The positive cash flows for said periods were primarily attributable to net premiums written, income from real estate development sales and net earnings. Because workers' compensation and general liability claims may be reported over an extended period of time, the Company has established loss reserves for such lines of business. The assets supporting the Company's reserves continue to earn investment income until claim payments are made.

Total assets increased from \$104.4 million at December 31, 1999 to \$207.3 at December 31, 2000, and to \$297.3 million at December 31, 2001, primarily due to increases in fixed maturities, short-term investments, reinsurance recoverables and real estate investments. Cash, invested assets and notes receivable increased from \$73 million at December 31, 1999 to \$104.2 million at December 31, 2000, and to \$139.6 million at December 31, 2001, as a result of increases in net premiums written and investment income and real estate. At December 31, 2001, the Company has repurchased 1,589,239 shares of its common stock at a total cost of \$9.5 million since January 1999.

American Safety is an insurance holding company whose principal assets are its investment portfolio and its investment in the capital stock of its subsidiaries. American Safety's ability to pay dividends to its shareholders will depend, to a significant degree, on the ability of the Company's subsidiaries to generate earnings from which to pay dividends to American Safety. The jurisdictions in which American Safety and its insurance and reinsurance subsidiaries are domiciled place limitations on the amount of dividends or other distributions payable by insurance companies in order to protect the solvency of insurers.

-44-

*Harbour Village Development.* The Company announced in March 2000 its plans to complete development of the Harbour Village Golf and Yacht Club ( Harbour Village ), located in Ponce Inlet, Florida, consisting of 786 residential condominium units, a marina containing 142 boat slips, a par 3 golf course and beach club. The Harbour Village property (comprising 173 acres) was acquired by the Company through foreclosure in April 1999, and has been under development by its subsidiary, Ponce Lighthouse Properties, Inc. and its contracting subsidiary, Rivermar Contracting Company. The number of residential condominium units planned for the project has been increased from 786 to 809. As of February 28, 2002, the Company's marketing efforts had generated approximately \$118 million of pre-sales of condominium units and boat slips.

Management anticipates that Harbour Village will be developed in three Phases through 2004-2005, depending on future sales activities and economic conditions that may impact the marketing of the condominium units. In July 2000, the Company initially closed a \$37 million acquisition, development and construction loan facility in order to commence construction of Phase I of the project, which loan facility was increased in July 2001. Through December 31, 2001, the Company had outstanding borrowings of approximately \$15.3 million from this loan facility. The estimated construction and development cost for the entire Harbour Village project is approximately \$200 million. Phase I of the development currently under construction consists of site work including a 142-boat slip marina, 294 residential units, and related amenities. No assurance can be given, however, as to either future sales activities of the condominium units or the impact of local and national economic conditions on the Company's marketing efforts for the development of the Harbour Village project.

Management believes that the bank loan facility, together with anticipated cash flows from marketing and sales operations, will meet the liquidity needs for the construction and development of Phase I of the Harbour Village project during the first 24 months of development. There can be no assurance, however, that the amounts available from the Company's sources of liquidity, exclusive of the bank loan facility for the project, will be sufficient or available to meet the Company's future capital needs for the project. See Exhibit 99 for further information regarding Harbour Village.

#### **Critical Accounting Policies**

The accounting policies described below are those the Company considers critical in preparing its financial statements. These policies include significant estimates made by management using information available at the time the estimates are made. However, as described below, these estimates could change materially if different information or assumptions were used. The descriptions below are summarized and have

been simplified for clarity. A more detailed description of the significant accounting policies used by the Company in preparing its financial statements is included in Note (1) of Notes to the Consolidated Financial Statements.

-45-

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**Reinsurance.** One of the Company's former reinsurers, Berkley Insurance Company, has disputed its obligations under several reinsurance treaties entered into during the soft reinsurance market that existed in 1998 and 1999. As of December 31, 2001, unreimbursed paid claims totaled \$6.5 million and additional ceded case and incurred but not reported reserves totals approximately \$25.8 million. A reserve for this dispute has not been established since the Company does not believe it is probable a loss will occur nor is any potential loss estimatable. If any of these factors change in the future, the Company will establish a reserve at that time, which could be material.

**Unpaid Losses & Loss Adjustment Expenses.** The Company is required to estimate its liability for loss and loss adjustment expenses. The estimated liability for unpaid losses and loss adjustment expenses recorded on the Company's balance sheet at the end of any given period should be adequate to cover all future payments required to be made on account of insured events that occurred on or before the balance sheet date. However, because the future cannot be predicted with certainty, the actual future payments are usually different from the previously recorded estimates, and sometimes the differences may be material. These differences are included in the Company's results of operations in the future periods in which they become known.

**Deferred Income Taxes.** The Company is required to establish a valuation allowance for the portion of any deferred tax asset, which amounted to \$7.4 million at December 31, 2001, that management believes will not be realized. The Company believes that it is more likely than not that the Company will realize the full benefit of its deferred tax assets in future periods. Accordingly, no valuation allowance has been established.

**Construction Accounting.** The Company recognizes revenue on Harbour Village, its real estate development project, when title to each condominium unit and boat slip transfers to the purchaser. When title transfers, the Company uses a percentage of completion method based on actual costs to total estimated costs (including allocated common costs) to recognize revenue. The estimated future common costs of amenities at December 31, 2001 were \$4.5 million, of which \$665,000 related to condominium units that were closed in 2001. The percentage of completion method is based upon future estimated costs, and actual costs may vary greatly from these estimated costs requiring an adjustment to be recorded in future periods.

#### Income Taxes

American Safety is incorporated under the laws of Bermuda and, under current Bermuda law, is not obligated to pay any taxes in Bermuda based upon income or capital gains. American Safety has received an undertaking from the Minister of Finance in Bermuda pursuant to the provisions of The Exempted Undertakings Tax Protection Act 1966, which exempts American Safety and its shareholders, other than shareholders ordinarily resident in Bermuda, from any Bermuda taxes computed on profits, income or any capital asset, gain or appreciation, or any tax in the nature of estate, duty or inheritance until March 28, 2016. The Company, exclusive of its United States subsidiaries, does not consider itself to be engaged in a trade or business in the United States and accordingly does not expect to be subject to direct United States income taxation. The Company's U.S. subsidiaries are subject to taxation in the United States.

-46-

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#### Impact of Inflation

Property and casualty insurance premiums are established before the amounts of losses and loss adjustment expenses are known and therefore before the extent by which inflation may affect such expenses is known. Consequently, the Company attempts, in establishing its premiums, to anticipate the potential impact of inflation. However, for competitive and regulatory reasons, the Company may be limited in raising its premiums consistent with anticipated inflation, in which event the Company, rather than its insureds, would absorb inflation costs. Inflation also affects the rate of investment return on the

#### Combined Ratio

The combined ratio of an insurance company measures only the underwriting results of insurance operations and not the profitability of the overall company. The Company's reported combined ratio for its insurance operations may not provide an accurate indication of the Company's overall profitability from insurance and reinsurance programs due to the exclusion of fee and commission income and expenses generated in related management and agency subsidiaries. Depending on the Company's mix of business going forward, the combined ratio may fluctuate from time to time and may not reflect the overall profitability of insurance programs to the Company.

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## Reserves

Certain of the Company's insurance policies and reinsurance assumed, including general and pollution liability policies covering environmental remediation, excess and surplus, and workers' compensation risks, may be subject to claims brought years after an incident has occurred or the policy period has ended. The Company is required to maintain reserves to cover its estimated liability for losses and loss adjustment expenses with respect to reported and unreported claims incurred. The Company engages an independent internationally recognized actuarial consulting firm to provide reserve studies, rate studies, and opinions. Reserves are estimates at a given time, which are established from actuarial and statistical projections by the Company of the ultimate settlement and administration costs of claims occurring on or prior to such time, including claims that have not yet been reported to the insurer. The establishment of appropriate loss reserves is an inherently uncertain process, and there can be no assurance that the ultimate payments will not materially exceed the Company's reserves.

## Forward Looking Statements

This Report contains certain forward-looking statements within the meaning of United States securities laws which are intended to be covered by the safe harbors created thereby. The use of such statements include estimations of future insurance claims and losses and estimated profits from Harbour Village as reflected in the Company's consolidated financial statements and Exhibit 99 to this Report. In addition, all statements, other than statements of historical facts, included or incorporated by reference in this Report that address activities, events or developments that the Company expects or anticipates will or may occur in the future constitute forward-looking statements.

Forward-looking statements involve risks and uncertainties which may cause actual results to differ materially, and are subject to change based on various insurance industry factors, including, without limitation, competitive conditions in the insurance industry, levels of new and renewal insurance business, unpredictable developments in loss trends, adequacy and changes in loss reserves, collectibility of reinsurance receivables, market acceptance of new coverages and enhancements, changes in reinsurance costs and availability, and changes in levels of general business activity and economic conditions. With respect to the development of the Harbour Village property, such forward-looking statements involve risks and uncertainties which may cause actual results to differ materially, and are subject to change based on various real estate development industry factors, including competitive housing conditions in the local market area, risks inherent in real estate development and new construction, increases in construction costs, construction delays, weather, zoning, litigation, changes in interest rates and the availability of mortgage financing for prospective purchasers of condominium units and boat slips, and changes in local and national levels of general business activity and economic conditions.

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Although the Company believes that the assumptions underlying the forward-looking statements contained herein are reasonable, any of the assumptions could over time prove to be inaccurate and therefore, there can be no assurance that the forward-looking statements included in this Report will themselves prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by the Company or any other person that the objectives and plans of the Company will be achieved. The Company expressly disclaims any obligation to update any forward-looking statements except as required by law.

## Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Market risk is the risk of economic losses due to adverse changes in the estimated fair value of a financial instrument as the result of changes in equity prices, interest rates, foreign exchange rates and commodity prices. The Company's Consolidated Balance Sheets includes assets whose estimated fair values are subject to market risk. The primary market risk to the Company is interest rate risk associated with investments in fixed maturities. The Company has no direct commodity or foreign exchange risk as of December 31, 2001. The estimated fair value of the Company's investment portfolio at December 31, 2001 was \$121 million, 69% of which was invested in fixed maturities and short-term investments, and 31% of which was invested in real estate.

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### *Interest Rate Risk*

The Company's fixed maturity investments and borrowings are subject to interest rate risk. Increases and decreases in interest rates typically result in decreases and increases in the fair value of these financial instruments.

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Approximately three quarters of the Company's investable assets come from premiums paid by policyholders. These funds are invested predominantly in high quality corporate, government and municipal bonds with relatively short durations. The fixed maturity portfolio is exposed to interest rate fluctuations; as interest rates rise, their fair values decline and as interest rates fall, the fair value of the fixed maturity portfolio rises. The changes in the fair market value of the fixed maturity portfolio are presented as a component of shareholders' equity in accumulated other comprehensive income, net of taxes.

