SAFETY INSURANCE GROUP INC
Form 10-Q
November 06, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2015

OR

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

For the transition period from ______to ______

Commission File Number: 000-50070

SAFETY INSURANCE GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	13-4181699
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

20 Custom House Street, Boston, Massachusetts 02110

(Address of principal executive offices including zip code)

(617) 951-0600

(Registrant's telephone number, including area code)

Not Applicable

(Former name or former address, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

Yes No

As of November 4, 2015 there were 15,093,073 shares of common stock with a par value of $0.01 per share outstanding.

Table of Contents

SAFETY INSURANCE GROUP, INC.

TABLE OF CONTENTS

Table of Contents

Safety Insurance Group, Inc. and Subsidiaries

Consolidated Balance Sheets

(Dollars in thousands, except share data)

	September 30, 2015 (Unaudited)	December 31, 2014
Assets		
Investments:		
Securities available for sale:		
Fixed maturities, at fair value (amortized cost: $1,046,663 and $1,102,517)	$ 1,071,167	$ 1,135,451
Equity securities, at fair value (cost: $100,704 and $97,910)	103,672	109,153
Other invested assets	15,319	11,657
Total investments	1,190,158	1,256,261
Cash and cash equivalents	43,243	42,455
Accounts receivable, net of allowance for doubtful accounts	193,768	175,532
Receivable for securities sold	795	—
Accrued investment income	9,394	10,295
Taxes recoverable	23,929	—
Receivable from reinsurers related to paid loss and loss adjustment expenses	42,092	6,267
Receivable from reinsurers related to unpaid loss and loss adjustment expenses	74,078	61,245
Ceded unearned premiums	22,214	19,638
Deferred policy acquisition costs	72,976	67,329
Deferred income taxes	4,298	—
Equity and deposits in pools	28,993	23,159
Other assets	13,717	13,538
Total assets	$ 1,719,655	$ 1,675,719
Liabilities		
Loss and loss adjustment expense reserves	$ 553,329	$ 482,012
Unearned premium reserves	425,009	390,361
Accounts payable and accrued liabilities	43,073	65,863
Payable for securities purchased	4,296	4,591
Payable to reinsurers	26,280	7,653
Deferred income taxes	—	1,614
Taxes payable	—	265
Other liabilities	23,226	15,077
Total liabilities	1,075,213	967,436

Commitments and contingencies (Note 7)

Shareholders' equity		
Common stock: $0.01 par value; 30,000,000 shares authorized; 17,371,903 and 17,288,728 shares issued	174	173
Additional paid-in capital	178,716	175,583
Accumulated other comprehensive income, net of taxes	17,425	28,715
Retained earnings	531,962	587,647
Treasury stock, at cost: 2,279,570 shares	(83,835)	(83,835)
Total shareholders' equity	644,442	708,283
Total liabilities and shareholders' equity	$ 1,719,655	$ 1,675,719

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

Table of Contents

Safety Insurance Group, Inc. and Subsidiaries

Consolidated Statements of Operations

(Unaudited)

(Dollars in thousands, except per share data)

	Three Months Ended September 30, 2015	2014	Nine Months Ended September 30, 2015	2014
Net earned premiums	$ 186,582	$ 180,277	$ 551,593	$ 534,397
Net investment income	9,950	10,809	30,824	31,291
Earnings from partnership investments	859	—	1,436	—
Net realized (losses) gains on investments	(310)	284	(72)	683
Net impairment losses on investments (a)	(434)	—	(434)	—
Finance and other service income	4,623	4,749	13,564	13,781
Total revenue	201,270	196,119	596,911	580,152
Losses and loss adjustment expenses	128,931	119,742	484,281	349,180
Underwriting, operating and related expenses	53,624	54,378	157,919	162,203
Interest expense	22	22	67	67
Total expenses	182,577	174,142	642,267	511,450
(Loss) income before income taxes	18,693	21,977	(45,356)	68,702
Income tax (credit) expense	6,712	6,541	(21,213)	19,718
Net income (loss)	$ 11,981	$ 15,436	$ (24,143)	$ 48,984
(Loss) earnings per weighted average common share:				
Basic	$ 0.80	$ 1.03	$ (1.62)	$ 3.23
Diluted	$ 0.80	$ 1.03	$ (1.62)	$ 3.21
Cash dividends paid per common share	$ 0.70	$ 0.70	$ 2.10	$ 1.90
Number of shares used in computing (loss) earnings per share:				
Basic	14,880,796	14,804,818	14,861,533	15,026,368
Diluted	14,907,672	14,910,177	14,861,533	15,091,844

(a) No portion of the other-than-temporary impairments recognized in the periods were included in other comprehensive income.

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

Safety Insurance Group, Inc. and Subsidiaries

Consolidated Statements of Comprehensive (Loss) Income

(Unaudited)

(Dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income (loss)	$ 11,981	$ 15,436	$ (24,143)	$ 48,984
Other comprehensive income, net of tax:				
Unrealized holding (losses) gains during the period, net of income tax expense of ($2,489), ($2,047), ($6,105) and $5,688.	(4,622)	(3,801)	(11,337)	10,564
Reclassification adjustment for losses or gains included in net income, net of income tax benefit (expense) of $109, ($100), $25 and ($239).	202	(185)	47	(444)
Unrealized (losses) gains on securities available for sale	(4,420)	(3,986)	(11,290)	10,120
Comprehensive (loss) income	$ 7,561	$ 11,450	$ (35,433)	$ 59,104

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

Table of Contents

Safety Insurance Group, Inc. and Subsidiaries

Consolidated Statements of Changes in Shareholders' Equity

(Unaudited)

(Dollars in thousands)

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income, Net of Taxes	Retained Earnings	Treasury Stock	Total Shareholders' Equity
Balance at December 31, 2013	$ 172	$ 170,391	$ 17,200	$ 567,792	$ (60,368)	$ 695,187
Net income, January 1 to September 30, 2014				48,984		48,984
Other comprehensive income, net of deferred federal income taxes			10,120			10,120
Restricted share awards issued	1	217				218
Recognition of employee share-based compensation, net of deferred federal income taxes		3,543				3,543
Exercise of options, net of federal income taxes		151				151
Dividends paid and accrued				(28,969)		(28,969)
Acquisition of treasury stock					(23,467)	(23,467)
Balance at September 30, 2014	$ 173	$ 174,302	$ 27,320	$ 587,807	$ (83,835)	$ 705,767

	Common	Additional Paid-in	Accumulated Other Comprehensive Income,	Retained	Treasury	Total Shareholders'

	Stock	Capital	Net of Taxes	Earnings	Stock	Equity
Balance at December 31, 2014	$ 173	$ 175,583	$ 28,715	$ 587,647	$ (83,835)	$ 708,283
Net loss, January 1 to September 30, 2015				(24,143)		(24,143)
Other comprehensive income, net of deferred federal income taxes			(11,290)			(11,290)
Restricted share awards issued	1	246				247
Recognition of employee share-based compensation, net of deferred federal income taxes		2,691				2,691
Exercise of options, net of federal income taxes		196				196
Dividends paid and accrued				(31,542)		(31,542)
Balance at September 30, 2015	$ 174	$ 178,716	$ 17,425	$ 531,962	$ (83,835)	$ 644,442

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

Table of Contents

Safety Insurance Group, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(Unaudited)

(Dollars in thousands)

	Nine Months Ended September 30,	
	2015	2014
Cash flows from operating activities:		
Net (loss) income	$ (24,143)	$ 48,984
Adjustments to reconcile net (loss) income to net cash (used for) provided by operating activities:		
Depreciation and amortization, net	8,829	9,804
(Credit) provision for deferred income taxes	(497)	138
Net realized losses / (gains) on investments	72	(683)
Net impairment losses on investments	434	—
Earnings from partnership investments	(1,436)	—
Changes in assets and liabilities:		
Accounts receivable	(18,236)	(21,823)
Accrued investment income	901	352
Receivable from reinsurers	(48,658)	(2,123)
Ceded unearned premiums	(2,576)	(541)
Deferred policy acquisition costs	(5,647)	(7,791)
Taxes recoverable	(23,929)	—
Other assets	(5,527)	(7,630)
Loss and loss adjustment expense reserves	71,317	12,759
Unearned premium reserves	34,648	41,321
Accounts payable and accrued liabilities	(23,110)	(14,014)
Payable to reinsurers	18,627	11,885
Other liabilities	8,149	(5,028)
Net cash (used for) provided by operating activities	(10,782)	65,610
Cash flows from investing activities:		
Fixed maturities purchased	(157,820)	(168,135)
Equity securities purchased	(23,725)	(20,840)
Other invested assets purchased	(3,434)	(2,900)
Proceeds from sales and paydowns of fixed maturities	109,346	119,351
Proceeds from maturities, redemptions, and calls of fixed maturities	97,403	24,500
Proceeds from sales of equity securities	23,032	8,656
Proceeds from other invested assets redeemed	1,195	—
Fixed assets purchased	(3,140)	(1,590)
Net cash provided by (used for) investing activities	42,857	(40,958)

Cash flows from financing activities:		
Proceeds from stock options exercised	193	147
Excess tax benefit from stock options exercised	2	4
Dividends paid to shareholders	(31,482)	(28,840)
Acquisition of treasury stock	—	(23,467)
Net cash used for financing activities	(31,287)	(52,156)
Net increase (decrease) in cash and cash equivalents	788	(27,504)
Cash and cash equivalents at beginning of year	42,455	55,877
Cash and cash equivalents at end of period	$ 43,243	$ 28,373

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

Table of Contents

Safety Insurance Group, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands except per share and share data)

1. Basis of Presentation

The consolidated financial statements have been prepared on the basis of accounting principles generally accepted in the United States of America ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates.

