

SAFETY INSURANCE GROUP INC
Form 10-K
February 26, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10 K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 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 (I.R.S. Employer Identification No.)
incorporation or organization)

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)

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

Title of each class	Name of each exchange on which registered
Common Shares, \$0.01 par value per share	NASDAQ Global Select Market

Indicate by check mark whether the registrant is a well known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

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Indicate by check mark whether the registrant is not required to file reports pursuant to Section 13 of Section 15(d) of the Act. Yes No

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 Regulations 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S K (§ 229.405 of this chapter) 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.

Indicate by check mark whether the registrant is a 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
(Do not check if a 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

The aggregate market value of the registrant's voting and non voting common equity (based on the closing sales price on NASDAQ) held by non affiliates of the registrant as of June 30, 2015, was approximately \$811,331,905.

As of February 17, 2016 there were 15,092,099 Common Shares with a par value of \$0.01 per share outstanding.

Documents Incorporated by Reference

Portions of the registrant's definitive proxy statement for its Annual Meeting of Shareholders to be held on May 18, 2016, which Safety Insurance Group, Inc. (the "Company", "we", "our", "us") intends to file within 120 days after its December 31, 2015 year end, are incorporated by reference into Part II and Part III hereof.

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In this Form 10-K, all dollar amounts are presented in thousands, except average premium, average claim and per claim data, share, and per share data.

PART I.

ITEM 1. BUSINESS

General

We are a leading provider of private passenger automobile insurance in Massachusetts. In addition to private passenger automobile insurance (which represented 59.6% of our direct written premiums in 2015), we offer a portfolio of property and casualty insurance products, including commercial automobile, homeowners, dwelling fire, umbrella and business owner policies. Operating exclusively in Massachusetts and New Hampshire through our insurance company subsidiaries, Safety Insurance Company ("Safety Insurance"), Safety Indemnity Insurance Company ("Safety Indemnity") and Safety Property and Casualty Insurance Company ("Safety P&C") (together referred to as the "Insurance Subsidiaries"), we have established strong relationships with independent insurance agents, who numbered 924 in 1,102 locations throughout Massachusetts and New Hampshire during 2015. We have used these relationships and our extensive knowledge of the Massachusetts market to become the third largest private passenger automobile carrier, capturing an approximate 10.2% share of the Massachusetts private passenger automobile insurance market, and the second largest commercial automobile carrier, with an 14.1% share of the Massachusetts commercial automobile insurance market in 2015 according to statistics compiled by Commonwealth Automobile Reinsurers ("CAR"). We are also the fourth largest homeowners insurance carrier in Massachusetts with a 7.2% share of the Massachusetts homeowners insurance market. In addition, we were also ranked the 45th largest automobile writer in the country according to A.M. Best, based on 2014 direct written premiums. We were incorporated under the laws of Delaware in 2001, but through our predecessors, we have underwritten insurance in Massachusetts since 1979.

Our Insurance Subsidiaries began writing private passenger automobile and homeowners insurance in New Hampshire during 2008, personal umbrella insurance during 2009, and commercial automobile insurance during 2011. During the years ended December 31, 2015, 2014, and 2013, the Company wrote \$22,731, \$18,755, and \$13,773 in direct written premiums, respectively, and approximately 24,364, 20,626 and 15,580 policies, respectively, 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 beginning in the first quarter of 2016.

Website Access to Information

The Internet address for our website is www.SafetyInsurance.com. All of our press releases and United States Securities and Exchange Commission ("SEC") reports are available for viewing or download at our website. These documents are made available on our website as soon as reasonably practicable after each press release is made and SEC report is filed with, or furnished to, the SEC. Copies of any current public information about our company are available without charge upon written, telephone, faxed or e-mailed request to the Office of Investor Relations, Safety Insurance Group, Inc., 20 Custom House Street, Boston, MA 02110, Tel: 877-951-2522, Fax: 617-603-4837, or e-mail: InvestorRelations@SafetyInsurance.com. The materials on our website are not part of this report on Form 10-K nor are they incorporated by reference into this report and the URL above is intended to be an inactive textual reference only.

Our Competitive Strengths

We Have Strong Relationships with Independent Agents. In 2015, Independent agents accounted for approximately 63.4% of the Massachusetts automobile insurance market measured by direct written premiums as

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compared to approximately 31.3% nationwide, based on data made available by A.M. Best. For that reason, our strategy is centered around, and we sell exclusively through, a network of independent agents, who numbered 924 in 1,102 locations throughout Massachusetts and New Hampshire during 2015. In order to support our independent agents and enhance our relationships with them, we:

- provide our agents with a portfolio of property and casualty insurance products at competitive prices to help our agents address effectively the insurance needs of their clients;
- provide our agents with a variety of technological resources which enable us to deliver superior service and support to them; and
- offer our agents competitive commission schedules and profit sharing programs.

Through these measures, we strive to become the preferred provider of the independent agents in our agency network and capture a growing share of the total insurance business written by these agents in Massachusetts and New Hampshire. We must compete with other insurance carriers for the business of independent agents.

We Have a History of Profitable Operations. In 34 out of 35 years since our inception in 1979, we have been profitable. The lone year where we did not have profits was 2015 when we were impacted by claims related to the highest recorded snowfall totals in Massachusetts history. We have achieved our profitability, among other things, by:

- maintaining a consistent number of private passenger automobile exposures we underwrite, which totaled 471,924 in 2015 compared to 477,238 in 2011;
- growing our commercial automobile exposures we underwrite, which totaled 68,591 in 2015 compared to 49,150 in 2011;
- growing our homeowner book of business which had total exposures of 162,703 in 2015 compared to 130,563 in 2011;
- maintaining a combined ratio that is typically below industry averages (refer to Insurance Ratios under Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations for a discussion on insurance ratios);
- taking advantage of the institutional knowledge our management has amassed during our long operating history in the Massachusetts market;
- introducing new lines and forms of insurance products;
- investing in technology to simplify internal processes and enhance our relationships with our agents; and
- maintaining a high-quality investment portfolio.