-49-

The Company works to manage the impact of interest rate fluctuations on its fixed maturity portfolio. The effective duration of the fixed maturity portfolio is managed with consideration given to the estimated duration of the Company's liabilities. The Company has investment policies which limit the maximum duration and maturity of the fixed maturity portfolio.

The table below summarizes the Company's interest rate risk and shows the effect of a hypothetical change in interest rates as of December 31, 2001. The selected hypothetical changes do not indicate what would be the potential best or worst case scenarios (dollars in thousands):

### Hypothetical

Fixed Maturity Investments	Estimated Fair Value at December 31, 2001	Estimated Change in Interest Rate  (bp=basis points)	Esti Va Hyp Change
Total Fixed Maturity	\$61,836	200bp decrease	\$ 6
Investments (including		100bp decrease	6
short-term investments)		100bp increase	5
		200bp increase	5

### Item 8. Financial Statements and Supplementary Data

The Company's consolidated financial statements required under this Item 8 are included as part of Item 14 of this Report.

### Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

-50-

## PART III

### Item 10. Directors and Executive Officers of the Registrant

The information required by this Item 10 regarding directors and executive officers of the Company will be set forth in the Company's 2002 Proxy Statement which will be filed with the Securities and Exchange Commission pursuant to applicable regulations, and is hereby incorporated by this reference. Additional information required by this Item 10 with respect to executive officers is set forth in Part I, Item 4 of this Report.

### Item 11. Executive Compensation

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The information required by this Item 11 regarding executive compensation will be set forth in the Company's 2002 Proxy Statement which will be filed with the Securities and Exchange Commission pursuant to applicable regulations, and is hereby incorporated by this reference.

### Item 12. Security Ownership of Certain Beneficial Owners and Management

The information required by this Item 12 regarding security ownership of certain beneficial owners and management of the Company will be set forth in the Company's 2002 Proxy Statement which will be filed with the Securities and Exchange Commission pursuant to applicable regulations, and is hereby incorporated by this reference.

### Item 13. Certain Relationships and Related Transactions

The information required by this Item 13 regarding certain relationships and related transactions of the Company will be set forth in the Company's 2002 Proxy Statement which will be filed with the Securities and Exchange Commission pursuant to applicable regulations, and is hereby incorporated by this reference.

-51-

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## PART IV

### Item 14. Exhibits, Financial Statements Schedules, and Reports on Form 8-K

(a) Financial Statements Schedules, and Exhibits

1. Financial Statements

The following is a list of financial statements, together with reports thereon, filed as part of this Report:

- Independent Auditors' Report
- Consolidated Balance Sheets at December 31, 2000 and 2001
- Consolidated Statements of Earnings for the Years Ended December 31, 1999, 2000 and 2001
- Consolidated Statements of Shareholders' Equity for the Years Ended December 31, 1999, 2000 and 2001
- Consolidated Statements of Cash Flow for the Years Ended December 31, 1999, 2000 and 2001
- Consolidated Statements of Comprehensive Earnings for the Years Ended December 31, 1999, 2000 and 2001
- Notes to Consolidated Financial Statements

2. Financial Statement Schedules

The following is a list of financial statement schedules filed as part of this Report:

Schedule Number

- Schedule II - Condensed Financial Statements  
(Parent only)
- Schedule III - Supplemental Information
- Schedule IV - Reinsurance

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Other schedules have been omitted as they are not applicable to the Company, or the required information has been included in the financial statements and related notes.

### 3. Exhibits

The following is a list of exhibits required to be filed as part of this Report:

Exhibit Number	Title
3.1*	Memorandum of Association of the Company
3.2*	Form of Bye-Laws of the Company
4.1*	Common Share Certificate
10.1*	Employment Contract between the Company and Lloyd A. Fox
10.2*	Incentive Stock Option Plan
10.3*	Directors Stock Award Plan
10.4**	Lease Agreement between 1845 Tenants-In-Common (formerly known as Windy Hill Exchange, L.L.C.) and American Safety Insurance Services, Inc. (formerly known as Environmental Management Services, Inc. ) for office space in Atlanta, Georgia
10.5*	Program Management Agreement between Synergy Insurance Services, Inc. (now known as American Safety Insurance Services, Inc.) and American Safety Risk Retention Group, Inc.
10.6	Employment Agreement between the Company and Stephen R. Crim
21	Subsidiaries of the Company
99	Harbour Village Development Status

-53-

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\*Incorporated by reference to the Exhibits to Registrant's Amendment No. 1 to Registration Statement filed January 27, 1998 on Form S-1 (Registration No. 333-42749)

\*\*Incorporated by reference to the Exhibits to Registrant's Registration Statement filed December 19, 1997 on Form S-1 (Registration No. 333- 42749)

(b) Reports on Form 8-K:

No reports on Form 8-K were filed during the fourth quarter of the year ended December 31, 2001.

-54-

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### SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized on March 29, 2002.



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AMERICAN SAFETY INSURANCE GROUP, LTD.

By: \_\_\_\_\_  
Lloyd A. Fox  
President

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed by the following persons in the capacities indicated on March 29, 2002.

Signature	Title
_____ Lloyd A. Fox	President and Director (Principal Executive Officer)
_____ Steven B. Mathis	Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)
_____ Frederick C. Treadway	Chairman of the Board of Directors
_____ David V. Brueggan	Director
_____ Cody W. Birdwell	Director
_____ William O. Mauldin, Jr.	Director
_____ Thomas W. Mueller	Director
_____ Jerome D. Weaver	Director

-55-

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**AMERICAN SAFETY INSURANCE GROUP, LTD. AND SUBSIDIARIES**  
**Consolidated Financial Statements**  
**December 31, 2000 and 2001**  
**With Independent Auditors' Report Thereon**

-56-

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**Independent Auditors' Report**

The Board of Directors  
American Safety Insurance Group, Ltd.:

We have audited the consolidated financial statements of American Safety Insurance Group, Ltd. and subsidiaries as listing in the accompanying index. In connection with our audits of the consolidated financial statements, we also have audited the financial statement schedules as listed in the accompanying index. These consolidated financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedules based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of American Safety Insurance Group, Ltd. and subsidiaries as of December 31, 2000 and 2001, and the results of their operations and their cash flow for each of the years in the three-year period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic consolidated financial

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statements taken as a whole, present fairly, in all material respects, the information set forth therein.

KPMG

Hamilton, Bermuda  
March 20, 2002

-57-

AMERICAN SAFETY INSURANCE GROUP, LTD. AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2000 and 2001

	2000	
	----	
Assets		
-----		
Investments:		
Securities available for sale, at fair value:		
Fixed maturities	\$45,985,656	
Common stock	162,322	
Investment in real estate	23,946,305	
Short-term investments	15,312,377	
	-----	
	85,406,660	
Total investments		
Cash	3,784,102	
Restricted cash	6,117,682	
Accrued investment income	1,543,675	
Notes receivable - other	8,878,018	
Premiums receivable	33,344,382	
Ceded unearned premium	22,190,095	
Reinsurance recoverable	27,929,794	
Funds on deposit	298,000	
Due from affiliate	985,320	
Income tax recoverable	160,333	
Deferred income taxes	7,383,191	
Deferred acquisition costs	3,039,144	
Property, plant and equipment	935,743	
Prepaid items	1,755,191	
Goodwill	1,553,863	
Other assets	1,992,923	
	-----	
	\$207,298,116	\$29
	=====	==
Total assets		
Liabilities and Shareholders' Equity		
-----		
Liabilities:		
Unpaid losses and loss adjustment expenses	50,508,627	
Unearned premiums	41,953,354	
Reinsurance on paid losses and loss adjustment expenses	928,865	
Ceded premiums payable	24,311,656	
Due to affiliate:		

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Ceded premiums payable	567,786
Reinsurance on paid losses and loss adjustment expenses	229,790
Escrow deposits	6,200,182
Accounts payable and accrued expenses	6,384,429
Funds held	4,861,472
Loan payable	11,435,221
Collateral held	1,544,839
Deferred Revenue	-
Unearned loan fees	568,750
	-----
	149,494,971
	-----
Total liabilities	
Shareholders' equity:	
Preferred stock, \$0.01 par value; authorized 5,000,000 shares; no shares issued and outstanding	-
Common stock, \$0.01 par value; authorized 15,000,000 shares; issued and outstanding at December 31, 2000, 6,281,386 shares, and at December 31, 2001, 6,287,266 shares	62,814
Additional paid-in capital	35,148,577
Retained earnings	29,262,582
Accumulated other comprehensive income, net	428,085
Treasury stock, 1,267,200 shares at December 31, 2000, and 1,589,239 shares at December 31, 2001	(7,098,913)
	-----
	57,803,145
	-----
Total shareholders' equity	
	\$207,298,116
	=====
Total liabilities and shareholders' equity	

See accompanying notes to consolidated financial statements.

-59-

**AMERICAN SAFETY INSURANCE GROUP, LTD. AND SUBSIDIARIES**

**Consolidated Statements of Earnings**

**Years ended December 31, 1999, 2000, and 2001**

	1999	
	----	
Revenues:		
Direct premiums earned	\$ 6,625,018	\$
Assumed premiums earned:		
Affiliate	3,449,178	
Nonaffiliates	8,065,737	
	-----	---
Total assumed premiums earned	11,514,915	
	-----	
Ceded premiums earned:		
Affiliate	3,972,686	
Nonaffiliates	2,042,216	
	-----	---

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Total ceded premiums earned	6,014,902	
	-----	
Net premiums earned	12,125,031	
	-----	
Net investment income	2,877,771	
Interest on notes receivable	2,614,572	
Brokerage commission income	1,389,242	
Management fees from affiliate	1,386,108	
Net realized gains (losses)	173,605	
Real estate income	-	
Other income	920,926	
	-----	
Total revenues	21,487,255	
	-----	
Expenses:		
Losses and loss adjustment expenses incurred	6,896,423	
Acquisition expenses	893,737	
Payroll and related expenses	5,032,382	
Real estate expenses		
Other expenses	2,661,723	
Expenses due to rescission	-	
	-----	
Total expenses	15,484,265	
	-----	
Earnings (loss) before income taxes	6,002,990	
Income taxes (benefit)	82,722	
	-----	
Net earnings (loss)	\$ 5,920,268	\$
	=====	
Net earnings (loss) per share:		
Basic	\$0.99	
	-----	
Diluted	\$0.98	
	-----	
Average number of shares outstanding:		
Basic	6,006,605	
	-----	
Diluted	6,032,364	
	-----	

See accompanying notes to consolidated financial statements.