The consolidated financial statements include Safety Insurance Group, Inc. and its subsidiaries (the "Company"). The subsidiaries consist of Safety Insurance Company, Safety Indemnity Insurance Company, Safety Property and Casualty Insurance Company, Whiteshirts Asset Management Corporation ("WAMC"), and Whiteshirts Management Corporation, which is WAMC's holding company. All intercompany transactions have been eliminated.

The financial information as of September 30, 2015 and for the three and nine months ended September 30, 2015 and 2014 is unaudited; however, in the opinion of the Company, the information includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the financial condition, results of operations, and cash flows for the periods. The financial information as of December 31, 2014 is derived from the audited financial statements included in the Company's 2014 annual report on Form 10-K filed with the SEC on March 2, 2015.

These unaudited interim consolidated financial statements may not be indicative of financial results for the full year and should be read in conjunction with the audited financial statements included in the Company's annual report on Form 10-K filed with the U.S. Securities and Exchange Commission ("SEC") on March 2, 2015.

The Company is a leading provider of property and casualty insurance focused primarily on the Massachusetts market. The Company's principal product line is automobile insurance. The Company operates through its insurance company subsidiaries, Safety Insurance Company, Safety Indemnity Insurance Company, and Safety Property and Casualty Insurance Company (together referred to as the "Insurance Subsidiaries").

The Insurance Subsidiaries began writing private passenger automobile and homeowners insurance in New Hampshire during 2008, personal umbrella insurance in New Hampshire during 2009, and commercial automobile insurance in New Hampshire during 2011.

2. Recent Accounting Pronouncements

In May 2015, the FASB issued ASU 2015-09, Disclosures about Short-Duration Contracts (“ASU 2015-09”). ASU 2015-09 requires companies that issue short duration contracts to disclose additional information, including: (i) incurred and paid claims development tables; (ii) frequency and severity of claims; and (iii) information about material changes in judgments made in calculating the liability for unpaid claim adjustment expenses, including reasons for the change and the effects on the financial statements. ASU 2015-09 is effective for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016. The amendments in ASU 2015-09 should be applied retrospectively by providing comparative disclosures for each period presented, except for those requirements that apply only to the current period. As the requirements of this literature are disclosure only, the application of this guidance will not impact our financial condition, results of operations or cash flows.

In May 2015, the FASB issued ASU 2015-07, Fair Value Measurement Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or Its Equivalent) (“ASU 2015-07”). ASU 2015-07 removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. The reporting entity should continue to disclose information on investments for which fair value is measured at net asset value (or its equivalent) as a practical expedient to help users understand the nature and risks of the investments and whether the investments, if sold, are probable of being sold at amounts different from net asset value. ASU 2015-07 is effective for fiscal years beginning after December 31, 2015. Early adoption is allowed and the reporting entity should apply ASU 2015-07 retrospectively to all periods presented. The Company does not expect the adoption of ASU 2015-07 to have a material impact on its financial position, results of operations or cash flows.

In April 2015, the FASB issued ASU No. 2015-03, Imputation of Interest (“ASU 2015-03”). ASU 2015-03 simplifies the presentation of debt issuance costs as the amendments in this update require that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of debt liability, consistent with debt discounts or premiums. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this update. ASU 2015-03 is effective for annual and interim reporting periods beginning after December 15, 2015. Early adoption is permitted for financial statements that have not been previously issued. The standard requires a retrospective approach where the balance sheet of each individual period presented should be adjusted to reflect the period-specific effects of applying the new guidance. The standard also requires compliance with applicable disclosures for a change in an accounting principle. The Company does not expect the adoption of ASU 2014-15 to have a material impact on its financial position, results of operations or cash flows.

In August 2014, the FASB issued ASU No. 2014-15, “Presentation of Financial Statements – Going Concern (Subtopic 205-40): Disclosures of Uncertainties about an Entity’s Ability as a Going Concern” (“ASU 2014-15”). ASU 2014-15 provides guidance on determining when and how to disclose going concern uncertainties in the financial statements, and requires management to perform interim and annual assessments of an entity’s ability to continue as a going concern within one year of the date the financial statements are issued. ASU 2014-15 is effective for annual periods ending after December 15, 2015 and interim periods thereafter. Early adoption is permitted. The Company does not expect the adoption of ASU 2014-15 to have a material impact on its financial position, results of operations, or cash flows.

In June 2014, the FASB issued ASU No. 2014-12, "Compensation—Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved After the Requisite Service Period" ("ASU 2014-12”), which revises the accounting treatment for stock compensation tied to performance targets. ASU 2014-12 is effective for calendar years beginning after December 15, 2015. The impact of adoption was not material to the Company’s financial position, results of operations or cash flows.

In May 2014, the FASB issued as final, ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)" which supersedes virtually all existing revenue recognition guidance under GAAP. The update's core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The update is effective for interim and annual reporting periods in fiscal years beginning after December 15, 2017 and allows early adoption. ASU 2014-09 allows for the use of either the retrospective or modified retrospective approach of adoption. The Company does not expect the adoption of ASU 2014-09 to have a material impact on its financial position, results of operations, or cash flows.

3. (Loss) Earnings per Weighted Average Common Share

Basic (loss) earnings per weighted average common share ("EPS") are calculated by dividing net (loss) income by the weighted average number of basic common shares outstanding during the period. Diluted (loss) earnings per share amounts are based on the weighted average number of common shares including non-vested performance stock grants and the net effect of potentially dilutive common stock options.

Table of Contents

Safety Insurance Group, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands except per share and share data)

The following table sets forth the computation of basic and diluted EPS for the periods indicated.

	Three Months Ended September 30, 2015		Three Months Ended September 30, 2014			Nine Months Ended September 30, 2015			Nine Months Ended September 30, 2014		
Earnings attributable to common shareholders - basic and diluted:											
Net (loss) income from continuing operations	$	11,981	$	15,436		$	(24,143)		$	48,984	
Allocation of income for participating shares		(90)		(142)	(1)		—			(475)	(1)
Net (loss) income from continuing operations attributed to common shareholders	$	11,891	$	15,294	(1)	$	(24,143)		$	48,509	(1)
Earnings per share denominator - basis and diluted											
Total weighted average common shares outstanding, including participating shares		14,993,162		14,941,685			14,982,697			15,173,415	
Less: weighted average participating shares		(112,366)		(136,867)			(121,164)			(147,047)	
Basic earnings per share denominator		14,880,796		14,804,818	(1)		14,861,533			15,026,368	(1)
Common equivalent shares- stock options		1,292		2,013			—	(2)		2,352	
Common equivalent shares- non-vested performance stock grants		25,584		103,346			—	(3)		63,124	
Diluted earnings per share denominator		14,907,672		14,910,177	(1)		14,861,533			15,091,844	(1)
Basic (loss) earnings per share	$	0.80	$	1.03		$	(1.62)		$	3.23	
Diluted (loss) earnings per share	$	0.80	$	1.03		$	(1.62)		$	3.21	
Undistributed (loss) earnings attributable to common shareholders - basic and diluted:											
Net (loss) income from continuing operations attributable to common shareholders -Basic	$	0.80	$	1.03		$	(1.62)		$	3.23	
Dividends declared		(0.70)		(0.70)			(2.10)			(1.90)	
Undistributed (loss) earnings	$	0.10	$	0.33		$	(3.72)		$	1.33	
Net (loss) income from continuing operations attributable to common shareholders -Diluted	$	0.80	$	1.03		$	(1.62)		$	3.21	
Dividends declared		(0.70)		(0.70)			(2.10)			(1.90)	
Undistributed (loss) earnings	$	0.10	$	0.33		$	(3.72)		$	1.31	

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(1) The 2014 basic and diluted earnings per share denominators were revised to correct the allocation of net income to participating securities under the two-class method. The revision did not yield in a change to basic or diluted earnings per share. The Company evaluated the materiality of these revisions in accordance with SEC Staff Accounting Bulletin No. 99, Materiality, and SEC Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements, and concluded that these revisions, individually and in the aggregate, were immaterial to all prior periods. The 2014 basic earnings per share denominator for the nine months ended September 30, 2014, as originally reported was 15,173,415 and the 2014 diluted earnings per share denominator as originally reported was 15,238,891. The 2014 basic earnings per share denominator for the three months ended September 30, 2014, as originally reported was 14,941,685 and the 2014 diluted earnings per share denominator as originally reported was 15,047,044.