We Are a Technological Leader. We have dedicated significant human and financial resources to the development of advanced information systems. Our technology efforts have benefited us in two distinct ways. First, we continue to develop technology that empowers our independent agent customers to make it easier for them to transact business with their clients and with the Insurance Subsidiaries. In our largest business line, private passenger automobile insurance, our agents now submit approximately 99.0% of all applications for new policies or endorsements for existing policies to us electronically through our proprietary information portal, the Agents Virtual Community ("AVC"). Our agents can also submit commercial automobile and homeowners insurance policies electronically over AVC. Second, our investment in technology has allowed us to re-engineer internal back office processes to provide more efficient service at lower cost.

We Have an Experienced, Committed and Knowledgeable Management Team. Our senior management team owns approximately 4.9% of the common stock of Safety Insurance Group, Inc. on a fully diluted basis. Our senior management team has an average of over 29 years of experience with Safety. The team has demonstrated an ability to operate successfully within the Massachusetts automobile and homeowner insurance markets.

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Our Strategy

To achieve our goal of increasing shareholder value, our strategy is to maintain and develop strong independent agent relationships by providing our agents with a full package of insurance products and information technology services. We believe this strategy will allow us to:

- further penetrate the Massachusetts, New Hampshire and Maine private passenger, commercial automobile and homeowners insurance markets;
- implement rates, forms and billing options that allow us to cross-sell homeowners, dwelling fire, and personal umbrella in the personal lines market and business owner policies, commercial property package and commercial umbrella in the commercial lines market in order to capture a larger share of the total Massachusetts property and casualty insurance business written by each of our independent agents; and
- continue to expand our technology to enable independent agents to more easily serve their customers and conduct business with us, thereby strengthening their relationships with us.

Property and Casualty Insurance Market

Introduction. We are licensed by the Commissioner of Insurance (the "Commissioner") to transact property and casualty insurance in Massachusetts. All of our Massachusetts business is extensively regulated by the Commissioner.

The Massachusetts Market for Private Passenger Automobile Insurance. Private passenger automobile insurance is generally considered to be more heavily regulated in Massachusetts than in other states, under what the Massachusetts Commissioner of Insurance calls Managed Competition. Since 2008, Massachusetts automobile insurance premium rates are strictly regulated under a prior approval rate review process, governed by regulations that set certain terms and conditions that insurers must comply with in establishing their rates. Certain of the historically unique factors in Massachusetts continue to exist, including compulsory insurance, affinity group marketing, and the prominence of independent agents.

Products

Historically, we have focused on underwriting private passenger automobile insurance, which is written through our subsidiary, Safety Insurance. In 1989, we formed Safety Indemnity to offer commercial automobile insurance at preferred rates. Since 1997, we have expanded the breadth of our product line in order for agents to address a greater portion of their clients' insurance needs by selling multiple products. Homeowners, business owners' policies, personal umbrella, dwelling fire and commercial umbrella insurance are written by Safety Insurance at standard rates, and written by Safety Indemnity at preferred rates. In December 2006, we formed Safety P&C to offer homeowners and commercial automobile insurance at ultra preferred rates.

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The table below shows our premiums in each of these product lines for the periods indicated and the portions of our total premiums each product line represented.

Direct Written Premiums	Years Ended December 31,					
	2015		2014		2013	
Private passenger automobile	\$ 468,187	59.6 %	\$ 472,553	61.7 %	\$ 467,431	63.9 %
Commercial automobile	108,013	13.8	95,398	12.5	86,003	11.8
Homeowners	170,410	21.7	161,388	21.1	144,925	19.8
Business owners	22,223	2.8	20,751	2.7	19,688	2.7
Personal umbrella	6,925	0.9	6,508	0.8	5,927	0.8
Dwelling fire	8,920	1.1	8,104	1.1	6,811	0.9
Commercial umbrella	1,052	0.1	983	0.1	895	0.1
Total	\$ 785,730	100.0%	\$ 765,685	100.0%	\$ 731,680	100.0%

Our product lines are as follows:

Private Passenger Automobile (59.6% of 2015 direct written premiums). Private passenger automobile insurance is our primary product, and we support all Massachusetts policy forms and limits of coverage. Private passenger automobile policies provide coverage for bodily injury and property damage to others, no-fault personal injury coverage for the insured/insured's car occupants, and physical damage coverage for an insured's own vehicle for collision or other perils. We have priced our private passenger coverage competitively by offering group discounts since 1995 and we currently offer approximately 95 affinity group discount programs ranging from 3.0% to 8.0% discounts. Under Massachusetts' Managed Competition regulations, we offer various new discounts including a discount of up to 10.0% when a private passenger policy is issued along with an other than private passenger policy with us, a longevity/renewal credit of up to 4.0% for policyholders who maintain continuous coverage with us, and up to a 7.0% e-Customer discount for policyholders who want electronic policy issuance with one combined bill for all of their policies with us. We filed and were approved for a Massachusetts private passenger automobile insurance rate increase of 3.8% effective June 1, 2015. We filed and were approved for a New Hampshire private passenger automobile rate increase of 5.0%, which was effective November 1, 2015.