-60-

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AMERICAN SAFETY INSURANCE GROUP, LTD. AND SUBSIDIARIES

Consolidated Statements of Shareholders' Equity

Years ended December 31, 1999, 2000 and 2001

1999	2000
----	----

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Common stock - number of shares:		
Balance at beginning of period	6,074,770	6,077,750
Issuance of common shares	2,980	203,636
	-----	-----
Balance at end of period	6,077,750	6,281,386
	=====	=====
Common stock:		
Balance at beginning of period	\$ 60,747	\$ 60,777
Issuance of common shares	30	2,037
	-----	-----
Balance at end of period	60,777	62,814
	-----	-----
Additional paid-in capital:		
Balance at beginning of period	33,809,141	33,810,387
Issuance of common shares	1,246	1,338,190
	-----	-----
Balance at end of period	33,810,387	35,148,577
	-----	-----
Retained earnings:		
Balance at beginning of period	24,705,471	30,625,739
Net earnings (loss)	5,920,268	(1,363,157)
	-----	-----
Balance at end of period	30,625,739	29,262,582
	-----	-----
Accumulated other comprehensive income:		
Balance at beginning of period	693,934	(1,288,804)
Unrealized gain (loss) during the period (net of deferred tax benefit (expense) of \$180,514, \$(240,095), and \$(152,279) respectively)		
	(1,982,738)	1,716,889
	-----	-----
Balance at end of period	(1,288,804)	428,085
	-----	-----
Treasury Stock:		
Balance at beginning of period	-	(2,169,339)
Shares purchased, 300,000 shares in 1999, 967,200 shares in 2000, and 322,039 shares in 2001	(2,169,339)	(4,929,574)
	-----	-----
Balance at end of period	(2,169,339)	(7,098,913)
	-----	-----
Total shareholders' equity	\$ 61,038,760	\$ 57,803,14

See accompanying notes to consolidated financial statements.

## AMERICAN SAFETY INSURANCE GROUP, LTD. AND SUBSIDIARIES

## Consolidated Statements of Cash Flow

Years ended December 31, 1999, 2000, and 2001

Cash flow from operating activities:	
Net earnings (loss)	\$ 5,920,268
Adjustments to reconcile net earnings to net cash provided by operating activities:	
Realized losses (gains) on sale of investments	(173,605)
Amortization of deferred acquisition costs, net	(334,906)
Accretion of loan discount	(510,636)
Change in:	
Accrued investment income	(1,321,926)
Premiums receivable	(6,400,977)
Commissions receivable	16,621
Reinsurance recoverable and ceded unearned premiums	(6,034,994)
Unearned loan fees	-
Due from affiliate	(1,420,674)
Prepaid items	(261,950)
Funds held	(357,509)
Funds deposited	353,407
Collateral held	1,208,976
Income taxes	(70,127)
Unpaid losses and loss adjustment expenses	5,712,763
Unearned premiums	5,264,831
Liability for deductible fees held	(529,053)
Ceded premiums payable	2,356,146
Due to affiliate	1,461,476
Accounts payable and accrued expenses	(794,531)
Deferred Revenue	-
Other, net	1,427,631
	-----
Net cash provided by operating activities	5,511,231
	-----
Cash flow from investing activities:	
Purchases of fixed maturities	(9,775,786)
Purchase of common stocks	(1,305,656)
Proceeds from maturity and redemption of fixed maturities	7,732,263
Proceeds from sales of fixed maturities	4,034,887
Proceeds from sales of common stock	4,467,664
Purchase of Trafalgar Insurance Company, net of cash of acquired company	-
Proceeds from notes receivable - related parties	-
Increase in short-term investments	(4,463,471)
Repayment (advance) in notes receivable - other	(3,967,511)
Advance on notes receivable - related parties	(1,420,000)
Increase in investment in real estate	(1,842,983)
Sales (purchases) of fixed assets, net	(1,112,553)
	-----
Net cash used in investing activities	(7,653,146)
	-----
Cash flow from financing activities:	
Proceeds from sale of common stock	1,276
Purchase of treasury stock	(2,169,339)
Proceeds of loan payable	-
Proceeds from escrow deposits	-
	-----
Net cash provided by (used in) financing activities	\$(2,168,063)

	-----
Net increase (decrease) in cash	(4,309,978)
Cash at beginning of period	4,737,132
	-----
Cash at end of period	\$ 427,154
	=====
Non Cash Items: Operating activities:	
Change in accrued interest income	980,120
Recoverable due to rescission in other assets	-
Change in prepaid items	-
Investing activities:	
Decrease in notes receivable-other	9,162,777
Purchase of real estate	(10,142,897)
Financing activities:	
Issuance of common stock	-
Notes receivable related parties	-
	-----
Net noncash adjustments	-
	=====
Supplemental disclosure of cash flow information:	
Income taxes paid (recovered)	\$ (217,427)
	=====
Interest paid	\$ -
	=====

See accompanying notes to consolidated financial statements.

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**AMERICAN SAFETY INSURANCE GROUP, LTD. AND SUBSIDIARIES**

**Consolidated Statements of Comprehensive Earnings**

**Years ended December 31, 1999, 2000 and 2001**

Net earnings (loss)	\$ 5,920,268
Other comprehensive earnings (loss) before income taxes:	
Unrealized gains (losses) on securities available for sale	(2,043,609)
Reclassification adjustment for realized gains (losses) included in net earnings	119,643
Total other comprehensive earnings (loss) before taxes	(2,163,252)
Income tax expense (benefit) related to items of comprehensive income	(180,514)
	-----
Other comprehensive earnings (loss) net of income taxes	(1,982,738)
	-----
Total comprehensive earnings	\$ 3,937,530

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**AMERICAN SAFETY INSURANCE GROUP, LTD. AND SUBSIDIARIES****Notes to Consolidated Financial Statements****December 31, 1999, 2000 and 2001****1. Summary of Significant Accounting Policies****a. Basis of Presentation**

The accompanying consolidated financial statements of American Safety Insurance Group, Ltd. ( American Safety ) and its subsidiaries (collectively, the Company ) are prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates, based on the best information available, in recording transactions resulting from business operations. The balance sheet amounts that involve a greater extent of accounting estimates and actuarial determinations subject to future changes are the Company's liabilities for unpaid losses and loss adjustment expenses. As additional information becomes available (or actual amounts are determinable), the recorded estimates may be revised and reflected in operating results. While management believes that the liability for unpaid losses and loss adjustment expenses is adequate to cover the ultimate liability, such estimates may be more or less than the amounts actually paid when claims are settled.

**b. Description of Common Stock - Voting and Ownership Rights**

The authorized share capital of the Company is 20 million shares, consisting of 15 million common shares, par value \$.01 per share ( Common Shares ), and 5 million preferred shares, par value \$.01 per share ( Preferred Shares ). The Common Shares are validly issued, fully paid, and non-assessable. There are no provisions of Bermuda law or the Company's Bye-Laws which impose any limitations on the rights of shareholders to hold or vote Common Shares by reason of such shareholders not being residents of Bermuda. Holders of Common Shares are entitled to receive dividends ratably when and as declared by the Board of Directors out of funds legally available therefor.

Each holder of Common Shares is entitled to one vote per share on all matters submitted to a vote of the Company's shareholders, subject to the 9.5% voting limitation described below. All matters, including the election of directors,

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voted upon at any duly held shareholders meeting shall be authorized by a majority of the votes cast at the meeting by shareholders represented in person or by proxy, except (i) approval of a merger, consolidation or amalgamation; (ii) the sale, lease, or exchange of all or substantially all of the assets of the Company; and (iii) amendment of certain provisions of the Bye-Laws, which each require the approval of at least 66-2/3% of the outstanding voting shares (in addition to any regulatory or court approvals). The Common Shares have noncumulative voting rights, which means that the holders of a majority of the Common Shares may elect all of the directors of the Company and, in such event, the holders of the remaining shares will not be able to elect any directors.

The Bye-Laws contain certain provisions that limit the voting rights that may be exercised by certain holders of Common Shares. The Bye-Laws provide that each holder of Common Shares is entitled to one vote per share on all matters submitted to a vote of the Company's shareholders,



except that if, and so long as, the Controlled Shares (as defined below) of any person constitute 9.5% or more of the issued and outstanding Common Shares, the voting rights with respect to the Controlled Shares owned by such person shall be limited, in the aggregate, to a voting power of 9.5%, other than the voting rights of Frederick C. Treadway or Treadway Associates, L.P., affiliates of a founding shareholder of the Company. Controlled Shares mean (i) all shares of the Company directly, indirectly, or constructively owned by any person and (ii) all shares of the Company directly, indirectly, or beneficially owned by such person within the meaning of Section 13(d) of the Exchange Act (including any shares owned by a group of persons, as so defined and including any shares that would otherwise be excluded by the provisions of Section 13(d)(6) of the Exchange Act). Under these provisions, if, and so long as, any person directly, indirectly, or constructively owns Controlled Shares having more than 9.5% of the total number of votes exercisable in respect of all shares of voting stock of the Company, the voting rights attributable to such shares will be limited, in the aggregate, to 9.5% of the total number of votes.

No holder of Common Shares of the Company shall, by reason only of such holder, have any preemptive right to subscribe to any additional issue of shares of any class or series nor to any security convertible into such shares.

-66-

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c. Principles of Consolidation

The consolidated financial statements include the accounts of American Safety Insurance Group, Ltd., a Bermuda company, American Safety Reinsurance, Ltd. (American Safety Re ) formed in January 1998 to serve as the successor for the reinsurance business of American Safety, as a 100%-owned licensed Bermuda insurance company, and American Safety Holdings Corp. (American Safety Holdings ), formed in July 1999 to serve as a 100%-owned insurance and financial services holding company. American Safety Holdings in turn wholly owns American Safety Casualty Insurance Company (American Safety Casualty ), a property and casualty insurance company, American Safety Insurance Services, Inc. (ASI Services ), an insurance management and brokerage company, Ponce Lighthouse Properties, Inc. (Ponce ), the development company of the Harbour Village project, and Rivermar Contracting Company (Rivermar ), the general contractor of the Harbour Village project. American Safety Casualty wholly owns American Safety Indemnity Company, a property and casualty excess and surplus lines insurance company. ASI Services wholly owns the following subsidiaries: Sureco Bond Services, Inc. (Sureco ), a bonding agency; Environmental Claims Services, Inc. (ECSI ), a claims consulting firm; American Safety Financial Corp., a financial services subsidiary; and American Safety Purchasing Group, Inc. , which acts as a purchasing group for the placement of business with American Safety Casualty. All significant intercompany balances have been eliminated in consolidation.

d. Business Environment

The following is a description of certain risks facing the Company and its subsidiaries:

*Legal/Regulatory Risk* is the risk that changes in the legal or regulatory environment in which an insurer operates will create additional expenses not anticipated by the insurer in pricing its products and beyond those recorded in the financial statements. That is, regulatory initiatives designed to reduce insurer profits or otherwise affecting the industry in which the insurer operates, new legal theories or insurance company insolvencies through guaranty fund assessments, may create costs for the insurer beyond those recorded in the financial statements. The Company attempts to mitigate this risk by actively writing insurance business in several states, thereby spreading this risk over a large geographic area.