(2) Excludes 1,735 of common equivalent shares related to stock options because their inclusion would be anti dilutive due to the net loss of the Company.

(3) Excludes 55,912 of common equivalent shares related to non-vested performance stock grants because their inclusion would be anti dilutive due to the net loss of the Company

Diluted EPS excludes stock options with exercise prices and exercise tax benefits greater than the average market price of the Company's common stock during the period because their inclusion would be anti-dilutive. There were no anti-dilutive stock options or non-vested performance stock grants for the three and nine months ended September 30, 2015 and 2014.

10

Table of Contents

Safety Insurance Group, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands except per share and share data)

4. Share-Based Compensation

Management Omnibus Incentive Plan

Long-term incentive compensation is provided under the Company's 2002 Management Omnibus Incentive Plan ("the Incentive Plan") which provides for a variety of share-based compensation awards, including nonqualified stock options, incentive stock options, stock appreciation rights and restricted stock ("RS") awards.

The maximum number of shares of common stock with respect to which awards may be granted is 2,500,000. The Incentive Plan was amended in March of 2013 to remove "share recycling" plan provisions. Hence, shares of stock covered by an award under the Incentive Plan that are forfeited are no longer available for issuance in connection with 2013 and future grants of awards. At September 30, 2015, there were 369,755 shares available for future grant. The Board of Directors and the Compensation Committee intend to issue more awards under the Incentive Plan in the future.

Accounting and Reporting for Stock-Based Awards

Accounting Standards Codification ("ASC") 718, Compensation —Stock Compensation requires the Company to measure and recognize the cost of employee services received in exchange for an award of equity instruments. Under the provisions of ASC 718, share-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as an expense over the requisite service period (generally the vesting period of the equity grant).

The following table summarizes stock option activity under the Incentive Plan for the nine months ended September 30, 2015.

	Shares Under Option	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at beginning of year	12,700	$ 42.85		
Exercised	(4,500)	$ 42.85		
Outstanding at end of period	8,200	$ 42.85	0.4 years	$ 93
Exercisable at end of period	8,200	$ 42.85	0.4 years	$ 93

The aggregate intrinsic value in the preceding table represents the total pre-tax intrinsic value, which is the difference between the fair value based upon the Company's closing stock price on September 30, 2015 and the exercise price which would have been received by the option holders had all option holders exercised their options as of that date. The exercise price on stock options outstanding under the Incentive Plan at September 30, 2015 and September 30, 2014 was $42.85. The total intrinsic value of options exercised during the nine months ended September 30, 2015 and 2014 was $95 and $69, respectively.

As of March 31, 2011, all compensation expense related to non-vested option awards had been recognized. Cash received from options exercised was $193 and $147 for the nine months ended September 30, 2015 and 2014, respectively.

Restricted Stock

Service-based restricted stock awarded in the form of unvested shares is recorded at the market value of the Company's common stock on the grant date and amortized ratably as compensation expense over the requisite service period. Service-based restricted stock awards generally vest over a three-year period and vest 30% on the first and

Table of Contents

Safety Insurance Group, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands except per share and share data)

second anniversaries of the grant date and 40% on the third anniversary of the grant date, except for non-executive employees' restricted stock awards which vest ratably over a five-year service period and independent directors' stock awards which vest immediately. Our independent directors are subject to stock ownership guidelines, which require them to have a value four times their annual cash retainer.

In addition to service-based awards, the Company grants performance-based restricted shares to certain employees. These performance shares cliff vest after a three-year performance period provided certain performance measures are attained. A portion of these awards, which contain a market condition, vest according to the level of total shareholder return achieved by the Company compared to its property-casualty insurance peers over a three-year period. The remainders, which contain a performance condition, vest according to the level of Company's combined ratio results compared to a target based on its property-casualty insurance peers.

Actual payouts can range from 0% to 200% of target shares awarded depending upon the level of achievement of the respective market and performance conditions during a three calendar-year performance period. Compensation expense for share awards with a performance condition is based on the probable number of awards expected to vest using the performance level most likely to be achieved at the end of the performance period.

Performance-based awards with market conditions are accounted for and measured differently from awards that have a performance or service condition. The effect of a market condition is reflected in the award's fair value on the grant date. That fair value is recognized as compensation cost over the requisite service period regardless of whether the market-based performance objective has been satisfied.

All of the Company's restricted stock awards are issued as incentive compensation and are equity classified.

The following table summarizes restricted stock activity under the Incentive Plan during the nine months ended September 30, 2015, assuming a target payout for the 2015 performance-based shares.

	Shares Under Restriction	Weighted Average Fair Value	Performance-based Shares Under Restriction	Weighted Average Fair Value
Outstanding at beginning of year	176,116	$ 46.38	64,724	$ 50.40
Granted	46,943	$ 61.57	37,722	$ 63.62
Vested and unrestricted	(64,130)	$ 45.17	-	$ -
Forfeited	(2,645)	$ 49.39	(3,345)	$ 46.91
Outstanding at end of period	156,284	$ 51.37	99,101	$ 55.55

As of September 30, 2015, there was $6,784 of unrecognized compensation expense related to non-vested restricted stock awards that is expected to be recognized over a weighted average period of 1.8 years. The total fair value of the shares that were vested and unrestricted during the nine months ended September 30, 2015 and 2014 was $2,897 and $3,554, respectively. For the nine months ended September 30, 2015 and 2014, the Company recorded compensation expense related to restricted stock of $1,710 and $2,245, net of income tax benefits of $921 and $1,209, respectively.

Table of Contents

Safety Insurance Group, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands except per share and share data)

5. Investments

The gross unrealized gains and losses on investments in fixed maturity securities, including redeemable preferred stocks that have characteristics of fixed maturities, and equity securities, including interests in mutual funds, and other invested assets were as follows for the periods indicated.

	As of September 30, 2015				
			Gross Unrealized Losses (3)		
	Cost or Amortized Cost	Gross Unrealized Gains	Non-OTTI Unrealized Losses	OTTI Unrealized Losses (4)	Estimated Fair Value
U.S. Treasury securities	$ 15,941	$ 114	$ —	$ —	$ 16,055
Obligations of states and political subdivisions	366,006	19,571	(632)	—	384,945
Residential mortgage-backed securities (1)	216,613	6,572	(726)	—	222,459
Commercial mortgage-backed securities	33,924	377	(18)	—	34,283
Other asset-backed securities	12,707	148	—	—	12,855
Corporate and other securities	401,472	5,761	(6,663)	—	400,570
Subtotal, fixed maturity securities	1,046,663	32,543	(8,039)	—	1,071,167
Equity securities (2)	100,704	9,345	(6,377)	—	103,672
Other invested assets (5)	15,319	—	—	—	15,319
Totals	$ 1,162,686	$ 41,888	$ (14,416)	$ —	$ 1,190,158

	As of December 31, 2014				
			Gross Unrealized Losses (3)		
	Cost or Amortized Cost	Gross Unrealized Gains	Non-OTTI Unrealized Losses	OTTI Unrealized Losses (4)	Estimated Fair Value

U.S. Treasury securities	$ 1,507	$ —	$ (1)	$ —	$ 1,506
Obligations of states and political subdivisions	437,299	23,562	(536)	—	460,325
Residential mortgage-backed securities (1)	201,950	7,015	(1,282)	—	207,683
Commercial mortgage-backed securities	34,216	256	(34)	—	34,438
Other asset-backed securities	10,204	48	(2)	—	10,250
Corporate and other securities	417,341	7,536	(3,628)	—	421,249
Subtotal, fixed maturity securities	1,102,517	38,417	(5,483)	—	1,135,451
Equity securities (2)	97,910	13,332	(2,089)	—	109,153
Other invested assets (5)	11,657	—	—		11,657
Totals	$ 1,212,084	$ 51,749	$ (7,572)	$ —	$ 1,256,261

(1) Residential mortgage-backed securities consists primarily of obligations of U.S. Government agencies including collateralized mortgage obligations issued, guaranteed and/or insured by the following issuers: Government National Mortgage Association (GNMA), Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA) and the Federal Home Loan Bank (FHLB).