Commercial Automobile (13.8% of 2015 direct written premiums). Our commercial automobile program supports all Massachusetts policy forms and limits of coverage including endorsements that broaden coverage over and above that offered on the standard Massachusetts policy forms. Commercial automobile policies provide coverage for bodily injury and property damage to others, no-fault personal injury coverage, and physical damage coverage for an insured's own vehicle for collision or other perils resulting from the ownership or use of commercial vehicles in a business. We offer insurance for commercial vehicles used for business purposes such as private passenger-type vehicles, trucks, tractors and trailers, and insure individual vehicles as well as commercial fleets. Commercial automobile policies are written at a standard rate through Safety Insurance. We filed and were approved for a Massachusetts commercial automobile insurance rate increase of 3.5% effective February 1, 2015. We filed and were approved for a New Hampshire commercial automobile insurance rate increase of 7.9% effective August 1, 2015. Qualifying risks eligible for preferred rates are written through Safety Indemnity which offers rates that are 20.0% lower than Safety Insurance. Qualifying risks eligible for ultra preferred rates are written through Safety P&C which offers rates that are 35.0% lower than Safety Insurance.

Homeowners (21.7% of 2015 direct written premiums). We offer a broad selection of coverage forms for qualified policyholders. Homeowners policies provide coverage for losses to a dwelling and its contents from numerous perils,

and coverage for liability to others arising from ownership or occupancy. We write policies on homes, condominiums, and apartments. We offer loss-free credits of up to 16.0% for eight years of loss-free experience, an account credit of up to 20.0% when a home is written together with an automobile, and up to a 5.0% e-Customer discount for policyholders who want electronic policy issuance with one combined bill for all of their policies with us. We filed and were approved for a Massachusetts rate increase of 9.1% which was effective November 1, 2015. We filed and were approved for a New Hampshire homeowners rate increase of 7.9%, which was effective November 1, 2015. All forms of homeowners coverage are written at a standard rate through Safety Insurance. Qualifying risks eligible for

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preferred rates are written through Safety Indemnity which offers rates that are 13.0% lower than Safety Insurance. Homes with high insured property values are written through Safety P&C.

Business Owners Policies (2.8% of 2015 direct written premiums). We serve eligible small and medium sized commercial accounts with a program that covers apartments and residential condominiums; mercantile establishments, including limited cooking restaurants; offices, including office condominiums; processing and services businesses; special trade contractors; and wholesaling businesses. Business owner policies provide liability and property coverage for many perils, including business interruption from a covered loss. Equipment breakdown coverage is automatically included, and a wide range of additional coverage is available to qualified customers. We write policies for business owners at standard rates with qualifying risks eligible for preferred lower rates.

Commercial Package Policies (Included in our Business Owners Policies direct written premiums). For larger commercial accounts or those clients that require more specialized or tailored coverages, we offer a commercial package policy program that covers a more extensive range of business enterprises. Commercial package policies provide any combination of property, general liability, crime and inland marine insurance. Property automatically includes equipment breakdown coverage, and a wide range of additional coverage is available to qualified customers. We write commercial package policies at standard rates with qualifying risks eligible for preferred lower rates.

Personal Umbrella (0.9% of 2015 direct written premiums). We offer personal excess liability coverage over and above the limits of individual automobile, watercraft, and homeowner's insurance policies to clients. We offer an account credit of 10.0% when an umbrella policy is written together with an automobile insurance policy. We write policies at standard rates with limits of \$1,000 to \$5,000.

Dwelling Fire (1.1% of 2015 direct written premiums). We underwrite dwelling fire insurance, which is a limited form of a homeowner's policy for non-owner occupied residences. We offer superior construction and protective device credits, with an account credit of 5.0% when a dwelling fire policy is issued along with an automobile policy. We write all forms of dwelling fire coverage at standard rates with qualifying risks eligible for preferred lower rates.

Commercial Umbrella (0.1% of 2015 direct written premiums). We offer an excess liability product to clients for whom we underwrite both commercial automobile and business owner policies. The program is directed at commercial automobile risks with private passenger-type automobiles or light and medium trucks. We write commercial umbrella policies at standard rates with limits ranging from \$1,000 to \$5,000.

Inland Marine (Included in our Homeowners direct written premiums). We offer inland marine coverage as an endorsement for all homeowners and business owner policies, and as part of our commercial package policy. Inland marine provides additional coverage for jewelry, fine arts and other items that a homeowners or business owner policy would limit or not cover. Scheduled items valued at more than \$5 must meet our underwriting guidelines and be appraised.

Watercraft (Included in our Homeowners direct written premiums). We offer watercraft coverage for small and medium sized pleasure craft with maximum lengths of 32 feet, valued at less than \$75 and maximum speed of 39 knots. We write this coverage as an endorsement to our homeowner's policies.

In the wake of the September 11, 2001 tragedies, the insurance industry is also impacted by terrorism, and we have filed and received approval for a number of terrorism endorsements from the Commissioner, which limit our liability and property exposure according to the Terrorism Risk Insurance Act of 2002, the Terrorism Risk Insurance Extension Act of 2005, the Terrorism Risk Insurance Program Reauthorization Act of 2007 and the Terrorism Risk

Insurance Program Reauthorization of 2014. See "Reinsurance," discussed below.