-67-

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*Potential Risk of United States Taxation of Bermuda Operations.* Under current Bermuda law, American Safety is not required to pay any taxes in Bermuda on either income or capital gains. American Safety has received an undertaking from the Minister of Finance in Bermuda that will

exempt American Safety from taxation until the year 2016 in the event of any such taxes being imposed. Whether a foreign corporation is engaged in a United States trade or business or is carrying on an insurance business in the United States depends upon the level of activities conducted in the United States. If the activities of a foreign company are continuous, regular, and considerable, the foreign company will be deemed to be engaged in a United States trade or business. Due to the fact that American Safety will continue to maintain an office in Bermuda and American Safety and American Safety Re's sole business is reinsuring contracts via treaty reinsurance agreements, which are all signed outside of the United States, American Safety does not consider itself to be engaged in a trade or business in the United States and, accordingly, does not expect to be subject to United States income taxes. This position is consistent with the position taken by various other entities that have similar operational structures as American Safety.

However, because the Internal Revenue Code of 1986, as amended, the Treasury Regulations and court decisions do not definitively identify activities that constitute being engaged in a United States trade or business, and because of the factual nature of the determination, there can be no assurance that the Internal Revenue Service will not contend that American Safety or its Bermuda insurance subsidiary are engaged in a United States trade or business. In general, if American Safety or its Bermuda insurance subsidiary are considered to be engaged in a United States trade or business, it would be subject to (i) United States Federal income tax on its taxable income that is effectively connected with a United States trade or business at graduated rates and (ii) the 30 percent branch profits tax on its effectively connected earnings and profits deemed repatriated from the United States. Certain subsidiaries of American Safety are, however subject to U.S. Federal and state income tax, as they are domiciled and conduct business in the United States.

*Credit Risk* is the risk that issuers of securities owned by the insurer or secured notes receivable will default or that other parties, including reinsurers that have obligations to the insurer, will not pay or perform. The Company attempts to mitigate this risk by adhering to a conservative investment strategy, by obtaining sufficient collateral for secured note obligations and by maintaining sound reinsurance, credit and collection policies.

-68-

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*Interest Rate Risk* is the risk that interest rates will change and cause a decrease in the value of an insurer's investments. The Company attempts to mitigate this risk by attempting to match the maturities of its assets with the expected payouts of its liabilities.

#### e. Investments

Fixed maturity securities for which the Company has the positive intent and ability to hold to maturity are classified as held to maturity and are reported at amortized cost. Fixed maturity and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as trading and are reported at fair value, with unrealized gains and losses included in earnings. Fixed maturity and equity securities not classified as either held to maturity or trading are classified as available for sale and are reported at fair value, with unrealized gains and losses (net of deferred taxes) charged or credited as a component of accumulated other comprehensive income.

While it is the Company's intent to hold fixed maturity securities until the foreseeable future or until maturity, it may sell such securities in response to, among other things, market conditions, liquidity needs, or interest rate fluctuations. At December 31, 2000 and 2001, the Company considered all of its fixed maturity and equity securities as available for sale.

Investment income is recorded as earned on the accrual basis and includes amortization of premiums and accretion of discounts using the interest method. Realized gains or losses on disposal of investments are determined on a specific identification basis and are included in revenues. Investments in real estate are carried at the lower of cost or market plus capitalized development costs.

The Company owns no on-balance sheet or off-balance sheet derivative instruments.

f. Notes Receivable

Notes receivable represent indebtedness under various secured lending arrangements with related and unrelated parties. Interest income, loan fees, and deferred loan costs are recognized on an effective yield basis over the life of the loan. The allowance for possible loan losses has been determined based on those losses management considers probable at each reporting date. At December 31, 1999, 2000 and 2001, no allowance was deemed necessary by Company management.

-69-

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The Company ceases the accrual of interest on loans when any payment is past due. Additionally, the Company assesses loan impairment by comparing the carrying value of such loan, including accrued but unpaid interest at the valuation date to the fair market value of collateral held with respect to such loan. Any shortage of fair value over carrying value is first recognized by reversing interest income recognized for the year of impairment and then recognizing any further loss against the allowance for loan losses.

g. Recognition of Premium Income

General liability premiums are primarily assumed from American Safety Risk Retention Group, Inc. ( American Safety RRG ), a non-subsidiary affiliate. General liability premiums are estimated based upon the annual revenues of the underlying insureds. Additional or return premiums are recognized for differences between provisional premiums billed and estimated ultimate general liability premiums due. General liability, surety, commercial auto, other commercial lines and workers compensation premiums are recorded ratably over the policy period with unearned premium calculated on a pro rata basis over the lives of the underlying coverages.

h. Brokerage Commission Income

Brokerage commissions on business produced by Sureco are recognized as income when the related insurance policies are underwritten. Commissions on business produced by ASI Services are recognized as the related insurance premiums are written. For ASI Services produced business which remains in the consolidated group, any commissions recognized are eliminated in consolidation or otherwise recognized in revenue consistent with the recognition of premiums earned.

i. Management Fees from Affiliate

The program management agreement between American Safety RRG and ASI Services provided for payment of a monthly program management fee, a managing general agency commission and producing agent commissions. The level of program management fees are designed to reimburse the Company for the allocable share of expenses incurred in managing the American Safety RRG program. The fees are earned as expenses are incurred.

-70-

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j. Deferred Policy Acquisition Costs

The costs of acquiring business, primarily commissions and underwriting expenses, are deferred (to the extent they are recoverable from future premium income) and amortized to earnings in relation to the amount of premiums earned. If necessary, investment income is considered in the determination of the recoverability of deferred policy acquisition costs. Deferred revenue results when reinsurance ceding commissions received exceed the related deferred acquisition costs for

direct and assumed business.

An analysis of deferred policy acquisition costs (deferred revenue) follows:

	Years ended -----
	1999 ----
Balance, beginning of period	(60,205)
Acquisition costs deferred	1,499,496
Amortized during the period	(1,164,590)
Balance, end of period	\$ 274,701 =====

k. Unpaid Losses and Loss Adjustment Expenses

The Company provides a liability for unpaid losses and loss adjustment expenses based upon aggregate case estimates for reported claims and estimates for incurred but not reported losses. Because of the length of time required for the ultimate liability for losses and loss adjustment expenses to be determined for certain lines of business underwritten, the Company has limited experience upon which to base an estimate of the ultimate liability. For this business, management has established loss and loss adjustment expense reserves based on an independent actuarial valuation that it believes is reasonable and representative of anticipated ultimate experience. Beginning in 1996, the Company's actuarial consultant refined the estimation process for the determination of ultimate loss and loss adjustment expense to begin to recognize differences between the Company's reporting and settlement patterns and industry patterns as sufficient Company specific data (10 years of Company specific actuarial data) was then available. This method (Bornhuetter-Ferguson) entails developing an initial expected loss ratio based upon gross ultimate losses from prior accident years, estimating the portion of ultimate losses expected to be reported and unreported, and adding the actual reported losses to the expected unreported losses to derive the indicated ultimate losses. However, the net amounts that will ultimately be paid to settle the liability may be more or less than the estimated amounts provided.

-71-

l. Income Taxes

For subsidiaries subject to taxation, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

m. Reinsurance

Reinsurance contracts do not relieve the Company from its obligation to policyholders. Failure of reinsurers to honor their obligations could result in losses to the Company. The Company evaluates the financial condition of its reinsurers and monitors concentration of credit risk to minimize its exposure to significant losses from reinsurer insolvencies. Reinsurance recoverables on unpaid losses and prepaid reinsurance represent amounts recoverable from reinsurers for unpaid losses and unearned ceded reinsurance premiums, respectively.

n. Goodwill

On April 2, 1993, American Safety Casualty exchanged 8% of its common shares for 100% of the common stock of ASI Services, which shares were subsequently re-acquired by the Company. The goodwill created from this transaction is being amortized ratably over 20 years. In March 2000, American Safety Holdings Corp. purchased 100% of the common stock of Trafalgar Insurance Company and renamed it American Safety Indemnity Company. The goodwill created from this transaction is being amortized ratably over 20 years. Accumulated amortization was \$193,582 at December 31, 2000 and \$280,816 at December 31, 2001. See paragraph (1)(p) below for additional information.

o. Net Earnings Per Share

Basic earnings (loss) per share and diluted earnings (loss) per share are computed by dividing net earnings (loss) by the weighted average number of shares outstanding for the period (basic EPS) plus dilutive shares subject to stock options (diluted EPS).

Earnings (loss) per share are as follows:

-72-

	1999	2000
	----	----
Weighted average shares outstanding	6,006,605	5,496,106
Shares attributable to stock options	25,759	1,328
	-----	-----
Weighted average common and common equivalents	6,032,364	5,497,434
	=====	=====
Earnings (loss) per share:		
Basic	\$ 0.99	\$ (0.25)
Diluted	\$ 0.98	\$ (0.25)

p. Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS No. 133, as amended, is effective for years beginning after June 15, 2000. The standard requires that all derivatives be recorded as an asset or liability, at estimated fair value, regardless of the purpose or intent for holding the derivative. If a derivative is not utilized as a hedge, all gains or losses from the change in the derivative's estimated fair value are recognized in earnings. The gains or losses from the change in estimated fair value of certain derivatives utilized as hedges are recognized in earnings or other comprehensive income depending on the type of hedge relationship. The adoption of SFAS No. 133, as amended, did not have an impact on the Company's consolidated financial position and results of operations.

In September 2000, the FASB issued SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities, a replacement of FASB Statement No. 125. SFAS No. 140 revises the standards of accounting for securitization and other transfers of financial assets and collateral and requires certain disclosures not previously required under SFAS No. 125. This statement is effective for all transfers and servicing of financial assets and liabilities occurring after March 31, 2001. For recognition and reclassification of collateral and for disclosures relating to securitization transactions and collateral, it is effective for fiscal years ended after December 15, 2000. The adoption of SFAS No. 140 did not have a material impact on the Company's consolidated financial position and results of operation.

In July 2001, the FASB issued Statement No. 141, Business Combinations, and Statement No. 142, Goodwill and Other Intangible Assets. Statement 141 requires that the purchase method of accounting be

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used for all business combinations initiated after June 30, 2001, as well as all purchase method business combinations completed after June 30, 2001. Statement 141 also specifies criteria intangible assets acquired in a purchase method business combination must meet to be recognized and reported apart

-73-

from goodwill, noting that any purchase price allocable to an assembled workforce may not be accounted for separately. Statement 142 will require that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually in accordance with the provisions of Statement 142. Statement 142 will also require that intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of.