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

(3) Our investment portfolio included 410 and 366 securities in an unrealized loss position at September 30, 2015 and December 31, 2014, respectively.

(4) Amounts in this column represent other-than-temporary impairment ("OTTI") recognized in accumulated other comprehensive income.

(5) Other invested assets are accounted for under the equity method which approximated fair value.

Safety Insurance Group, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands except per share and share data)

The amortized cost and the estimated fair value of fixed maturity securities, by maturity, are shown below for the period indicated. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	As of September 30, 2015	
	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 56,472	$ 57,095
Due after one year through five years	252,812	255,020
Due after five years through ten years	197,857	197,138
Due after ten years	276,278	292,318
Asset-backed securities	263,244	269,596
Totals	$ 1,046,663	$ 1,071,167

The gross realized gains and losses on sales of investments were as follows for the periods indicated.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Gross realized gains				
Fixed maturity securities	$ 81	$ 120	$ 346	$ 604
Equity securities	1,022	316	2,465	1,133
Gross realized losses				
Fixed maturity securities	(1,302)	(48)	(2,520)	(911)
Equity securities	(111)	(104)	(363)	(143)
Net realized (losses) gains on investments	$ (310)	$ 284	$ (72)	$ 683

In the normal course of business, the Company enters into transactions involving various types of financial instruments, including investments in fixed maturities and equity securities. Investment transactions have credit exposure to the extent that a counter party may default on an obligation to the Company. Credit risk is a consequence of carrying, trading and investing in securities. To manage credit risk, the Company focuses on higher quality fixed income securities, reviews the credit strength of all companies in which it invests, limits its exposure in any one investment and monitors the portfolio quality, taking into account credit ratings assigned by recognized statistical rating organizations.

The following tables as of September 30, 2015 and December 31, 2014 present the gross unrealized losses included in the Company's investment portfolio and the fair value of those securities aggregated by investment category. The tables also present the length of time that they have been in a continuous unrealized loss position.

	As of September 30, 2015					
	Less than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
U.S. Treasury securities	$ —	$ —	$ —	$ —	$ —	$ —
Obligations of states and political subdivisions	35,169	611	1,774	21	36,943	632
Residential mortgage-backed securities	68,215	629	5,491	97	73,706	726
Commercial mortgage-backed securities	1,556	18	—	—	1,556	18
Other asset-backed securities	—	—	—	—	—	—
Corporate and other securities	133,189	4,038	29,848	2,625	163,037	6,663
Subtotal, fixed maturity securities	238,129	5,296	37,113	2,743	275,242	8,039
Equity securities	23,768	3,133	9,205	3,244	32,973	6,377
Total temporarily impaired securities	$ 261,897	$ 8,429	$ 46,318	$ 5,987	$ 308,215	$ 14,416

Table of Contents

Safety Insurance Group, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands except per share and share data)

	As of December 31, 2014					
	Less than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
U.S. Treasury securities	$ —	$ —	$ 1,506	$ 1	$ 1,506	$ 1
Obligations of states and political subdivisions	65,174	489	3,553	47	68,727	536
Residential mortgage-backed securities	18,853	44	47,769	1,238	66,622	1,282
Commercial mortgage-backed securities	10,485	34	—	—	10,485	34
Other asset-backed securities	1,999	2	—	—	1,999	2
Corporate and other securities	119,722	3,079	37,469	549	157,191	3,628
Subtotal, fixed maturity securities	216,233	3,648	90,297	1,835	306,530	5,483
Equity securities	16,119	1,986	1,277	103	17,396	2,089
Total temporarily impaired securities	$ 232,352	$ 5,634	$ 91,574	$ 1,938	$ 323,926	$ 7,572

Other-Than-Temporary Impairments

ASC 320, Investments – Debt and Equity Securities requires entities to separate an OTTI of a debt security into two components when there are credit related losses associated with the impaired debt security for which the Company asserts that it does not have the intent to sell the security, and it is more likely than not that it will not be required to sell the security before recovery of its cost basis. Under ASC 320, the amount of the OTTI related to a credit loss is recognized in earnings, and the amount of the OTTI related to other factors is recorded as a component of other comprehensive income (loss). In instances where no credit loss exists but it is more likely than not that the Company will have to sell the debt security prior to the anticipated recovery, the decline in market value below amortized cost is recognized as an OTTI in earnings. In periods after the recognition of an OTTI on debt securities, the Company accounts for such securities as if they had been purchased on the measurement date of the OTTI at an amortized cost basis equal to the previous amortized cost basis less the OTTI recognized in earnings. For debt securities for which OTTI was recognized in earnings, the difference between the new amortized cost basis and the cash flows expected to be collected will be accreted or amortized into net investment income.

The Company holds no subprime mortgage debt securities. All of the Company's holdings in mortgage-backed securities are either U.S. Government or Agency guaranteed or are rated investment grade by either Moody's or Standard & Poor's.

The unrealized losses in the Company's fixed income and equity portfolio as of September 30, 2015 were reviewed for potential other-than-temporary asset impairments. The Company held three securities at September 30, 2015 with a material (20% or greater) unrealized loss for four or more consecutive quarters. As a result of our analysis, during the three and nine months ended September 30, 2015, the Company recognized OTTI of $434 which consisted entirely of credit losses related to fixed maturity securities. There was no OTTI related to fixed maturity securities during the three and nine months ended September 30, 2014.

Specific qualitative analysis was also performed for any additional securities appearing on the Company's "Watch List," if any. Qualitative analysis considered such factors as the financial condition and the near term prospects of the issuer, whether the debtor is current on its contractually obligated interest and principal payments, changes to the rating of the security by a rating agency and the historical volatility of the fair value of the security.

The qualitative analysis performed by the Company concluded that outside of the securities that were recognized through OTTI, the unrealized losses recorded on the investment portfolio at September 30, 2015 resulted from fluctuations in market interest rates and other temporary market conditions as opposed to fundamental changes in the credit quality of the issuers of such securities. Therefore, decreases in fair values of the Company's securities are viewed as being temporary.

Table of Contents

Safety Insurance Group, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands except per share and share data)

The following table summarizes the credit loss recognized in earnings related to fixed maturity securities.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Credit losses on fixed maturity securities, beginning of period	$ -	$ -	$ -	$ -
Add: credit losses on OTTI not previously recognized	434	-	434	-
Less: credit losses on securities sold	-	-	-	-
Less: credit losses on securities impaired due to intent to sell	-	-	-	-
Add: credit losses on previously impaired securities	-	-	-	-
Less: increases in cash flows expected on previously impaired securities	-	-	-	-
Credit losses on fixed maturity securities, end of period	$ 434	$ -	$ 434	$ -

At September 30, 2015 and December 31, 2014, there were no amounts included in accumulated other comprehensive income related to securities which were considered by the Company to be other-than-temporarily impaired.

Based upon the qualitative analysis performed, the Company’s decision to hold these securities, the Company’s current level of liquidity and our history of positive operating cash flows, management believes it is more likely than not that it will not be required to sell any of its securities before the anticipated recovery in the fair value to its amortized cost basis.

Net Investment Income

The components of net investment income were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Interest on fixed maturity securities	$ 9,663	$ 10,457	$ 29,820	$ 30,477
Dividends on equity securities	733	842	2,155	2,242
Equity in earnings of other invested assets	194	150	785	453
Interest on other assets	18	19	58	59
Interest on cash and cash equivalents	1	1	3	2
Total investment income	10,609	11,469	32,821	33,233
Investment expenses	659	660	1,997	1,942
Net investment income	$ 9,950	$ 10,809	$ 30,824	$ 31,291

Fair Value Measurements

ASC 820, Fair Value Measurements and Disclosure provides a revised definition of fair value, establishes a framework for measuring fair value and expands financial statement disclosure requirements for fair value information. Under ASC 820, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants (an exit price). ASC 820 establishes a fair value hierarchy that distinguishes between inputs based on market data from independent sources ("observable inputs") and a reporting entity's internal assumptions based upon the best information available when external market data is limited or unavailable ("unobservable inputs"). The fair value hierarchy in ASC 820 prioritizes fair value measurements into three levels based on the nature of the inputs as follows:

Level 1 — Valuations based on quoted prices in active markets for identical assets and liabilities;

Level 2 — Valuations based on observable inputs that do not meet the criteria for Level 1, including quoted prices in inactive markets and quoted prices in active markets for similar, but not identical instruments; and

Level 3 — Valuations based on unobservable inputs.