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Distribution

We distribute our products exclusively through independent agents, unlike some of our competitors who use multiple distribution channels. We believe this gives us a competitive advantage with the agents. With the exception of personal automobile business assigned to us by the Massachusetts Automobile Insurance Plan ("MAIP") or written through CAR's commercial automobile Limited Servicing Carrier program, we do not accept business from insurance brokers. Our voluntary agents have authority pursuant to our voluntary agency agreement to bind our Insurance Subsidiaries for any coverage that is within the scope of their authority. We reserve the ability under Massachusetts law to cancel any coverage, other than private passenger automobile insurance, within the first 30 days after it is bound. In total, our independent agents numbered 924 and had 1,102 offices (some agencies have more than one office) and approximately 8,118 customer service representatives during 2015.

Voluntary Agents. In 2015, we obtained approximately 93.2% of our direct written premiums for automobile insurance and 100% of our direct written premiums for all of our other lines of business through our voluntary agents. As of December 31, 2015, we had agreements with 749 voluntary agents. Our voluntary agents are located in all regions of Massachusetts and New Hampshire.

We look for agents with profitable portfolios of business. To become a voluntary agent for our Company, we generally require that an agency: (i) have been in business for at least five years; (ii) have exhibited a three year private passenger average ratio of losses, excluding loss adjustment expenses, to net earned premiums ("pure loss ratio") of 65.0% or less on the portion of the agent's portfolio that we would underwrite; (iii) make a commitment for us to underwrite at least 300 policies from the agency during the first twelve months after entering an agreement with us; and (iv) offer multiple product lines. Every year, we review the performance of our agents during the prior year. If an agent fails to meet our profitability standards, we try to work with the agent to improve the profitability of the business it places with us. We generally terminate contracts each year with a few agencies, which, despite our efforts, have been consistently unable to meet our standards. Although independent agents usually represent several unrelated insurers, our goal is to be one of the top two insurance companies represented in each of our agencies, as measured by premiums. No individual agency generated more than 5.0% of our direct written premiums in 2015.

Massachusetts law guarantees that CAR provides motor vehicle insurance coverage to all qualified applicants. Under MAIP, personal automobile policies are assigned to us for three years, unless the policyholder is offered a voluntary policy by another insurer. All Massachusetts agents are authorized to submit eligible business to the MAIP for random assignment to a servicing carrier such as Safety Insurance. We are allocated all private passenger residual market business through the MAIP.

CAR runs a reinsurance pool for ceded commercial automobile policies through a Limited Servicing Carrier Program ("LSC"). CAR has approved Safety and three other servicing carriers to process ceded commercial automobile insurance. Approximately \$140,000 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 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 as one of the two servicing carriers for this program beginning January 1, 2011 for a five-year term. Approximately \$10,000 of ceded premium was spread equitably between the two servicing carriers.

We are assigned independent agents by CAR who can submit commercial business to us in the LSC and Taxi/Limo Program, and we classify those agents as commercial LSC producers.

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The table below shows our direct written exposures in each of our product lines for the periods indicated and the change in exposures for each product line.

Line of Business	Years Ended December 31,							
	2015		2014		2013			
	Exposures	Change	Exposures	Change	Exposures	Change		
Private passenger automobile:								
Voluntary agents	462,917	-1.8	% 471,546	1.1	% 466,209	0.9	%	
MAIP	9,007	4.6	8,611	-10.4	9,615	-36.4		
Total private passenger automobile	471,924	-1.7	480,157	0.9	475,824	0.3		
Commercial automobile:								
Voluntary agents	60,995	4.2	58,550	6.6	54,934	11.2		
LSC Producers	7,596	20.6	6,299	-1.8	6,411	9.1		
Total commercial automobile	68,591	5.8	64,849	5.7	61,345	10.9		
Other:								
Homeowners	162,703	2.4	158,942	7.5	147,882	5.7		
Business owners	10,166	4.4	9,739	3.8	9,384	9.5		
Personal umbrella	24,083	2.6	23,483	9.0	21,551	7.9		
Dwelling fire	7,381	4.0	7,095	12.6	6,302	6.6		
Commercial umbrella	690	3.0	670	2.8	652	11.5		
Total other	205,023	2.6	199,929	7.6	185,771	6.2		
Total	745,538	0.1	744,935	3.0	722,940	2.2		
Total voluntary agents	728,935	-0.2	730,025	3.3	706,914	3.0		

Our total written exposures increased by 0.1% for the year ended December 31, 2015. Our commercial automobile exposures increased by 5.8% in 2015 due to additional exposures from voluntary agents. Our other than auto exposures increased by 2.6% in 2015 primarily as a result of our voluntary agents' efforts to sell multiple products to their clients and our pricing strategy of offering account discounts to policyholders who insure both their home and automobile with us. In 2015, 55.8% of the private passenger automobile exposures we insure had an other than private passenger policy with us, compared to 55.4% and 52.4% in 2014 and 2013, respectively. In addition, 81.8% of our homeowners' policyholders had a matching automobile policy with us in 2015 compared to 83.2% in 2014 and 83.6% in 2013.

Marketing

We view the independent agent as our customer and business partner. As a result, a component of our marketing efforts focuses on developing interdependent relationships with leading Massachusetts and New Hampshire agents that write profitable business and positioning ourselves as the preferred insurance carrier of those agents, thereby receiving a larger portion of each agent's aggregate business. Our principal marketing strategies to agents are:

- to offer a range of products, which we believe enables our agents to meet the insurance needs of their clients, and overcomes the agents' resistance to placing their clients' private passenger and commercial automobile, homeowners, commercial property and other coverage's with different insurers;
 - to price our products competitively, including offering discounts when and where appropriate for safer drivers for our personal automobile products, loss-free credits for our homeowner products and also offering account discounts for policyholders that have more than one policy with us;
 - to design, price and market our products to our agents for their customers to place all their insurance with us;
 - to offer agents competitive commissions, with incentives for placing their more profitable business with us; and
 - to provide a level of support and service that enhances the agent's ability to do business with its clients and with us.
- We have a comprehensive branding campaign using a variety of radio, television, internet and print advertisements.