Statement 141 will require upon adoption of Statement 142, that the Company evaluate its existing intangible assets and goodwill that were acquired in a prior purchase business combination, and to make any necessary reclassifications in order to conform with the new criteria in Statement 141 for recognition apart from goodwill. Upon adoption of Statement 142, the Company will be required to reassess the useful lives and residual values of all intangible assets acquired in purchase business combinations, and make any necessary amortization period adjustments by the end of the first interim period after adoption. In addition, to the extent an intangible asset is identified as having an indefinite useful life, the Company will be required to test the intangible asset for impairment in accordance with the provisions of Statement 142 within the first interim period. Any impairment loss will be measured as of the date of adoption and recognized as the cumulative effect of a change in accounting principle in the first interim period.

As of the date of adoption, the Company expects to have unamortized goodwill in the amount of \$1.5 million, which will be subject to the transition provisions of Statement 141 and 142. Amortization expense related to goodwill was \$87,234 and \$69,869 for the year ended December 31, 2001 and the year ended December 31, 2000, respectively.

During 2001, the FASB also issued Statements No. 143 and 144 dealing with impairment and disposition of long-lived assets. The adoption of SFAS No. 143 and No. 144 is not expected to have a material impact on the Company's consolidated financial position and results of operations.

### q. Reclassifications

Certain items in the prior periods financial statements have been reclassified to conform with the 2001 presentation.

-74-

## 2. Investments

Net investment income is summarized as follows:

		Years ended D -----
	1999	2000
		----
Fixed maturities	\$ 2,449,362	\$2,18
Equity securities	1,507	4
Short-term investments and cash	422,173	46

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	-----	-----
	2,873,042	2,69
Less investment expenses	(4,729)	87
	-----	-----
Net investment income	\$ 2,877,771	\$2,60
	=====	=====

Realized and unrealized gains and losses were as follows:

	1999	2000
	-----	-----
Realized gains:		
Fixed maturities	\$ 16,608	
Equity securities	124,637	
Real estate	53,962	
	-----	-----
Total gains	195,207	
	-----	-----
Realized losses:		
Fixed maturities	(17,171)	
Equity securities	(4,431)	
Real Estate	-	
	-----	-----
Total losses	(21,602)	
	-----	-----
Net realized gains (losses)	\$ 173,605	\$ (
	=====	=====

-75-

At December 31, 2000 and 2001, the Company did not hold fixed-maturity securities which individually exceeded 10% of shareholders' equity, except U.S. government and government agency securities. The amortized cost and estimated fair values of investments at December 31, 2000 and 2001 are as follows: Gross Amortized cost Estimated cost gains losses fair value

December 31, 2000: Securities available for sale: Fixed maturities: U.S. Treasury securities and obligations of U.S. Government corporations and agencies \$ 30,952,452 \$ 615,498 \$ 112,524 \$ 31,455,426 Obligations of states and political subdivisions 6,083,661 190,974 - 6,274,635 Corporate securities 6,799,319 17,688 153,243 6,663,764 Mortgage-backed securities 1,562,888 31,997 3,054 1,591,831 -----

----- Total fixed maturities 45,398,320 856,157 268,821 45,985,656 Equity investments - common stocks 162,322 - 162,322 ----- Total \$ 45,560,642 \$ 856,157 \$ 268,821 \$ 46,147,978 =====

December 31, 2001: Securities available for sale: Fixed maturities: U.S. Treasury securities and obligations of U.S. Government corporations and agencies \$28,618,104 \$1,091,312 \$101,892 \$29,607,524 Obligations of states and political subdivisions Corporate securities 24,157,207 380,283 146,968 24,390,522 Mortgage-backed securities 7,914,282 3,956 80,183 7,838,055 ----- Total fixed maturities 60,689,593 1,475,551 329,043 61,836,101 -----

----- Total \$60,689,593 \$ 1,475,551 \$329,043 \$61,836,101 =====

-76-

The amortized cost and estimated fair values of fixed maturities at December 31, 2001, by contractual maturity are shown below. Expected maturities may differ from contractual maturities as certain borrowers may have the right to call or prepay obligations with or without call or prepayment penalty.

	Amortized cost -----
Due in one year or less	\$ 549
Due after one year through five years	22,933
Due after five years through ten years	21,758
Due after ten years	7,533
Mortgage-backed securities	7,914
	-----
Total	\$60,689 =====

Bonds with an amortized cost of \$12,648,910 and \$14,199,157 were on deposit with insurance regulatory authorities at December 31, 2000 and 2001 in accordance with statutory requirements.

### 3. Investment in Real Estate

The Company's investment in real estate is comprised of 173 acres of property in Ponce Inlet, Florida that was acquired in foreclosure during April 1999. At the date of foreclosure the Company evaluated the carrying value of its investment in real estate by comparing the fair value of the foreclosed collateral to the book value of the underlying loan and accrued interest. As the book value of the loan and accrued interest was less than the fair value of the collateral, no loss was recognized on foreclosure and the book balance of the loan and accrued interest became the basis of the real estate.

Throughout 1999, it was the Company's intent to sell the property known as Harbour Village Golf and Yacht Club ( Harbour Village ) and the Company negotiated with a potential purchaser who was interested in developing the property. During the negotiation period, the Company agreed to manage the property development on the potential purchaser's behalf.

On February 17, 2000 the Company was informed that the potential purchaser was unable to secure acceptable construction financing terms and requested an extension of time to seek other financing. The Company denied the potential purchaser's request and is developing the property for its own account.

-77-

During 1999, the Company recognized \$360,000 in property management fees for the management of the property during the due diligence period on behalf of the potential purchaser and applied \$140,000 in nonrefundable earnest monies against the carrying value of its investment in real estate.

As of December 31, 2000 and 2001, the investment in real estate for the Harbour Village project is broken down as follows (in thousands):

2000	2001
-----	-----



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Land	\$6,149	\$ 4,360
Capitalized overhead, interest and taxes	3,886	3,925
Work in process	8,961	28,328
	-----	-----
Total	\$18,996	\$36,613
	=====	=====

In October 2000, the Company refinanced several secured notes receivable into one secured note receivable and the Company took title to several parcels of land as partial payment of the notes receivable. The repayment value given to the borrower was \$4.27 million and the Company was paid a fee of \$650,000.

### 4. Notes Receivable

As of December 31, 2001, notes receivable consists of two notes which are secured by real and personal property and various corporate and personal guarantees. These notes bear interest rates at 12% and are payable on various dates. These notes are currently in default.

The recorded investment in notes receivable, which meet the definition of impaired loans at December 31, 2000 and 2001 were -0- and \$8,081,899, respectively. The Company did not maintain an allowance for loan losses, as it believes that the value of collateral held is sufficient to preclude any losses. The weighted average recorded investment in impaired notes receivable as of December 31, 2000 and 2001 were -0- and \$2,494,294, respectively. Interest income recognized on impaired notes receivable during the twelve months ended December 31, 2000 and 2001 were \$0 and \$0, respectively.

### 5. Financial Instruments

The carrying amounts for short-term investments, cash, premiums receivable, commissions receivable, accrued investment income, liability for deductible fees held, ceded premiums payable, funds held, collateral held and accounts payable and accrued expenses approximate their fair values due to the short-term nature of these instruments.

Estimated fair values for fixed maturities were provided by outside consultants using market quotations, prices provided by market makers or estimates of fair values obtained from yield data relating to investment securities with similar characteristics.

The estimated fair values for equity securities were determined by using market quotations on the principal public exchange markets for which such securities are traded.

Of the two notes receivable at December 31, 2000 and 2001, all have fair values which approximate market values, and have maturity dates in 2002.

### 6. Reinsurance

#### *General Liability*

The Company has excess of loss reinsurance treaties with Berkley Insurance Company, QBE Reinsurance Corporation, Partner Reinsurance Company US, Hartford Fire Insurance Company, Trenwick America Reinsurance Corporation, Alea London, Ltd., Terra Nova Insurance Company and Lloyds of London (the Reinsurers) for the Company's general liability lines of business. These treaties provide \$9.75 million excess \$250,000 to the Company.

#### *Workers' Compensation*

The Company assumes workers' compensation business from Legion Insurance Company ( Legion ). This business is produced by ASI Services, which bills and collects the premiums on behalf of Legion and remits net of its agent's commissions. Legion then deducts its expenses for the program as well as 10% of the premium to deposit in its loss fund. The balance of the premium is ceded to American Safety Casualty. Legion uses the 10% loss fund to pay claims, and when this fund is extinguished, Legion cedes the losses to American Safety Casualty. American Safety Casualty has a 50% quota share arrangement between itself and American Reinsurance, Ltd. Pursuant to the arrangement with Legion Insurance Company, the Company's exposure is limited to \$250,000 per occurrence and a 70% aggregate stop-loss ratio

percentage.

During 2000, American Safety Casualty began direct writing the workers' compensation business that had been previously written by Legion. The reinsurance structure described above is also utilized by American Safety Casualty except the 10% loss fund is not applicable to business directly written by American Safety Casualty. Effective January 2001, Legion terminated new and renewal writings under the program.

-79-

The Company has excess of loss treaties with Berkley Insurance Company, QBE Reinsurance Company U.S., Partners Reinsurance Company U.S., Hartford Fire Insurance Company, Trenwick America Reinsurance Corporation, Lloyd's of London, American Healthcare Indemnity Company, and Transatlantic Reinsurance Company for the Company's workers' compensation line of business. These treaties provide \$49.75 million excess \$250,000 to the Company.

#### *Surety*

The Company has an excess of loss reinsurance treaty with Berkley Insurance Company for the Company's surety line of business. The treaties provide per bond and per principal reinsurance of \$750,000 excess \$250,000. American Safety Casualty also has a 50% quota share arrangement between itself and American Safety Reinsurance, Ltd. Effective January 1, 2002, the Company has no reinsurance for its surety line of business and has substantially reduced writing contract surety business.

#### *Excess and Surplus*

Effective January 1, 2001, the Company entered into an excess of loss reinsurance treaty with Folksamerica Reinsurance Company, QBE Reinsurance Corporation, Partner Reinsurance Company and Trenwick America Reinsurance Corporation to reinsure the Company's excess and surplus risks. The treaty provides \$650,000 excess \$350,000 of coverage to the Company.

#### *Commercial Lines*

Effective January 1, 2000, the Company entered into various reinsurance treaties to limit its commercial lines exposure. A liability treaty with Signet Star Reinsurance Company provides \$900,000 excess of \$100,000. Three property treaties provide \$400,000 excess \$100,000 and \$500,000 excess \$500,000 and \$2 million excess \$1 million of coverage to the Company on a 100% basis. Two property catastrophe treaties provide \$500,000 excess \$500,000 and \$2.5 million excess \$1 million of coverage to the Company.