Table of Contents

Safety Insurance Group, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands except per share and share data)

Fair values for the Company's fixed maturity securities are based on prices provided by its custodian bank and its investment managers. Both the Company's custodian bank and investment managers use a variety of independent, nationally recognized pricing services to determine market valuations. If the pricing service cannot provide fair value determinations, the Company obtains non-binding price quotes from broker-dealers. A minimum of two quoted prices is obtained for the majority of the Company's available-for-sale fixed maturity securities in its investment portfolio. The Company's custodian bank is its primary provider of quoted prices from third-party pricing services and broker-dealers. To provide reasonable assurance of the validity of each price or quote, a secondary third-party pricing service or broker-dealer quote is obtained from the Company's investment managers. An examination of the pricing data is then performed for each security. If the variance between the primary and secondary price quotes for a security is within an accepted tolerance level, the quoted price obtained from the Company's custodian bank is used in the financial statements for the security. If the variance between the primary and secondary price quotes exceeds an accepted tolerance level, the Company obtains a quote from an alternative source, if possible, and documents and resolves any differences between the pricing sources. In addition, the Company may request that its investment managers and its traders provide input as to which vendor is providing prices that its traders believe are reflective of fair value for the security. Following this process, the Company may decide to value the security in its financial statements using the secondary or alternative source if it believes that pricing is more reflective of the security's value than the primary pricing provided by its custodian bank. The Company analyzes market valuations received to verify reasonableness, to understand the key assumptions used and their sources, and to determine an appropriate ASC 820 fair value hierarchy level based upon trading activity and the observability of market inputs. Based on this evaluation and investment class analysis, each price is classified into Level 1, 2 or 3.

Fair values of instruments are based on (i) quoted prices in active markets for identical assets (Level 1), (ii) quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-derived valuations in which all significant inputs are observable in active markets (Level 2) or (iii) valuations derived from valuation techniques in which one or more significant inputs are unobservable in the marketplace (Level 3).

The Company's Level 1 securities consist of equity securities whose values are based on quoted prices in active markets for identical assets. The Company's Level 2 securities are comprised of available-for-sale fixed maturity securities whose fair value was determined using observable market inputs. The Company's Level 3 securities consist of two investments; (1) a real estate investment trust equity investment whose fair value was determined using the trust's net asset value obtained from its audited financial statements; however, the Company is required to submit a request 45 days before a quarter end to dispose of the security; and (2) an investment in the Federal Home Loan Bank of Boston related to Safety Insurance Company's membership stock, which is not redeemable in a short-term time frame. Fair values for securities for which quoted market prices were unavailable were estimated based upon reference to observable inputs such as benchmark interest rates, market comparables, and other relevant inputs. Investments valued using these inputs include U.S. Treasury securities, obligations of states and political subdivisions, corporate and other securities, commercial and residential mortgage-backed securities, and other asset-backed securities. Inputs into the fair value application that are utilized by asset class include but are not limited to:

- Obligations of states and political subdivisions: overall credit quality, including assessments of market sectors and the level and variability of sources of payment such as general obligation, revenue or lease; credit support such as insurance, state or local economic and political base, prefunded and escrowed to maturity covenants.
- Corporate fixed maturities: overall credit quality, the establishment of a risk adjusted credit spread over the applicable risk-free yield curve for discounted cash flow valuations; assessments of the level of industry economic sensitivity, company financial policies, indenture restrictive covenants, and/or security and collateral.
- Residential mortgage-backed securities, U.S. agency pass-throughs, collateralized mortgage obligations (“CMOs”), non U.S. agency CMOs: estimates of prepayment speeds based upon historical prepayment rate trends, underlying collateral interest rates, original weighted average maturity, vintage year, borrower credit

Safety Insurance Group, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands except per share and share data)

quality characteristics, interest rate and yield curve forecasts, U.S. government support programs, tax policies, and delinquency/default trends.

- Commercial mortgage-backed securities: overall credit quality, including assessments of the level and variability of credit support and collateral type such as office, retail, or lodging, predictability of cash flows for the deal structure, prevailing economic market conditions.
- Other asset-backed securities: overall credit quality, estimates of prepayment speeds based upon historical trends and characteristics of underlying loans, including assessments of the level and variability of collateral, revenue generating agreements, area licenses agreements, product sourcing agreements and equipment and property leases.
- Real estate investment trust ("REIT"): net asset value per share derived from member ownership in capital venture to which a proportionate share of independently appraised net assets is attributed.
- Federal Home Loan Bank of Boston ("FHLB-Boston"): value is equal to the cost of the member stock purchased.

In order to ensure the fair value determination is representative of an exit price (consistent with ASC 820), the Company's procedures for validating quotes or prices obtained from third parties include, but are not limited to, obtaining a minimum of two price quotes for each fixed maturity security if possible, as discussed above, the periodic testing of sales activity to determine if there are any significant differences between the market price used to value the security as of the balance sheet date and the sales price of the security for sales that occurred around the balance sheet date, and the periodic review of reports provided by its investment manager regarding those securities with ratings changes and securities placed on its "Watch List." In addition, valuation techniques utilized by pricing services and prices obtained from external sources are reviewed by the Company's external investment manager, whose investment professionals are familiar with the securities being priced and the markets in which they trade, to ensure the fair value determination is representative of an exit price (consistent with ASC 820).

All unadjusted estimates of fair value for our fixed maturities priced by the pricing services as described above are included in the amounts disclosed in Level 2. With the exception of the REIT and FHLB-Boston securities, which are categorized as Level 3 securities, the Company's entire available-for-sale portfolio was priced based upon quoted market prices or other observable inputs as of September 30, 2015. There were no significant changes to the valuation process during the nine months ended September 30, 2015. As of September 30, 2015 and December 31, 2014, no quotes or prices obtained were adjusted by management. All broker quotes obtained were non-binding.

At September 30, 2015 and December 31, 2014, investments in fixed maturities and equity securities classified as available-for-sale had a fair value which equaled carrying value of $1,174,839 and $1,244,604, respectively. We have no short-term investments. The carrying values of cash and cash equivalents and investment income accrued approximated fair value.

The following tables summarize the Company’s total fair value measurements for available-for-sale investments for the periods indicated.

	As of September 30, 2015			
	Total	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
U.S. Treasury securities	$ 16,055	$ —	$ 16,055	$ —
Obligations of states and political subdivisions	384,945	—	384,945	—
Residential mortgage-backed securities	222,459	—	222,459	—
Commercial mortgage-backed securities	34,283	—	34,283	—
Other asset-backed securities	12,855	—	12,855	—
Corporate and other securities	400,570	—	400,570	—
Equity securities	103,672	84,500	—	19,172
Total investment securities	$ 1,174,839	$ 84,500	$ 1,071,167	$ 19,172

Table of Contents

Safety Insurance Group, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands except per share and share data)

	As of December 31, 2014			
	Total	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
U.S. Treasury securities	$ 1,506	$ —	$ 1,506	$ —
Obligations of states and political subdivisions	460,325	—	460,325	—
Residential mortgage-backed securities	207,683	—	207,683	—
Commercial mortgage-backed securities	34,438	—	34,438	—
Other asset-backed securities	10,250	—	10,250	—
Corporate and other securities	421,249	—	421,249	—
Equity securities	109,153	91,523	—	17,630
Total investment securities	$ 1,244,604	$ 91,523	$ 1,135,451	$ 17,630

There were no transfers between Level 1 and Level 2 during the three and nine months ended September 30, 2015 and 2014.

The following table summarizes the changes in the Company's Level 3 fair value securities for the periods indicated.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	Level 3 Fair Value Securities	Level 3 Fair Value Securities	Level 3 Fair Value Securities	Level 3 Fair Value Securities
Balance at beginning of period	$ 18,657	16,386	$ 17,630	$ 15,920
Net gains and losses included in earnings	—	—	—	
Net gains included in other comprehensive income	515	454	1,500	920
Purchases	—	505	42	505
Sales	—	—	—	—
Transfers into Level 3	—	—	—	—
Transfers out of Level 3	—	—	—	—
Balance at end of period	$ 19,172	$ 17,345	$ 19,172	$ 17,345
	$ —	$ —	$ —	$ —

Amount of total losses included in earnings attributable to the change in unrealized losses related to assets still held at end of period

Transfers in and out of Level 3 are attributable to changes in the ability to observe significant inputs in determining fair value exit pricing. As noted in the table above, no transfers were made in or out of Level 3 during the 2015 and 2014. The Company held two Level 3 securities at September 30, 2015 and September 30, 2014.

Table of Contents

Safety Insurance Group, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands except per share and share data)

6. Loss and Loss Adjustment Expense Reserves

The following table sets forth a reconciliation of beginning and ending reserves for losses and loss adjustment expenses ("LAE"), as shown in the Company's consolidated financial statements for the periods indicated.