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Commission Schedule and Profit Sharing Plan. We have several programs designed to attract profitable new business from agents by paying them competitive commissions. We recognize our top performing agents by making them members of either our Chairman's Elite, Chairman's, President's, Executive's or Preferred Agent's Club. In 2015, members of these Clubs received a commission of up to 18.0% of premiums for each new private passenger auto policy, up to 22.0% of premiums for each new homeowner policy, up to 20.0% for each new commercial auto policy and up to 22.0% for each new commercial property policy.

Further, we have a competitive agency incentive commission program under which we pay agents up to 7.5% of premiums based on the loss ratio on their business.

Service and Support. We believe that the level and quality of service and support we provide helps differentiate us from other insurers. We have made a significant investment in information technology designed to facilitate our agents' business. Our AVC website helps agents manage their work efficiently. We provide a substantial amount of information online that agents need to serve their customers, such as information about the status of new policies, bill payments and claims. Providing this type of content reduces the number of customer calls we receive and empowers the agent's customer service representatives by enabling them to respond to customers' inquiries while the customer is on the telephone. Finally, we believe that the knowledge and experience of our employees enhances the quality of support we provide.

Underwriting

Our underwriting department is responsible for a number of key decisions affecting the profitability of our business, including:

- pricing of our private passenger automobile, commercial automobile, homeowners, dwelling fire, personal umbrella, business owners, commercial umbrella and commercial package products;
- developing new products, coverages, forms and discounts, as well as expansion into new states;
- determining underwriting guidelines for all our products; and
- evaluating whether to accept transfers of a portion of an existing or potential new agent's portfolio from another insurer.

Pricing. Subject to the Commissioner's review, we set rates for our private passenger business using industry loss cost data, our own loss experience, residual market deficits, catastrophe modeling and prices charged by our competitors in the Massachusetts market. Additionally subject to the Commissioner's review, Commonwealth Automobile Reinsurers ("CAR") establishes the rates for personal automobile policies assigned to carriers through the Massachusetts Automobile Insurance Plan ("MAIP"). In accordance with Massachusetts law, insurers may only charge MAIP policyholders the lower of the CAR/MAIP rate or the company's competitive voluntary market rate. We offer group discounts to private passenger auto policyholder who are members of 95 affinity groups. In general, we target affinity groups with a mature and stable membership base along with favorable driving records, offering between a 3.0% and 8.0% discount (with 4.7% being the average discount offered).

Subject to the Commissioner's review, CAR sets the premium rates for commercial automobile policies reinsured through the CAR residual market pool. We set rates for voluntary commercial automobile policies that are not reinsured through CAR, and for all other insurance lines we offer, including homeowners, dwelling fire, personal umbrella, commercial umbrella, commercial package policies and business owner policies. All of these rates are subject to the approval of the Commissioner of Insurance. In each line of business, we base our rates on our own loss experience, residual market deficits, catastrophe modeling, industry loss cost data and prices charged by our competitors in the Massachusetts market. We have three pricing segments for most products, utilizing Safety

Insurance for standard rates, Safety Indemnity for preferred rates and Safety Property and Casualty for ultra preferred rates.

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CAR Reinsurance Pool. CAR operates a reinsurance pool for commercial automobile policies and we are one of four approved servicing carriers. CAR also operates a reinsurance pool for taxi/limousine/car service commercial automobile policies, and we are one of two servicing carriers that service these policies for CAR. All commercial automobile business and taxi/limousine/car service business that is not written in the voluntary market in Massachusetts is apportioned to one of these servicing carriers who handle that business on behalf of CAR. Every Massachusetts commercial automobile insurer must bear a portion of the losses of the total commercial reinsurance pool that is serviced by the approved servicing carriers.

Bulk Policy Transfers and New Voluntary Agents. From time to time, we receive proposals from an existing voluntary agent to transfer a portfolio of the agent's business from another insurer to us. Our underwriters model the profitability of these portfolios before we accept these transfers. Among other things, we usually require that the private passenger portion of the portfolio have a pure loss ratio of 65.0% or less on the portion of the agent's portfolio that we would underwrite. In addition, we require any new voluntary agent to commit to transfer a portfolio to us consisting of at least 300 policies.

Policy Processing and Rate Pursuit. Our underwriting department assists in processing policy applications, endorsements, renewals and cancellations. Our proprietary software, Safety Express, provides our agents with new business and endorsement entry, real-time policy issuance for personal lines, immediate printing of declarations pages in agents' offices, policy downloads to most major agency management systems and data imports from Boston Software's WinRater (Massachusetts) and Vertafore's PL Rater (New Hampshire).

In personal lines, our agents now submit approximately 99% of all applications for new policies or endorsements for existing policies through Safety Express.

Our rate pursuit team aggressively monitors all insurance transactions to make sure we receive the correct premium for the risk insured. We accomplish this by verifying pricing criteria, such as proper classification of drivers, the make, model, and age of insured vehicles, and the availability of discounts. We verify that operators are properly listed and classified, assignment of operators to vehicles, vehicle garaging, vehicle pre-inspection requirements, and in some cases the validity of discounts. In our homeowners and dwelling fire lines, our team has completed a project to update the replacement costs for each dwelling. We use third-party software to assist in these appraisal efforts.