#### *Program Business*

The Company's program business division buys various forms of reinsurance on both a quota share basis as well as an excess of loss basis. These treaties cover the majority of risks written by the Company in this division. Where appropriate, collateral is obtained from the reinsurers to secure their obligations.

-79-

The approximate effect of reinsurance on the financial statement accounts listed below is as follows:

	1999	Years ended December 31, ----- 2000	2001
		(In thousands)	
Written premiums:			
Direct	\$10,820	\$64,227	\$131,2
Assumed	12,585	22,646	26,7
Ceded	(8,864)	(44,873)	(78,9

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	-----	-----	-----
Net	\$14,541	\$42,000	\$79,000
	=====	=====	=====
Earned premiums:			
Direct	\$ 6,625	\$35,602	\$119,100
Assumed	11,515	18,477	27,600
Ceded	(6,015)	(27,274)	(81,900)
	-----	-----	-----
Net	\$12,125	\$26,805	\$64,700
	=====	=====	=====
Losses and loss adjustment expenses incurred:			
Direct	\$ 4,800	\$ 29,291	\$111,700
Assumed	6,045	13,739	18,100
Ceded	(3,949)	(24,524)	(85,800)
	-----	-----	-----
Net	\$ 6,896	\$ 18,506	\$43,900
	=====	=====	=====
Unpaid loss and loss adjustment expenses:			
Direct	\$ 5,638	\$28,431	\$97,700
Assumed	14,775	22,077	23,600
Ceded	(6,065)	(27,930)	(77,500)
	-----	-----	-----
Net	\$14,348	\$22,578	\$ 43,800
	=====	=====	=====

-81-

During the fourth quarter of 2001, one of the Company's former reinsurers, Berkley Insurance Company, disputed its obligations under several reinsurance treaties entered into during the "soft reinsurance market" that existed in 1998 and 1999. As a result of adverse loss experience to the reinsurer from certain lines of business, Berkley has stopped reimbursing the Company for amounts due under such treaties and has requested that the Company retroactively consider taking a greater portion of the losses than is required under the treaties. As of December 31, 2001, unreimbursed paid claims under the treaties totaled \$6.5 million and additional ceded case reserves and reserves for incurred but not reported losses totaled approximately \$25.8 million. The Company is discussing resolution of this matter with Berkley, although the Company believes the reinsurer's request has no merit and was made in bad faith. If this dispute cannot be resolved, the Company will institute legal and arbitration proceedings against the reinsurer. Berkley is a subsidiary of W.R. Berkley Corp. (NYSE:BER).

## 7. Income Taxes

Total income tax expense (benefit) for the years ended December 31, 1999, 2000 and 2001 were allocated as follows:

	1999	2000
	----	----
Tax expense (benefit) attributable to:		
Income (loss) from continuing operations	\$ 82,722	\$ (1,156,000)
Unrealized gains (losses) on securities available for sale	(180,514)	240,000
	-----	-----
Total	\$ (97,792)	\$ (916,000)
	=====	=====

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U.S. Federal and state income tax expense (benefit) from continuing operations consists of the following components:

	Current	Deferred
December 31, 1999	\$ 272,484	\$ (189,771)
December 31, 2000	(106,588)	(1,050,111)
December 31, 2001	1,345,427	(184,111)

The state income tax (benefit) components aggregated \$93,627, \$(43,357) and \$55,698 for the years ended December 31, 1999, 2000, and 2001, respectively. Income tax expense for the years ended December 31, 1999, 2000, and 2001 differed from the amount computed by applying the U.S. Federal income tax rate of 34% to earnings before Federal income taxes as a result of the following:

-82-

	1999	2000
Expected income tax expense (benefit)	\$ 2,041,017	\$ (856,771)
Foreign earned income not subject to direct taxation	(2,028,352)	(169,111)
Tax-exempt interest	(77,895)	(151,771)
State taxes and other	147,952	20,888
	-----	-----
	\$ 82,722	\$ (1,156,771)
	=====	=====

Deferred income taxes are based upon temporary differences between the financial statement and tax bases of assets and liabilities. The following deferred taxes recorded:

	December 31, 2000
	-----
	2000
	-----
Deferred tax assets:	
Loss reserve discounting	\$1,075,061
Unearned premium reserves	1,209,162
Net operating loss carry forward	398,597
Difference between tax and GAAP basis of Harbour Village project	5,839,919
	-----
Gross deferred tax assets	8,522,739
	-----
Deferred tax liabilities:	
Deferred acquisition costs	978,785
Unrealized gain on securities	159,251
Other	1,512
	-----
Gross deferred tax liabilities	1,139,548
	-----
Net deferred tax asset	\$7,383,191

A valuation allowance has not been established as the Company believes it is more likely than not that the deferred tax asset will be realized.

## 8. Insurance Accounting

The consolidated financial statements have been prepared in conformity with generally accepted accounting principles which vary in certain respects, for the Company, American Safety Casualty and American Safety Indemnity, from statutory accounting practices prescribed or permitted by regulatory authorities. Statutory accounting practices includes state laws, regulations, and general administrative rules, as well as a variety of publications of the National Association of Insurance Commissioners (the NAIC ). In its March 1998 meeting, the NAIC membership adopted the Codification of Statutory Accounting Principles Project (the Codification ) as the NAIC-supported basis of accounting. The Codification was

-83-

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approved with a provision allowing for commissioner discretion in determining appropriate statutory accounting for insurers. Accordingly, such discretion will continue to allow prescribed or permitted accounting practices that may differ from state to state.

The implementation date of Codification for the Company is January 1, 2001. The Company evaluated the impact of adopting Codification on statutory capital and surplus at January 1, 2001 and determined that statutory capital and surplus increased by \$803,935 due to the recognition of a deferred tax asset for statutory reporting.

The Bermuda Insurance Act of 1978 and related regulations (the Act ) requires the Company to meet a minimum solvency margin. Statutory capital and surplus as of December 31, 1999, 2000 and 2001 were \$61,038,760, \$57,709,998 and \$60,066,839, respectively, and the amounts required to be maintained by the Company were \$2,355,558, \$3,179,716 and \$3,610,139, respectively. In addition, a minimum liquidity ratio must be maintained whereby relevant assets, as defined by the Act, must exceed 75% of relevant liabilities. Once these requirements have been met, there is no restriction on the retained earnings available for distribution.

As reported in American Safety Casualty's 2001 annual statement, the statutory capital and surplus of American Safety Casualty approximated \$24,600,583. The maximum amount of dividends which can be paid, without prior written approval of the Commissioner of Insurance of the State of Delaware, is limited to the greater of 10% of surplus as regards policyholders or net income, excluding realized capital gains, of the preceding year. Accordingly, American Safety Casualty can pay dividends in 2002 of approximately \$2,460,058.

The National Association of Insurance Commissioners (the NAIC ) has established risk-based capital ( RBC ) requirements to help state regulators monitor the financial strength and stability of property and casualty insurers by identifying those companies that may be inadequately capitalized. Under the NAIC's requirements, each insurer must maintain its total capital above a calculated threshold or take corrective measures to achieve the threshold. The threshold of adequate capital is based on a formula that takes into account the amount of risk each company faces on its products and investments. The RBC formula takes into consideration four major areas of risk: (i) asset risk which primarily focuses on the quality of investments; (ii) insurance risk which encompasses coverage-related issues and anticipated frequency and severity of losses when pricing and designing insurance coverages; (iii) interest rate risk which involves asset/liability matching issues; and (iv) other business risks.

American Safety Casualty and American Safety Indemnity have calculated their RBC level and have determined that their capital and surplus is in excess of threshold requirements.

-83-

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## 9. Loans Payable

Acquisition and Development Loan

In July 2000, the Company, through its subsidiary, Ponce Lighthouse Properties, Inc., initially closed a \$37,900,000 acquisition, development and construction loan facility with a commercial bank for the Harbour Village Golf and Yacht Club project. As of December 31, 2000, the Company had outstanding borrowings of \$11,021,976. The loan facility was increased in July 21, 2001 and through December 31, 2001, the Company had outstanding borrowings of \$15,290,265. Interest only is due monthly until July 19, 2002, at which time all outstanding principal and interest is due. Partial repayments are required as residential condominium units and boat slips are sold. The loan bears interest at a variable rate equal to 30 day LIBOR plus 2.25%, adjusted monthly. The loan is secured by a first mortgage on the real estate and a first priority security interest in all contracts for the sale of condominium units and boat slips, as well as all personal property used in the project. Both the Company and American Safety Holdings Corp., a subsidiary, have provided partial loan guarantees. The Company has also provided a \$1,928,932 letter of credit as additional security.

Finance of Insurance Premiums

The Company through its subsidiary, Ponce Lighthouse Properties, Inc., financed various insurance premiums in connection with the Harbour Village project. The premium financing loan is unsecured and bear interest at a rate of 8.5%. The outstanding balance at December 31, 2001 was \$43,433. The outstanding principal of \$43,433 is due in 2002.

-85-

Maturities of Loans Payable

Loans payable mature as follows: \$15,333,698 in 2002.

Interest Cost

The Company capitalizes interest as a component of cost during the development and construction period. In 2001, the Company incurred \$1,232,860 in interest cost, all of which was capitalized.

10. Related Party and Affiliate Transactions

The Company has entered into reinsurance agreements with two companies, Intersure Reinsurance Company ( Intersure Re ) and Omega Reinsurance Company ( Omega Re ), each of which is owned and controlled, respectively, by a senior officer of the Company, in order to provide limits of coverage on terms not readily available in the commercial reinsurance market. Reinsurance premiums ceded and earned aggregated \$206,000, \$308,875 and \$587,071 for the years ended December 31, 1999, 2000 and 2001, respectively. Intersure Re has exercised a previously granted option to purchase common shares of American Safety at an option price approximating fair value at the date of the grants. See Note (14).

ASI Services, American Safety's underwriting and administrative services subsidiary, leases office space from an entity which is owned by certain directors and shareholders of the Company. The lease commenced on March 1, 2001 and expires on February 28, 2006. The Company pays base annual rent of \$343,255 plus an annual increase based on the consumer price index of at least 4%.

The following tables reconcile the income statement effects to the Company from American Safety RRG:

Years 1  
-----  
1999  
-----

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Assumed premiums from American Safety RRG	\$ 3,449
Ceded premiums to American Safety RRG	3,973 -----
Net premiums earned	(524)
Management fee	1,386
Loss control fees	75
Brokerage commission income	1,080 -----
	\$ 2,017 =====
Total revenues	
Loss and Loss adjustment expense incurred	\$ 181 =====

-86-

For the years ended December 31, 1999, 2000 and 2001, ASI Services and ECSI received fees from American Safety RRG for risk management, claims administration and other management services. ASI Services also recognized brokerage commission income from American Safety RRG.