	Nine Months Ended September 30,	
	2015	2014
Reserves for losses and LAE at beginning of year	$ 482,012	$ 455,014
Less receivable from reinsurers related to unpaid losses and LAE	(61,245)	(60,346)
Net reserves for losses and LAE at beginning of year	420,767	394,668
Incurred losses and LAE, related to:		
Current year	504,073	378,519
Prior years	(19,792)	(29,339)
Total incurred losses and LAE	484,281	349,180
Paid losses and LAE related to:		
Current year	310,803	223,709
Prior years	114,994	112,245
Total paid losses and LAE	425,797	335,954
Net reserves for losses and LAE at end of period	479,251	407,894
Plus receivable from reinsurers related to unpaid losses and LAE	74,078	59,879
Reserves for losses and LAE at end of period	$ 553,329	$ 467,773

At the end of each period, the reserves were re-estimated for all prior accident years. The Company's prior year reserves decreased by $19,792 and $29,339 for the nine months ended September 30, 2015 and 2014, respectively, and resulted from re-estimations of prior years ultimate loss and LAE liabilities. The decreases in prior years reserves during the 2015 and 2014 periods are primarily composed of reductions in our retained automobile and retained homeowners reserves.

The Company's automobile lines of business reserves decreased for 2015 and 2014 primarily due to fewer incurred but not yet reported claims than previously estimated and better than previously estimated severity on the Company's established bodily injury and property damage case reserves. Due to the nature of the risks that the Company underwrites and has historically underwritten, management does not believe that it has an exposure to asbestos or environmental pollution liabilities.

7. Commitments and Contingencies

Various claims, generally incidental to the conduct of normal business, are pending or alleged against the Company from time to time. In the opinion of management, based in part on the advice of legal counsel, the ultimate resolution of such claims will not have a material adverse effect on the Company's consolidated financial statements. However, if estimates of the ultimate resolutions of those proceedings are revised, liabilities related to those proceedings could be adjusted in the near term.

Massachusetts law requires that insurers licensed to do business in Massachusetts participate in the Massachusetts Insurers Insolvency Fund ("Insolvency Fund"). Members of the Insolvency Fund are assessed a proportionate share of the obligations and expenses of the Insolvency Fund in connection with an insolvent insurer. It is anticipated that there will be additional assessments from time to time relating to various insolvencies. Although the timing and amounts of any future assessments are not known, based upon existing knowledge, management's opinion is that such future assessments are not expected to have a material effect upon the financial position of the Company.

8. Debt

The Company has a Revolving Credit Agreement (the "Credit Agreement") with RBS Citizens, NA ("RBS Citizens"). The Credit Agreement provides a $30,000 revolving credit facility with an accordion feature allowing for future expansion of the committed amount up to $50,000. Loans under the credit facility bear interest at the Company's option at either (i) the LIBOR rate plus 1.25% per annum or (ii) the higher of RBS Citizens prime rate or 0.5% above the federal funds rate plus 1.25% per annum. Interest only is payable prior to maturity. The Credit Agreement has a maturity date of August 14, 2018.

The Company's obligations under the credit facility are secured by pledges of its assets and the capital stock of its operating subsidiaries. The credit facility is guaranteed by the Company's non-insurance company subsidiaries. The credit facility contains covenants including requirements to maintain minimum risk-based capital ratios and statutory surplus of Safety Insurance Company as well as limitations or restrictions on indebtedness, liens, and other matters. As of September 30, 2015, the Company was in compliance with all covenants. In addition, the credit facility includes customary events of default, including a cross-default provision permitting the lenders to accelerate the facility if the Company (i) defaults in any payment obligation under debt having a principal amount in excess of $10,000 or (ii) fails to perform any other covenant permitting acceleration of all such debt.

The Company had no amounts outstanding on its credit facility at September 30, 2015 and December 31, 2014. The credit facility commitment fee included in interest expense was computed at a rate of 0.25% per annum on the $30,000 commitment at September 30, 2015 and 2014.

Safety Insurance Company became a member of the FHLB-Boston during the quarter ended September 30, 2014. Membership in the FHLB-Boston allows the Company to borrow money at competitive interest rates provided the loan is collateralized by specific U.S Government residential mortgage backed securities. At September 30, 2015, the Company has the ability to borrow approximately $174,706 using eligible invested assets that would be used as collateral. The Company has no amounts outstanding from the FHLB-Boston at September 30, 2015 and at December 31, 2014.

9. Income Taxes

Federal income tax expense for the nine months ended September 30, 2015 and 2014 has been computed using estimated effective tax rates. These rates are revised, if necessary, at the end of each successive interim period to reflect the current estimates of the annual effective tax rates. The 2015 effective rate is the result of the expected tax benefit related to net losses incurred by the Company during the nine months ended September 30, 2015, calculated under ASC 740, Income Taxes (ASC 740-270-55), and adjustments for tax-exempt investment income. The effective rate in 2014 was lower than the statutory rate primarily due to adjustments for tax-exempt investment income.

The Company believes that the positions taken on its income tax returns for open tax years will be sustained upon examination by the Internal Revenue Service ("IRS"). Therefore, the Company has not recorded any liability for uncertain tax positions under ASC 740, Income Taxes.

During the nine months ended September 30, 2015, there were no material changes to the amount of the Company's unrecognized tax benefits or to any assumptions regarding the amount of its ASC 740 liability.

The Company's U.S. federal tax return for the year ended December 31, 2011 was examined by the IRS. The examination was completed during the quarter ended September 30, 2014 with no findings. In the Company's opinion, adequate tax liabilities have been established for all open years. However, the amount of these tax liabilities could be revised in the near term if estimates of the Company's ultimate liability are revised. Tax years prior to 2012 are closed.

10. Share Repurchase Program

On August 3, 2007, the Board of Directors approved a share repurchase program of up to $30,000 of the Company's outstanding common shares. As of September 30, 2015, the Board of Directors had cumulatively authorized

Safety Insurance Group, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands except per share and share data)

increases to the existing share repurchase program of up to $150,000 of its outstanding common shares. Under the program, the Company may repurchase shares of its common stock for cash in public or private transactions, in the open market or otherwise. The timing of such repurchases and actual number of shares repurchased will depend on a variety of factors including price, market conditions and applicable regulatory and corporate requirements. The program does not require the Company to repurchase any specific number of shares and it may be modified, suspended or terminated at any time without prior notice.

No share purchases were made by the Company under the program during the nine months ended September 30, 2015. During the nine months ended September 30, 2014, the Company purchased 460,023 shares under the program at a cost of $23,467. As of September 30, 2015, and December 31, 2014, the Company has purchased 2,279,570 shares at a cost of $83,835.

11. Related Party Transactions

Mr. A. Richard Caputo, Jr., a member of the Company's Board of Directors and the Chairman of its Investment Committee, is a principal of The Jordan Company, LP ("Jordan"). In 2012, the Company participated as a lender in two loans made by syndicates of lenders to a portfolio company in which funds managed by Jordan are controlling or a significant investor. The first loan, made to Vantage Specialties, Inc., currently bears interest at a rate of 5.00% per annum and matures in February 2019. The Company's participation in the loan was $1,434 and $1,451 at September 30, 2015 and December 31, 2014, respectively. The loan amortizes in equal quarterly installments of 0.25% of the principal amount per quarter. The second loan, made to ARCAS Automotive (formerly known as Sequa Auto), was disposed of in 2014. The Company made the loans on the same terms as the other lenders participating in the syndicate. The loans were subject to the approval of the Company's full Investment Committee.

12. Subsequent Events

The Company has evaluated subsequent events for recognition or disclosure in the consolidated financial statements filed on Form 10-Q with the SEC and no events has occurred that require recognition or disclosure.

Item 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with our accompanying consolidated financial statements and notes thereto, which appear elsewhere in this document. In this discussion, all dollar amounts are presented in thousands, except share and per share data.

The following discussion contains forward-looking statements. We intend statements which are not historical in nature to be, and are hereby identified as "forward-looking statements" to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. In addition, the Company's senior management may make forward-looking statements orally to analysts, investors, the media and others. This safe harbor requires that we specify important factors that could cause actual results to differ materially from those contained in forward-looking statements made by or on behalf of us. We cannot promise that our expectations in such forward-looking statements will turn out to be correct. Our actual results could be materially different from and worse than our expectations. See "Forward-Looking Statements" below for specific important factors that could cause actual results to differ materially from those contained in forward-looking statements.

Executive Summary and Overview

In this discussion, "Safety" refers to Safety Insurance Group, Inc. and "our Company," "we," "us" and "our" refer to Safety Insurance Group, Inc. and its consolidated subsidiaries. Our subsidiaries consist of Safety Insurance Company ("Safety Insurance"), Safety Indemnity Insurance Company ("Safety Indemnity"), Safety Property and Casualty Insurance Company ("Safety P&C"), Whiteshirts Asset Management Corporation ("WAMC"), and Whiteshirts Management Corporation, which is WAMC's holding company.