Product Management. The Product Management area is responsible for the overall review and updating of our products. The department maintains an annual schedule where each line of business is reviewed and benchmarked with our major competitors. Product offerings, discounts, rate levels and underwriting guidelines are reviewed and updates are performed as required. The department is also responsible for the updating of producer material such as rate and rule manuals, and underwriting guidelines as well as promotional materials. In conjunction with the underwriting operations area, the department works with third party vendors that assist with risk information gathering and rate pursuit for in force policies. The area also provides product training and general marketplace education for the organization.

Legal and Regulatory Compliance. The Legal and Regulatory Compliance department provides general legal and compliance support to all business units within the company. The department monitors legal and regulatory changes affecting the company and provides guidance on how to comply with those changes. The department reviews business unit operations to identify and address compliance vulnerabilities. It serves as the primary liaison for company regulators on regulatory matters, including complaints, inquiries, data requests and the like. The department

also provides general legal support to all areas of the company, including the review of contracts and legal agreements with vendors and consultants. Legal and Regulatory Compliance additionally is responsible for the rate and form filing function at the company, across all states and lines of business.

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Technology

The focuses of our information technology (IT) efforts are:

- to support the strategic goals, objectives and business needs of the Company by aligning our IT annual goals with those of the business assuring that IT resources are being utilized efficiently;
- to constantly re-engineer internal processes to allow more efficient operations, resulting in lower operating costs;
- to make it easier for independent agents to transact business with us; and
- to enable agents to efficiently provide their clients with a high level of service.

We believe that our technology initiatives have increased revenue and decreased costs. For example, these initiatives have allowed us to reduce the number of call-center transactions which we perform, and to transfer many manual processing functions from our internal operations to our independent agents. We also believe that these initiatives have contributed to overall increases in productivity.

Internal Applications (Intranet)

Our employees access our proprietary applications through our corporate intranet. Our intranet applications streamline internal processes and improve overall operational efficiencies in areas including:

Claims. Our claims workload management application allows our claims and subrogation adjusters to better manage injury claims. Subrogation refers to the process by which we are reimbursed by other insurers for claims costs we incur due to the fault of their insureds. The use of this application has reduced the time it takes for us to respond to and settle casualty claims, which we believe helps reduce the total amount of our claims expense.

The automated adjuster assignment system categorizes our new claims by severity and assigns them to the appropriate adjuster responsible for investigation. Once assigned, the integrated workload management tools facilitate the work of promptly assigning appraisers, investigating liability, issuing checks and receiving subrogation receipts.

The RadicalGlass.com application allows our claims department to contain glass costs by increasing the windshield repair to replacement ratio. For every windshield that is repaired rather than replaced there is an average savings of approximately \$316 per windshield claim.

Our first VIP Claims Center was introduced during 2006 to provide increased service levels to our independent insurance agents and their clients. We currently operate three VIP Claims Centers which use a network of rental car centers and auto body repair shops to provide a higher level of service to the clients of the independent insurance agents while reducing costs, such as rental expense, through reduced cycle times.

Billing. Proprietary billing systems, integrated with the systems of our print and lock-box vendors, expedite the processing and collection of premium receipts and finance charges from agents and policyholders. We believe the sophistication of our direct bill system helps us to limit our bad debt expense. Our bad debt expense as a percentage of direct written premiums was 0.1% in both 2015 and 2014.

External Applications

Our Agent Technology offerings are centralized within our agency portal and feature PowerDesk and Safety Express. PowerDesk is a web based application that allows for billing inquiry, agent payments on behalf of their policyholders, policy inquiry and claims inquiry. Safety Express provides agents with new business and endorsement entry, real time policy issuance for personal lines, immediate printing of declarations pages in agents' offices, policy

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downloads to most major agency management systems and data imports from Boston Software's WinRater (Massachusetts) and Vertafore's PL Rater (New Hampshire). In addition, we provide our agents with commission and claims download for all lines of business, Transformation Station and Transact Now Inquires, e-Claims online claims reporting, e-View daily transaction reports and e-Docs online electronic document file cabinet.

We also provide electronic billing (eBill), online bill pay (including credit and debit cards), online declarations pages, billing inquiry, claims inquiry, auto and homeowners claims first notice of loss, online auto insurance cards, and bill pay reminder alerts to our agent's policyholders through our public website, SafetyInsurance.com. We have also updated our telephone system to provide a voice activated phone directory, automated billing inquiry and payments, and call center screen pop-up technology.

We also provide policyholders mobile technology through our Safety Mobile App for iPhone and Android devices. Safety Mobile provides consumers with access to their agent information, bill pay capabilities, the ability to report an automobile or homeowners claim and access to their insurance card, among other features.

Claims

Because of the unique differences between the management of casualty claims and property claims, we use separate departments for each of these types of claims.

Casualty Claims

We have adopted stringent claims settlement procedures, which include guidelines that establish settlement ranges for soft tissue injuries, which constituted approximately 70% of our bodily injury claims in 2015. If we are unable to settle these claims within our pricing guidelines, we explore other cost effective options including alternative disputes resolutions and/or litigation. We believe that these procedures result in providing our adjusting staff with a uniform approach to negotiation.

We believe an important component of handling claims efficiently is prompt investigation and settlement. We find that faster claims settlements often result in less expensive claims settlements. Our E-Claim reporting system is an online product that reduces the time it takes for agents to notify our adjusters about claims, thereby enabling us to contact third-party claimants and other witnesses quickly. Our insureds are able to report claims directly by phone, web or mobile application. In addition, we utilize an after- hours reporting vendor to ensure that new claims can be reported 24 hours per day and 365 days per year.