The following table shows the balance sheet effects to the Company from American Safety RRG:

	December 31, -----	December -----
Assets -----	1999 -----	2000 -----
Due from affiliate	\$ 2,088,748	\$985
Liabilities -----		
Unpaid loss and Loss adjustment expenses	6,541,918	5,902
Unearned premiums	2,114,813	1,508
Ceded premiums payable	1,636,207	567
Reinsurance payable on paid loss and Loss adjustment expenses	79,198	229

### 11. Segment Information

*Factors used to identify the Company's reportable segments:*

The Company's United States and Bermuda operating segments were identified by management as separate operating segments based upon the regulatory environments of each of these countries. Significant differences exist under United States and Bermuda law concerning the regulation of insurance entities, including differences in: types of permissible investments, minimum capital requirements, solvency monitoring, pricing, corporate taxation, etc.

*Products and services from each reportable segment:*

The Company is a specialty insurance holding company which, through its United States and Bermuda operating segments, develops, underwrites, manages and markets primary casualty insurance and reinsurance programs in the alternative insurance market for environmental remediation risks, employee leasing and staffing industry risks, and other specialty risks. The Company has demonstrated expertise in developing specialty insurance coverages and custom designed risk management programs not generally available in the standard insurance market.

The Company is the owner/developer of the Harbour Village project in Ponce Inlet, Florida, as discussed in Note 3, and this item is reflected in the segment United States-Real Estate.

The United States operating segment's specialty insurance programs include insurance and reinsurance for general, pollution and professional liability, workers' compensation, surety, as well as custom designed risk management programs for contractors, consultants and other business and property owners who are involved with environmental remediation, general construction and other specialty risks.

Through its United States brokerage and management services subsidiaries, the Company also provides specialized insurance program development, underwriting, risk and reinsurance placement, program management, brokerage, loss control, claims administration and marketing services. The Company also insures and places risks through two United States insurance subsidiaries, as well as its non-subsidiary risk retention group affiliate and other unaffiliated insurance companies.

Through its Bermuda operating segment, the Company places and reinsures a portion of the risks underwritten directly by its United States segment, its risk retention group affiliate and other insurers.

*Information about segment profit or loss and assets*

	1999
	----
United States - Insurance	
Net premiums earned - All other	\$ 9,626
Net premiums earned - Intersegment	(4,082)
Net investment income and interest on notes receivable	807
Other income	4,061
Total revenues	10,412
Interest expense	-
Depreciation and amortization expense	126
Equity in net earnings of subsidiaries	437
Income taxes	83

## 12. Commitments and Contingencies

At December 31, 2000 and 2001, the Company had aggregate outstanding irrevocable letters of credit which had not been drawn amounting to \$1,000,000 in favor of the Vermont Department of Banking, Insurance, Securities and Health Care Administration. Investments in the amount of \$1,000,000 have been pledged as collateral to the issuing bank.

## 13. Liability for Unpaid Loss and Loss Adjustment Expenses

Activity in the liability for unpaid claims and claim adjustment expenses is summarized as follows:

	Years e
	-----
	1999
	----



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Unpaid loss and loss adjustment expenses, January 1	\$14,701
Reinsurance recoverable on unpaid losses and loss adjustment expenses at end of period	1,841
	-----
Net unpaid loss and loss adjustment expenses, January 1	12,860
	-----
Incurred related to:	
Current year	7,449
Prior years	(553)
	-----
Total incurred	6,896
	-----
Paid related to:	
Current year	1,707
Prior years	3,701
	-----
Total paid	5,408
	-----
Net unpaid losses and loss adjustment expenses at end of period	14,348
Reinsurance recoverable on unpaid losses and loss adjustment expenses at end of period	6,065
	-----
Unpaid loss and loss adjustment end expenses at of period	\$20,413
	=====

The negative development in 2000 and 2001 is attributable to the Company's commercial lines and surety lines of business. Management continually attempts to improve its loss estimation process by refining its ability to analyze loss development patterns, claims payments and other information, but many reasons remain for potential adverse development of estimated ultimate liabilities. For example, the uncertainties inherent in the loss estimation process have become increasingly subject to changes in legal trends. In recent years, this trend has expanded the liability of insureds, established new liabilities and reinterpreted contracts to provide unanticipated coverage long after the related policies were written. Such changes from past experience significantly affect the ability of insurers to estimate liabilities for unpaid losses and related expenses.

Management recognizes the higher variability associated with certain exposures and books of business and considers this factor when establishing liabilities for losses.

Management currently believes the Company's gross and net liabilities are adequate.

The net liabilities for losses and loss adjustment expenses maintained by the Company's insurance subsidiaries are equal under both statutory and generally accepted accounting principles.

-91-

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### 14. Stock Options

The following table shows the stock option activity for the Company during 1999, 2000 and 2001.

Weighted

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	Option shares -----	average exercise price -----
Outstanding at December 31, 1998	451,181 =====	\$ 9.8 =====
1999 activity:		
Granted	106,500	9.5
Canceled	(15,250) -----	-----
Outstanding at December 31, 1999	542,431 =====	\$ 9.7 =====
2000 activity:		
Granted	99,650	6.0
Canceled	(17,891) -----	-----
Outstanding at December 31, 2000	624,190 =====	\$ 9.2 =====
2001 activity:		
Granted	328,724	6.0
Canceled	(15,341) -----	-----
Outstanding at December 31, 2001	937,573 =====	\$ 8.1 =====

Of the 937,573 outstanding options at December 31, 2001, 834,718 were exercisable. Of the 624,190 outstanding options at December 31, 2000, 361,140 were exercisable. Of the 542,431 outstanding options at December 31, 1999, 232,348 were exercisable.

The remainder of the options vest evenly over a three year period.

The following table summarizes information about stock options outstanding at December 31, 2001:

Range of exercise prices -----	Number outstanding -----	Options ----- outstanding ----- Weighted average remaining contractual life -----	Weighted average exercise price -----	Options exer ----- Grant Year -----
\$ 5.96	51,090	0.18	\$ 5.96	1997
7.08	65,500	5.75	7.08	1997
11.00	320,000	6.13	11.00	1998
9.50	93,400	7.13	9.50	1999
6.00	107,583	8.17	6.00	2000
6.00	300,000 -----	9.04	6.00	2001
\$5.96-11.00 =====	937,573 =====	7.04 =====	\$ 8.13 =====	

Had compensation cost for the Company's stock options granted in 1999, 2000 and 2001 been determined using the fair-value-based method as described in SFAS No. 123, the Company's net earnings (loss) and earnings (loss) per share would approximate the pro forma amounts indicated below:

	1999	2000
	-----	-----
	(In thousands)	
	per share	
Net earnings (loss):		
As reported	\$ 5,920	\$ 5,920
Effect of stock options	736	736
	-----	-----
Pro forma net earnings (loss)	\$ 5,184	\$ 5,184
	=====	=====
Net earnings (loss) per share:		
As reported	\$ .98	\$ .98
Effect of stock options	.12	.12
	-----	-----
Pro forma net earnings (loss) per share	\$ .86	\$ .86
	=====	=====

The fair value of each option granted during 1999, 2000 and 2001 was estimated on the date of grant using the Black-Scholes multiple option approach with the following assumptions: dividend yield of 0.0%; expected volatility of 37.87%, 51.08% and 44.33% in 1999, 2000 and 2001, respectively; risk-free interest rate of 5.40%; and expected life from the vesting dates ranging from 0.50 years to 10.00 years.

The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future amounts. The Company expects to grant additional awards in future years. The Company granted options in 1999, 2000 and 2001 at an amount deemed to be fair market value at the date of grant.

## 15. Acquisitions

On March 24, 2000, the Company purchased Trafalgar Insurance Company, an Oklahoma licensed insurance company, which has authority to operate as an excess and surplus lines insurance company in 34 states and the District of Columbia. Trafalgar Insurance Company's stock was acquired from Houston Casualty Company for a purchase price of \$16.3 million cash, and Trafalgar had, at closing, cash of \$9.3 million and investments of \$5.7 million creating \$1.3 million of goodwill. The net cash outlay for this acquisition was \$7.0 million. Prior to closing, Trafalgar entered into a bulk assumption reinsurance agreement with Houston Casualty, under which Houston Casualty assumed all of Trafalgar's prior and existing insurance business. Trafalgar has been renamed American Safety Indemnity Company.

On January 6, 2000, the Company acquired (i) the stock of L&W Holdings, Inc. and its wholly-owned subsidiary, RCA Syndicate #1, Ltd., an Illinois licensed insurance carrier operating on the INEX (formerly the Illinois Insurance Exchange), (ii) the stock of Principal Management, Inc., an insurance program development and management company headquartered in Okemos, Michigan, and in a related transaction, the Company also acquired (iii) the stock of Pegasus Insurance, a Cayman Islands licensed insurance carrier. The transactions were structured as stock acquisitions, with the purchase price paid by the Company consisting of \$3,500,000 plus 200,000 American Safety common shares and earnout provisions for up to an additional 254,000 American Safety common shares over a five-year period. Of the purchase price, \$1,000,000 of cash and 109,086 shares of stock are held in escrow to secure the obligations of the sellers. The

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Company also obtained a security interest in a real estate condominium in the Cayman Islands with an estimated value of \$600,000 to secure the obligations of the sellers. On April 21, 2000, the Company filed a lawsuit to rescind these acquisitions based upon the sellers' misrepresentations as to the business affairs and financial condition of the acquired companies, and recognized an expense, net of recoverables, of \$3.5 million in 2000 and \$600,000 in 2001 for such rescission. The sellers' misrepresentations as to the business affairs and financial condition of the acquired companies, and the under-reserving for claims, relate only to the operations of the acquired companies. The lawsuit is in the final stages of pre-trial discovery.

### 16. Litigation

The Company is a defendant in various litigation matters considered to be in the normal course of or related to its business. While the outcome of these matters cannot be estimated with certainty, it is the opinion of management (after consultation with legal counsel) that the resolution of such litigation will not have a material adverse effect on the Company's financial statements.