We are a leading provider of property and casualty insurance focused primarily on the Massachusetts market. Our principal product line is automobile insurance. In addition to private passenger automobile insurance (which represented 61.7% of our direct written premiums in 2014) and commercial automobile insurance (which represented 12.5% of our direct written premiums in 2014), we offer a portfolio of other insurance products, including homeowners (21.1% of 2014 direct written premiums) and dwelling fire, umbrella and business owner policies (totaling 4.7% of 2014 direct written premiums). Operating exclusively in Massachusetts and New Hampshire through our insurance company subsidiaries, Safety Insurance, Safety Indemnity, and Safety P&C (together referred to as the “Insurance Subsidiaries”), we have established strong relationships with independent insurance agents, who numbered 930 in 1,076 locations throughout Massachusetts and New Hampshire during 2014. We have used these relationships and our extensive knowledge of the Massachusetts market to become the third largest private passenger automobile and the third largest commercial automobile insurance carrier in Massachusetts, capturing an approximate 10.7% and 13.5% share, respectively, of the Massachusetts private passenger and commercial automobile markets in 2014 according to statistic compiled by the Commonwealth Automobile Reinsurers (“CAR”).

The Insurance Subsidiaries began writing private passenger automobile and homeowners insurance in New Hampshire during 2008, personal umbrella insurance in New Hampshire during 2009, and commercial automobile insurance in New Hampshire during 2011. During the nine months ended September 30, 2015 and 2014, we wrote $16,861 and $13,901, respectively, in direct written premiums in New Hampshire.

On February 9, 2015, the Insurance Subsidiaries each received a license to begin writing our property and casualty insurance products in the state of Maine. We anticipate that we will begin to write new business in Maine in early 2016.

Table of Contents

Recent Trends and Events

For the quarter ended September 30, 2015, loss and loss adjustment expense incurred increased by $9,189, or 7.7%, to $128,931 from $119,742 for the comparable 2014 period due to $12,462 of hail storm claims experienced in 2015.

For the nine months ended September 30, 2015, loss and loss adjustment expenses incurred increased by $135,101, or 38.7%, to $484,281 from $349,180 for the comparable 2014 period due to winter snowfall catastrophe losses previously reported in 2015. Safety has recorded direct catastrophe losses related to the snowfall total of $156,700 with an expected reinsurance recovery of $64,918 for the nine months ended September 30, 2015. This winter storm event is the first time in the history of the Company that a loss pierced our catastrophe reinsurance program.

The following rate changes have been filed and approved by the insurance regulators of Massachusetts and New Hampshire in 2015 and 2014. Our Massachusetts private passenger automobile rates include a 13% commission rate for agents.

Line of Business	Effective Date	Rate Change
Massachusetts Homeowner	November 1, 2015	9.1%
New Hampshire Personal Automobile	November 1, 2015	5.0%
New Hampshire Homeowner	November 1, 2015	7.9%
New Hampshire Commercial Auto	August 1, 2015	7.9%
Massachusetts Private Passenger Automobile	June 1, 2015	3.8%
Massachusetts Commercial Automobile	February 1, 2015	3.5%
Massachusetts Homeowner	December 1, 2014	2.4%
New Hampshire Personal Automobile	November 1, 2014	3.0%
New Hampshire Homeowner	October 1, 2014	3.3%

Massachusetts Automobile Insurance Market

We have been subject to extensive regulation in the private passenger automobile insurance industry in Massachusetts, which represented 61.7% of our direct written premiums in 2014. Private passenger automobile insurance has been heavily regulated in Massachusetts. In many respects, the private passenger automobile insurance market in Massachusetts prior to 2008 was unique, in comparison to other states. This was due to a number of factors, including unusual regulatory conditions, the market dominance of domestic companies, the relative absence of large national companies, and the heavy reliance on independent insurance agents as the market's principal distribution channel. Perhaps most significantly, prior to 2008, the Massachusetts Commissioner of Insurance (the "Commissioner") fixed and established the premium rates and the rating plan to be used by all insurance companies doing business in the private passenger automobile insurance market and the Massachusetts private passenger automobile insurance residual market mechanism featured a reinsurance program run by CAR in which companies were assigned producers.

In 2008, the Commissioner issued a series of decisions to introduce what the Commissioner termed “managed competition” to Massachusetts automobile insurance premium rates and in doing so replaced the fixed and established regime with a prior approval rate review process, governed by regulations that set certain terms and conditions that insurers must comply with in establishing their rates. The Commissioner also replaced the former reinsurance program with an assigned risk plan.

These decisions removed many of the factors that had historically distinguished the Massachusetts private passenger automobile insurance market from the market in other states. However, certain of the historically unique factors have not been eliminated, including compulsory insurance, affinity group marketing, and the prominence of independent agents.

CAR runs a reinsurance pool for commercial automobile policies and, beginning January 1, 2006, CAR implemented a Limited Servicing Carrier Program (“LSC”) for ceded commercial automobile policies. CAR has approved Safety and three other servicing carriers to process ceded commercial automobile insurance. Approximately $110,000 of ceded premium is spread equitably among the four servicing carriers. Subject to the Commissioner’s review, CAR sets the premium rates for commercial automobile policies reinsured through CAR and this reinsurance pool can generate an underwriting result that is a profit or deficit based upon CAR’s rate level. This underwriting result

Table of Contents

is allocated among every Massachusetts commercial automobile insurance company, including us, based on a company's commercial automobile voluntary market share.

CAR also runs a reinsurance pool for Taxi, Limousine and Car Service risks (the "Taxi/Limo Program"). CAR approved Safety Insurance as one of the two servicing carriers for this program beginning January 1, 2011 for a five-year term.

Insurance Ratios

The property and casualty insurance industry uses the combined ratio as a measure of underwriting profitability. The combined ratio is the sum of the loss ratio (losses and loss adjustment expenses incurred as a percent of net earned premiums) plus the expense ratio (underwriting and other expenses as a percent of net earned premiums, calculated on a GAAP basis). The combined ratio reflects only underwriting results and does not include income from investments or finance and other service income. Underwriting profitability is subject to significant fluctuations due to competition, catastrophic events, weather, economic and social conditions, and other factors.

Our GAAP insurance ratios are outlined in the following table.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
GAAP ratios:				
Loss ratio	69.1 %	66.4 %	87.8 %	65.3 %
Expense ratio	28.7	30.2	28.6	30.4
Combined ratio	97.8 %	96.6 %	116.4 %	95.7 %

Share-Based Compensation

Long-term incentive compensation is provided under the Company's 2002 Management Omnibus Incentive Plan ("the Incentive Plan") which provides for a variety of share-based compensation awards, including nonqualified stock options, incentive stock options, stock appreciation rights and restricted stock ("RS") awards.

The maximum number of shares of common stock with respect to which awards may be granted is 2,500,000. The Incentive Plan was amended in March of 2013 to remove "share recycling" plan provisions. Hence, shares of stock covered by an award under the Incentive Plan that are forfeited are no longer available for issuance in connection with 2013 and future grants of awards. At September 30, 2015, there were 369,755 shares available for future grant. The Board of Directors and the Compensation Committee intend to issue more awards under the Incentive Plan in the future.

A summary of share based awards granted under the Incentive Plan during the nine months ended September 30, 2015 is as follows:

Type of Equity Awarded	Effective Date	Number of Awards Granted	Fair Value per Share		Vesting Terms
RS - Service	February 24, 2015	24,076	$ 61.68	(1)	3 years, 30%-30%-40%
RS	February 24, 2015	4,000	$ 61.68	(1)	No vesting period
RS - Service	February 24, 2015	17,321	$ 61.68	(1)	5 years, 20% annually (3)
RS - Performance	February 24, 2015	35,932	$ 63.73	(2)	3 years, cliff vesting (4)
RS - Service	July 1, 2015	1,546	$ 58.21	(1)	3 years, 30%-30%-40%
RS - Performance	July 1, 2015	1,790	$ 61.45	(2)	3 years, cliff vesting (4)

(1) The fair value per share of the restricted stock grant is equal to the closing price of our common stock on the grant date.

(2) The fair value per share of the restricted stock grant is equal to the performance-based restricted stock award calculation.

(3) The shares represent awards granted to non-executive employees and vest ratably over a five-year service period.

(4) The shares represent performance-based restricted share awards. Vesting of these shares is dependent upon the attainment of pre-established performance objectives, and any difference between shares granted and earned at the end of the performance period will be reported at the conclusion of the performance period in 2017.