We believe that early notification results in our adjusters conducting prompt investigations of claims and compiling more accurate information about those claims. Our claims workload management software also assists our adjusters in handling claims quickly.

We believe the structure of our casualty claims unit allows us to respond quickly to claimants anywhere in Massachusetts and New Hampshire. Comprising 120 people, the department is organized into distinct claim units that contain loss costs on injury claims. Field adjusters are located geographically for prompt response to claims, with our litigation unit focused on managing loss costs and litigation expenses for serious injury claims.

Additionally, we utilize a special unit to investigate fraud in connection with casualty claims. This special unit has seven dedicated employees including five field investigators. In cases where adjusters suspect fraud in connection with a claim, we deploy this special unit to conduct investigations. We deny payment to claimants in cases in which we have succeeded in accumulating sufficient evidence of fraud.

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Property Claims

Our property claims unit handles property claims arising in our private passenger and commercial automobile, homeowners and other insurance lines. Process automation has streamlined our property claims function. Many of our property claims are now handled by our agents through AVC using our Power Desk software application. As agents receive calls from claimants, Power Desk permits the agent to immediately send information related to the claim directly to us and to an independent appraiser selected by the agent to value the claim. Once we receive this information, an automated system redirects the claim to the appropriate internal adjuster responsible for investigating the claim to determine liability. Upon determination of liability, the system automatically begins the process of seeking a subrogation recovery from another insurer, if liable. We believe this process results in a shorter time period from when the claimant first contacts the agent to when the claimant receives a claim payment, while enabling our agents to build credibility with their clients by responding to claims in a timely and efficient manner. We benefit from decreased labor expenses from the need for fewer employees to handle the reduced property claims call volume.

Another important factor in keeping our overall property claims costs low is collecting subrogation recoveries. We track the amounts we pay out in claims costs and identify cases in which we believe we can reclaim some or all of those costs through the use of our automated workload management tools.

Reserves

Significant periods of time can elapse between the occurrence of an insured loss, the reporting of the loss to the insurer and the insurer's payment of that loss. To recognize liabilities for unpaid losses, insurers establish reserves as balance sheet liabilities representing estimates of amounts needed to pay reported and unreported losses and the expenses associated with investigating and paying the losses, or loss adjustment expenses. Every quarter, we review and establish our reserves. Regulations promulgated by the Commissioner require us to annually obtain a certification from either a qualified actuary or an approved loss reserve specialist who may be one of our employees that our loss and loss adjustment expenses reserves are reasonable.

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

In accordance with industry practice, we also maintain reserves for estimated losses incurred but not yet reported. Incurred but not yet reported reserves are determined in accordance with commonly accepted actuarial reserving techniques on the basis of our historical information and experience. We make adjustments to incurred but not yet reported reserves quarterly to take into account changes in the volume of business written, claims frequency and severity, our mix of business, claims processing and other items that can be expected to affect our liability for losses and loss adjustment expenses over time.

When reviewing reserves, we analyze historical data and estimate the impact of various loss development factors, such as our historical loss experience and that of the industry, legislative enactments, judicial decisions, legal developments in imposition of damages, and changes and trends in general economic conditions, including the effects of inflation. There is no precise method, however, for evaluating the impact of any specific factor on the adequacy of reserves, because the eventual development of reserves is affected by many factors. After taking into account all

relevant factors, management believes that our provision for unpaid losses and loss adjustment expenses at December 31, 2015 is adequate to cover the ultimate net cost of losses and claims incurred as of that date.

Management determines its loss and loss adjustment expense ("LAE") reserves estimates based upon the analysis of the Company's actuaries. Management has established a process for the Company's actuaries to follow in establishing reasonable reserves. The process consists of meeting with our claims department, establishing ultimate

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incurred losses by using development models accepted by the actuarial community, and reviewing the analysis with management. The Company's estimate for loss and LAE reserves, net of the effect of ceded reinsurance, ranges from a low of \$446,368 to a high of \$495,541 as of December 31, 2015. The Company's net loss and LAE reserves, based on our actuaries' best estimate, were set at \$485,716 as of December 31, 2015. The ultimate liability may be greater or less than reserves carried at the balance sheet date. Establishment of appropriate reserves is an inherently uncertain process, and there can be no certainty that currently established reserves will prove adequate in light of subsequent actual experience. To the extent that reserves are inadequate and are strengthened, the amount of such increase is treated as a charge to earnings in the period that the deficiency is recognized. To the extent that reserves are redundant and are released, the amount of the release is a credit to earnings in the period the redundancy is recognized. We do not discount any of our reserves.

The following table presents development information on changes in the reserves for losses and LAE of our Insurance Subsidiaries for each year in the three year period ended December 31, 2015.