-94-

#### Exhibit 21.1

The Company's subsidiaries are:

American Safety Reinsurance, Ltd. a Bermuda company  
 American Safety Holdings Corp., a Georgia corporation  
 American Safety Casualty Insurance Company, a Delaware corporation  
 American Safety Indemnity Company, an Oklahoma corporation  
 American Safety Insurance Services, Inc., a Georgia corporation  
 American Safety Financial Corp., a Georgia corporation  
 American Safety Purchasing Group, Inc., a Georgia corporation  
 American Safety ReSources, Inc., a Georgia corporation  
 Environmental Claims Services, Inc., a Georgia corporation  
 Sureco Bond Services, Inc., a Georgia corporation  
 Ponce Lighthouse Properties, Inc., a Florida corporation  
 Harbour Village Realty Corporation, a Florida corporation  
 Rivermar Contracting Company, a Florida corporation

-95-

### AMERICAN SAFETY INSURANCE GROUP, LTD. QUARTERLY INFORMATION

(UNAUDITED)

The following table presents the quarterly results of consolidated operations for 2000 and 2001 (dollars in thousands, except per share amounts):

2000	Mar. 31 -----	June 30 -----
Operating revenues	\$6,723	\$7,776
Income (loss) before taxes	(3,019)	(783)
Net earnings (loss)	(1,949)	(492)
Comprehensive income (loss)	(1,572)	(458)
Net earnings (loss) per share		
Basic	\$ (0.33)	\$ (0.09)
Diluted	(0.33)	(0.09)
Common stock price ranges		
High	\$ 7.38	\$ 5.94
Low	5.50	3.75

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2001	Mar. 31 -----	June 30 -----
Operating revenues	\$16,017	\$19,291
Income (loss) before taxes	1,301	1,806
Net earnings (loss)	1,262	1,585
Comprehensive income (loss)	1,744	988
Net earnings (loss) per share		
Basic	\$ 0.26	\$ 0.33
Diluted	0.25	0.32
Common stock price ranges		
High	\$ 9.10	\$10.25
Low	5.75	7.95

-96-

**AMERICAN SAFETY INSURANCE GROUP, LTD.**

**SCHEDULE II - CONDENSED BALANCE SHEETS**

**DECEMBER 31, 2000 and 2001**

Assets	2000 ----
Investment in subsidiary	\$47,821,1
Other investments:	
Fixed maturities	4,033,0
Cash	152,6
Short Term Investments	
Secured note receivable	4,494,9
Accrued investment income	317,7
	-----
Total investments and cash	56,819,5
Premiums receivable	1,445,8
Due from affiliate	1,871,3
Ceded loss reserves	793,6
Other assets	1,107,3
	-----
Total Assets	\$62,037,6 =====
Liability and Shareholders' Equity	
Unpaid losses and loss adjustments expenses	\$4,188,1
Ceded premiums payable	108,4
Assumed loss and LAE payable	(121,3)
Due to related party:	47,1
Accounts payable and Accrued expenses	12,0
	-----
Total Liabilities	4,234,4 -----
Common stock	62,8
Additional paid in capital	35,148,5
Accumulated other comprehensive earnings (loss), net	428,0
Retained earnings	29,262,5
Treasury stock	(7,098,9)
	-----
Total Shareholders' Equity	57,803,1 -----
Total Liabilities &	

Shareholders' Equity

\$62,037,6  
=====

See accompanying independent auditors' report.

-97-

**AMERICAN SAFETY INSURANCE GROUP, LTD.****SCHEDULE II - CONDENSED INCOME STATEMENT****YEARS ENDED DECEMBER 31, 1999, 2000 and 2001**

	1999 ----
Revenues:	
Direct and Assumed Premiums Earned	\$ 563,543
Ceded Premiums Earned	(23,487)
	-----
Net Premiums Earned	540,056
Investment Income	1,989,252
Interest on Notes Receivable	1,170,484
Realized Gains (losses) on Sale of Investments	134,316
Other Income	142,495
	-----
Total Revenues	3,976,603 -----
Expenses:	
Losses and LAE Incurred	141,869
Acquisition Expenses	37,959
Other Underwriting Expenses	589,888
Expenses Due to Recission	-
	-----
Total Expenses	769,716 -----
Earnings Before Equity In	
Earnings of Subsidiary	3,206,887
Equity in Net Earnings of Subsidiary	2,713,381
	-----
Net Earnings	\$ 5,920,268 =====

See accompanying independent auditors' report.

-98-

**AMERICAN SAFETY INSURANCE GROUP, LTD.****SCHEDULE II - CONDENSED STATEMENT OF CASH FLOW****YEARS ENDED DECEMBER 31, 1999, 2000 and 2001**

	1999 ----
Cash flow from operating activities:	
Net earnings (loss) before equity in earnings of subsidiary	\$ 3,206,887

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Adjustments to reconcile net earnings (loss) to net cash provided (used) by operating activities:

Change in:	
	(854,318)
Accrued investment income	(1,291,491)
Premiums receivable/payable	(1,145,360)
Due from/to affiliate	(1,406,369)
Unpaid losses and loss adjustment expenses	(529,053)
Liability for deductible fees held	(78,800)
Accounts payable and accrued expenses	793,296
Loss and LAE payable	(174,430)
	-----
Other, net	(1,479,638)
	-----
Net cash provided (used) by operating activities	
Cash flow from investing activities:	
Decrease (increase) in investments	3,179,743
Investment in subsidiary	(500)
Sales (purchases) of fixed assets, net	(841,701)
	-----
Net cash provided (used) by investing activities	2,337,542
	-----
Cash flow from financing activities:	
Proceeds from sale of common stock	1,276
Purchase of Treasury Stock	(2,169,339)
	-----
Net cash provided (used) by financing activities	(2,168,063)
	-----
Net decrease in cash	(1,310,159)
Cash at beginning of year	1,820,578
	-----
Cash at end of year	\$ 510,419
	=====

See accompanying independent auditors' report.

-99-

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AMERICAN SAFETY INSURANCE GROUP, LTD. SCHEDULE II - CONDENSED COMPREHENSIVE INCOME

YEARS ENDED DECEMBER 31, 1999, 2000 and 2001

	1999
	----
Net earnings (loss)	\$ 5,920,268
Other comprehensive earnings (loss) before income taxes:	(2,043,609)
Unrealized gains (losses) on securities available for sale	

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Reclassification adjustment for realized gains (losses) included in net earnings	119,643
	-----
Total other comprehensive earnings (loss) before taxes	(2,163,252)
Income tax expense (benefit) related to items of comprehensive income	(180,514)
	-----
Other comprehensive earnings (loss) net of income taxes	(1,982,738)
	-----
Total comprehensive earnings	\$ 3,937,530
	=====

See accompanying independent auditors' report.

-100-

**AMERICAN SAFETY INSURANCE GROUP, LTD. AND SUBSIDIARIES**

**SCHEDULE III - SUPPLEMENTAL INFORMATION CONCERNING**

**PROPERTY-CASUALTY**

**INSURANCE OPERATIONS**

(in thousands)

	Column B	Column C Reserves for Unpaid Claims and Claim Adjust- ment Expenses	Column D Discount, if any, Deducted in Column C	Column E Unearned Premiums
-----	-----	-----	-----	-----
United States				
December 31, 1999	212	11,855	-	7,318
December 31, 2000	2,974	38,651	-	38,103
December 31, 2001	5,459	107,793	-	52,903
	-----	-----	-----	-----
Bermuda				
December 31, 1999	62	8,558	-	2,178
December 31, 2000	65	11,858	-	3,850
December 31, 2001	323	13,630	-	303
	-----	-----	-----	-----
Combined Total				
December 31, 1999	274	20,413	-	9,159
December 31, 2000	3,039	50,509	-	41,953
December 31, 2001	5,782	121,423	-	53,206
	-----	-----	-----	-----

See accompanying independent auditors' report.



## AMERICAN SAFETY INSURANCE GROUP, LTD. AND SUBSIDIARIES

## SCHEDULE IV - REINSURANCE

## Year Ended

December 31, 1999, 2000 and 2001

Property-Liability Insurance Premiums Earned	Gross Amount	Ceded to Other Companies	Assumed from Other Companies
-----			
United States			
December 31, 1999	6,625	5,934	8,935
December 31, 2000	35,602	26,971	15,783
December 31, 2001	119,121	81,391	25,205
-----			
Bermuda			
December 31, 1999	-	81	2,580
December 31, 2000	-	303	2,694
December 31, 2001	-	587	2,439
-----			
Combined Total			
December 31, 1999	6,625	6,015	11,515
December 31, 2000	35,602	27,274	18,477
December 31, 2001	119,121	81,978	27,644
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See accompanying independent auditors' report.

## EXHIBIT 99

	Phase 1									
	Buildings								Townhou	
12/31/01	100	200	300	400	500	600	700	800	Hammock	R
Planned Number of Condo Units and Boat Slips	32	32	32	32	24	32	32	32	18	2
Condo Units and Boat Slips under Contract	32	32	32	32	23	30	31	31	14	2
Value of Pre-sale Contracts (Note 1)	7,643	7,312	7,607	7,963	6,321	8,146	8,649	7,798	6,384	9,7
Building Foundation	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No

(in thousands)

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Completed Vertical Building	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No
Completed Interior Finish	Yes	Yes	Yes	Yes	No	No	No	No	No	No	No
Completed Certificate of Occupancy Received	Yes	Yes	Yes	Yes	No	No	No	No	No	No	No
Actual 12/31/2001 YTD											
-----											
Units Closed	32	32	30	8	-	-	-	-	-	-	-
Revenue Recognized on Units and Docks	7,528	7,082	6,933	1,921	-	-	-	-	-	-	-
Other Revenue											
Total Revenue											
Gross Profit Recognized	897	596	615	255	-	-	-	-	-	-	-
Other Expense (Income) Items											
Pre-Tax Profit											
Actual 12/31/2001 QTD											
-----											
Units Closed	20	32	30	8	-	-	-	-	-	-	-
Revenue Recognized	4,861	7,082	6,933	1,921	-	-	-	-	-	-	-
Other Revenue											
Total Revenue											
Gross Profit Recognized	625	596	615	255	-	-	-	-	-	-	-
Other Expense (Income) Items											
Pre-Tax Profit											
Projected First Quarter 2002											
-----											
Projected Unit Closings	-	-	2	24	4	-	-	-	30	-	-
Projected Revenue Recognized	65	68	432	5,872	1,250	-	-	-	7,209	-	-
Projected Other Revenue											
Total Projected Revenue											
Projected Gross Profit	1	2	35	769	138	-	-	-	901	-	-
Projected Other Expense (Income) - Net											
Projected Pre-Tax Profit											

Note 1 - No assurance can be given that purchasers under binding pre-sale contracts with deposit transaction .

Note 2 - Other includes net brokerage commissions, advertising, promotion, and other general expenses. These items are not allocated to specific buildings.

The projected results contained above for unit closings, revenue, gross profit, fixed costs

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looking statements. With respect to the Company's development of the Harbour Village property involve risks and uncertainties which may cause actual results to differ materially, and are real estate development industry factors, including competitive housing conditions in the local real estate development and new construction, increases in construction costs, construction litigation, changes in interest rates and the availability of mortgage financing for prospective units and boat slips, and changes in local and national levels of general business activity and

Our independent auditors (accountants) have not examined, compiled or otherwise applied procedures herein and, accordingly, do not express an opinion or any other form of assurance on it.