Reinsurance

We reinsure with other insurance companies a portion of our potential liability under the policies we have underwritten, thereby protecting us against an unexpectedly large loss or a catastrophic occurrence that could produce large losses, primarily in our homeowners line of business. We use various software products to measure our exposure to catastrophe losses and the probable maximum loss to us for catastrophe losses such as hurricanes. The models include estimates for our share of the catastrophe losses generated in the residual market for property insurance by the Massachusetts Property Insurance Underwriting Association ("FAIR Plan"). The reinsurance market has seen from the various software modelers, increases in the estimate of damage from hurricanes in the southern and northeast portions of the United States due to revised estimations of increased hurricane activity and increases in the estimation of demand surge in the periods following a significant event. We continue to manage and model our exposure and adjust our reinsurance programs as a result of the changes to the models. As of January 1, 2015, we have purchased three layers of excess catastrophe reinsurance providing $515,000 of coverage for property losses in excess of $50,000 up to a maximum of $565,000. Our reinsurers' co-participation is 65.0% of $100,000 for the 1st layer, 80.0% of $280,000 for the 2nd layer, and 80.0% of $135,000 for the 3rd layer. As a result of the changes to the models, and our revised reinsurance program, our catastrophe reinsurance in 2015 protects us in the event of a "111-year storm" (that is, a storm of a severity expected to occur once in a 111-year period). Swiss Re, our primary reinsurer, maintains an A.M. Best rating of "A" (Excellent). Most of our other reinsurers have an A.M. Best rating of "A+" (Excellent) or "A" (Excellent).

We are a participant in CAR, a state-established body that runs the residual market reinsurance programs for commercial automobile insurance in Massachusetts under which premiums, expenses, losses and loss adjustment expenses on ceded business are shared by all insurers writing automobile insurance in Massachusetts. We also participate in the FAIR Plan in which premiums, expenses, losses and loss adjustment expenses on homeowners business that cannot be placed in the voluntary market are shared by all insurers writing homeowners insurance in Massachusetts. The FAIR Plan's exposure to catastrophe losses increased and as a result, the FAIR Plan decided to buy reinsurance to reduce their exposure to catastrophe losses. On July 1, 2015, the FAIR Plan purchased $1,325,000 of catastrophe reinsurance for property losses with retention of $100,000. At September 30, 2015, our total expected reinsurance recovery from reinsurers under our catastrophe reinsurance program related to the 2015 snow event as discussed in the Recent Trends and Event section is $64,918. Amounts recoverable from reinsurers are billed to the reinsurer as claims are paid by the Company. The current reinsurance recoverable related to the 2015 snow event is $46,571. We also had $55,385 recoverable from CAR.

Effects of Inflation

We do not believe that inflation has had a material effect on our consolidated results of operations, except insofar as inflation may affect interest rates.

Table of Contents

Results of Operations

Three and Nine Months Ended September 30, 2015 Compared to Three and Nine Months Ended

September 30, 2014

The following table shows certain of our selected financial results.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Direct written premiums	$ 204,381	$ 197,415	$ 612,360	$ 597,326
Net written premiums	$ 194,200	$ 188,751	$ 583,667	$ 575,176
Net earned premiums	$ 186,582	$ 180,277	$ 551,593	$ 534,397
Net investment income	9,950	10,809	30,824	31,291
Earnings from partnership investments	859	—	1,436	—
Net realized (losses) gains on investments	(310)	284	(72)	683
Net impairment losses on investments	(434)	—	(434)	—
Finance and other service income	4,623	4,749	13,564	13,781
Total revenue	201,270	196,119	596,911	580,152
Loss and loss adjustment expenses	128,931	119,742	484,281	349,180
Underwriting, operating and related expenses	53,624	54,378	157,919	162,203
Interest expense	22	22	67	67
Total expenses	182,577	174,142	642,267	511,450
(Loss) income before income taxes	18,693	21,977	(45,356)	68,702
Income tax (credit) expense	6,712	6,541	(21,213)	19,718
Net (loss) income	$ 11,981	$ 15,436	$ (24,143)	$ 48,984
(Loss) earnings per weighted average common share:				
Basic	$ 0.80	$ 1.03	$ (1.62)	$ 3.23
Diluted	$ 0.80	$ 1.03	$ (1.62)	$ 3.21
Cash dividends paid per common share	$ 0.70	$ 0.70	$ 2.10	$ 1.90

Direct Written Premiums. Direct written premiums for the quarter ended September 30, 2015 increased by $6,966, or 3.5%, to $204,381 from $197,415 for the comparable 2014 period. Direct written premiums for the nine months ended September 30, 2015 increased by $15,034, or 2.5%, to $612,360 from $597,326 for the comparable 2014 period. The 2015 increases occurred primarily in our commercial and homeowners business lines, which experienced increases of 5.6%, and 2.4%, respectively, in average written premium per exposure. Written exposures increased in our commercial automobile and homeowners business lines by 5.5% and 3.2%, respectively.

Net Written Premiums. Net written premiums for the quarter ended September 30, 2015 increased by $5,449, or 2.9%, to $194,200 from $188,751 for the comparable 2014 period. Net written premiums for the nine months ended September 30, 2015 increased by $8,491, or 1.5%, to $583,667 from $575,176 for the comparable 2014 period.

Net Earned Premiums. Net earned premiums for the quarter ended September 30, 2015 increased by $6,305, or 3.5%, to $186,582 from $180,277 for the comparable 2014 period. Net earned premiums for the nine months ended September 30, 2015 increased by $17,196, or 3.2%, to $551,593 from $534,397 for the comparable 2014 period. The 2015 increase was primarily due to the factors that increased direct commercial automobile and homeowners written premiums.

Table of Contents

The effect of reinsurance on net written and net earned premiums is presented in the following table.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Written Premiums				
Direct	$ 204,381	$ 197,415	$ 612,360	$ 597,326
Assumed	7,205	4,861	21,137	19,199
Ceded	(17,386)	(13,525)	(49,830)	(41,349)
Net written premiums	$ 194,200	$ 188,751	$ 583,667	$ 575,176
Earned Premiums				
Direct	$ 196,533	$ 188,348	$ 579,818	$ 557,359
Assumed	6,430	5,662	19,030	17,845
Ceded	(16,381)	(13,733)	(47,255)	(40,807)
Net earned premiums	$ 186,582	$ 180,277	$ 551,593	$ 534,397

Net Investment Income. Net investment income for the quarter ended September 30, 2015 decreased by $859, or 7.9%, to $9,950 from $10,809 for the comparable 2014 period. Net investment income for the nine months ended September 30, 2015 decreased by $467, or 1.5%, to $30,824 from $31,291 for the comparable 2014 period. Net effective annualized yield on the investment portfolio was 3.3% for the quarter ended September 30, 2015 compared to 3.6% for the quarter ended September 30, 2014. Net effective annualized yield on the investment portfolio was 3.4% for the nine months ended September 30, 2015 and 2014. The investment portfolio's duration was 4.2 years at September 30, 2015 and 3.8 years at December 31, 2014.

Earnings from Partnership Investments. Earnings from partnership investments was $859 and $1,436 for the quarter and nine months ended September 30, 2015, respectively. Investment in this partnership commenced in the fourth quarter of 2014.

Net Realized (Losses) Gains on Investments. Net realized losses on investments was $310 for the quarter ended September 30, 2015 compared to net realized gains of $284 for the comparable 2014 period. Net realized losses on investments was $72 for the nine months ended September 30, 2015 compared to net realized gains of $683 for the comparable 2014 period.

The gross unrealized gains and losses on investments in fixed maturity securities, equity securities, including interests in mutual funds, and other invested assets were as follows:

	As of September 30, 2015				
			Gross Unrealized Losses (3)		
	Cost or Amortized Cost	Gross Unrealized Gains	Non-OTTI Unrealized Losses	OTTI Unrealized Losses (4)	Estimated Fair Value
U.S. Treasury securities	$ 15,941	$ 114	$ —	$ —	$ 16,055
Obligations of states and political subdivisions	366,006	19,571	(632)	—	384,945
Residential mortgage-backed securities (1)	216,613	6,572	(726)	—	222,459
Commercial mortgage-backed securities	33,924	377	(18)	—	34,283
Other asset-backed securities	12,707	148	—	—	12,855
Corporate and other securities	401,472	5,761	(6,663)	—	400,570
Subtotal, fixed maturity securities	1,046,663	32,543	(8,039)	—	1,071,167
Equity securities (2)	100,704	9,345	(6,377)	—	103,672
Other invested assets (5)	15,319	—	—	—	15,319
Totals	$ 1,162,686	$ 41,888	$ (14,416)	$ —	$ 1,190,158

(1) Residential mortgage-backed securities consists primarily of obligations of U.S. Government agencies including collateralized mortgage obligations issued, guaranteed and/or insured by the following issuers: Government National Mortgage Association (GNMA), Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA) and the Federal Home Loan Bank (FHLB).

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

(3) Our investment portfolio included 410 securities in an unrealized loss position at September 30, 2015.