	Year Ended December 31,		
	2015	2014	2013
Reserves for losses and LAE at beginning of year	\$ 482,012	\$ 455,014	\$ 423,842
Less receivable from reinsurers related to unpaid losses and LAE	(61,245)	(60,346)	(52,185)
Net reserves for losses and LAE at beginning of year	420,767	394,668	371,657
Incurred losses and LAE, related to:			
Current year	642,882	513,734	476,638
Prior years	(30,313)	(37,368)	(28,889)
Total incurred losses and LAE	612,569	476,366	447,749
Paid losses and LAE related to:			
Current year	415,256	316,979	299,882
Prior years	132,364	133,288	124,856
Total paid losses and LAE	547,620	450,267	424,738
Net reserves for losses and LAE at end of period	485,716	420,767	394,668
Plus receivable from reinsurers related to unpaid losses and LAE	68,261	61,245	60,346
Reserves for losses and LAE at end of period	\$ 553,977	\$ 482,012	\$ 455,014

At the end of each period, the reserves were re-estimated for all prior accident years. Our prior year reserves decreased by \$30,313, \$37,368, and \$28,889 for the years ended 2015, 2014, and 2013, respectively. The decreases in prior year reserves in 2015 resulted from re-estimations of prior year's ultimate loss and LAE liabilities and are primarily composed of reductions of \$18,644 in our retained automobile reserves and \$7,964 in our retained homeowner's reserves. The decreases in prior year reserves in 2014 resulted from re-estimations of prior year's ultimate loss and LAE liabilities and is primarily composed of reductions of \$23,272 in our retained automobile reserves and \$8,804 in our retained homeowner reserves. The decrease in prior year reserves during 2013 is primarily composed of reductions of \$23,938 in our retained automobile reserves and \$4,740 in our retained homeowners reserves. It is not appropriate to extrapolate future favorable or unfavorable development of reserves from this past experience.

Our private passenger automobile line of business prior year reserves decreased by \$14,411 for the year ended December 31, 2015, primarily due to improved retained private passenger results of \$12,716 for the accident years 2009 through 2013. Our private passenger automobile line of business prior year reserves decreased by \$20,815 for

the year ended December 31, 2014, primarily due to improved retained private passenger results of \$17,789 for accident years 2007 through 2012. Our private passenger automobile line of business reserves decreased by \$21,090 for the year ended December 31, 2013, primarily due to improved retained private passenger results of \$18,116 for accident years 2007 through 2012. The improved retained private passenger results were 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. Our homeowners line of business prior year reserves decreased by \$7,255 for the year ended December 31, 2015, primarily due to improved retained homeowner results of \$7,354 for the years 2010 through 2013.

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The following table represents the development of reserves, net of reinsurance, for calendar years 2005 through 2015. The top line of the table shows the reserves at the balance sheet date for each of the indicated years. This represents the estimated amounts of losses and loss adjustment expenses for claims arising in all years that were unpaid at the balance sheet date, including losses that had been incurred but not yet reported to us. The upper portion of the table shows the cumulative amounts paid as of the end of each successive year with respect to those claims. The lower portion of the table shows the re-estimated amount of the previously recorded reserves based on experience as of the end of each succeeding year, including cumulative payments made since the end of the respective year. The estimate changes as more information becomes known about the payments, frequency and severity of claims for individual years. Favorable loss development, shown as a cumulative redundancy in the table, exists when the original reserve estimate is greater than the re-estimated reserves at December 31, 2015.

Information with respect to the cumulative development of gross reserves (that is, without deduction for reinsurance ceded) also appears at the bottom portion of the table.

In evaluating the information in the table, it should be noted that each amount entered incorporates the effects of all changes in amounts entered for prior periods. Thus, if the 2012 estimate for a previously incurred loss was \$150 and the loss was reserved at \$100 in 2008, the \$50 deficiency (later estimate minus original estimate) would be included in the cumulative (redundancy) deficiency in each of the years 2008-2012 shown in the table. It should further be noted that the table does not present accident or policy year development data. In addition, conditions and trends that have affected the development of liability in the past may not necessarily recur in the future. Accordingly, it is not appropriate to extrapolate future redundancies or deficiencies from the table.

	As of and for the Year Ended December 31,										
	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005
Reserves for											
losses and											
LAE											
originally	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
estimated:	485,716	420,767	394,668	371,657	352,098	351,244	374,832	391,070	393,430	370,980	370,166
Cumulative											
amounts											
paid as of:											
one year											
after		132,363	133,288	124,855	130,204	128,854	130,960	126,858	142,259	122,806	133,213
two years											
after			178,411	175,822	181,739	176,774	183,061	189,897	195,798	183,457	187,231
three years											
after				199,741	211,578	205,171	211,182	217,695	234,359	212,331	221,390
four years											
after					223,941	219,310	224,831	233,160	248,560	233,438	234,705
five years											
after						224,354	232,177	239,553	254,915	240,275	244,454
six years											
after							233,853	241,587	257,362	242,298	247,299
seven years											
after								241,999	257,889	243,120	247,983

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eight years											
ter									258,173	243,270	248,206
nine years											
ter										243,505	248,272
ten years											
ter											248,391

As of and for the Year Ended December 31,

	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005
reserves											
-estimated											
of:											
one year	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
ter	390,454	357,300	342,767	334,788	314,561	314,561	326,676	347,004	357,492	340,189	327,419
two years											
ter			328,182	308,028	309,096	293,480	294,696	307,918	325,317	311,972	310,614
three years											
ter				283,592	282,441	273,332	279,542	282,565	297,224	287,875	289,109
four years											
ter					268,759	254,652	264,697	271,693	281,068	269,446	274,840
five years											
ter						245,869	252,249	261,845	274,179	258,506	264,408
six years											
ter							247,023	254,308	268,596	253,919	258,055
seven years											
ter								250,760	263,797	251,304	254,812
eight years											
ter									261,319	248,031	252,818
nine years											
ter										246,317	250,876
ten years											
ter											249,571

cumulative											
(redundancy)											
efficiency											
2015	(30,313)	(66,486)	(88,065)	(83,339)	(105,375)	(105,375)	(127,809)	(140,310)	(132,111)	(124,663)	(120,599)

As of and for the Year Ended December 31,

2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
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