SAFETY INSURANCE GROUP INC
Form 10-K
February 28, 2019
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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, 2018
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)

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

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 smaller reporting company)	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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, 2018, was approximately $1,241,821,554.

As of February 15, 2019 there were 15,286,569 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 22, 2019, which Safety Insurance Group, Inc. (the "Company", "we", "our", "us") intends to file within 120 days after its December 31, 2018 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 and commercial automobile insurance in Massachusetts. In addition to private passenger and commercial automobile insurance, we offer a portfolio of property and casualty insurance products, including homeowners, dwelling fire, umbrella and business owner policies. Operating exclusively in Massachusetts, New Hampshire and Maine 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 899 in 1,120 locations throughout these three states during 2018. We have used these relationships and, in particular, our extensive knowledge of the Massachusetts market to become the largest commercial automobile carrier, capturing an approximate 15.7% share of the Massachusetts commercial automobile insurance market, and the fourth largest private passenger automobile carrier, with a 9.0% share of the Massachusetts private passenger automobile insurance market in 2018 according to statistics compiled by Commonwealth Automobile Reinsurers ("CAR"). We also are the third largest homeowners insurance carrier in Massachusetts with a 7.2% share of that market. We were ranked the 49th largest automobile writer in the country according to S&P Global Market Intelligence, based on 2017 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 insurance in New Hampshire during 2008 and Maine in 2016. The table below shows the amount of direct written premiums written in each state during the years ended December 31, 2018, 2017, and 2016.

	Years Ended December 31,		
Direct Written Premiums	2018	2017	2016
Massachusetts	$ 813,857	$ 799,427	$ 785,376
New Hampshire	29,159	27,637	26,128
Maine	659	252	55
Total	$ 843,675	$ 827,316	$ 811,559

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 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 is 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. The SEC maintains a website at www.sec.gov that contains reports, proxy and information statements and other

information regarding issuers that file electronically with the SEC.

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Our Competitive Strengths

We Have Strong Relationships with Independent Agents. In 2018, Independent agents accounted for approximately 60.8% of the Massachusetts automobile insurance market measured by direct written premiums as compared to approximately 30.7% nationwide, based on data made available by Independent Insurance Agents and Brokers of America, Inc. and Commonwealth Automobile Reinsurers. For that reason, our strategy is centered around, and we sell exclusively through, a network of independent agents. 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 them effectively address 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, New Hampshire and Maine. We must compete with other insurance carriers for the business of independent agents.

We Have a History of Profitable Operations. In 37 out of 38 years since our inception in 1979, we have been profitable. The lone year in which 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 level of private passenger automobile premiums, which totaled $469,340 in 2018 compared to $472,553 in 2014.
- growing our commercial automobile premiums, which totaled $139,628 in 2018 compared to $96,268 in 2014;
- growing our homeowner premiums which totaled $193,482 in 2018 compared to $161,388 in 2014;
- 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 its long tenure in the industry;
- 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 Have Developed Advanced Technology for Our Business. 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 by making 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 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 also can submit commercial automobile and homeowners insurance policies electronically over the AVC. Second, our investment in technology has allowed us to re-engineer internal back office processes to provide more efficient service at a lower cost.

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We Have an Experienced, Committed and Knowledgeable Management Team. Our senior management team has an average of over 30 years of experience with Safety and a demonstrated ability to operate successfully within the property and casualty market.

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 markets in all lines of business;

- implement rates, forms and billing options that allow us to cross-sell private passenger automobile, homeowners, dwelling fire, and personal umbrella policies in the personal lines market and commercial automobile, business owner policies, commercial property package and commercial umbrella policies in the commercial lines market in order to capture a larger share of the total Massachusetts, New Hampshire and Maine 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 respective state insurance departments to transact property and casualty insurance in Massachusetts, New Hampshire, and Maine. All of our business is regulated by these departments, with the most extensive oversight from our domestic regulator, the Massachusetts Division of Insurance.

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.

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.

	Years Ended December 31,								
Direct Written Premiums	2018			2017			2016		
Private passenger automobile	$ 469,340	55.7	%	$ 468,908	56.7	%	$ 467,845	57.7	%
Commercial automobile	139,628	16.5		129,529	15.7		120,641	14.9	
Homeowners	193,482	22.9		187,623	22.7		182,128	22.4	
Business owners	22,182	2.6		22,734	2.7		22,933	2.8	
Personal umbrella	8,132	1.0		7,870	0.9		7,693	1.0	

Dwelling fire	9,829	1.2		9,603	1.2		9,256	1.1	
Commercial umbrella	1,082	0.1		1,049	0.1		1,063	0.1	
Total	$ 843,675	100.0	%	$ 827,316	100.0	%	$ 811,559	100.0	%

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Our product lines are as follows:

Private Passenger Automobile (55.7% of 2018 direct written premiums). Private passenger automobile insurance is our primary product. These 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.

Commercial Automobile (16.5% of 2018 direct written premiums). 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.

Homeowners (22.9% of 2018 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.

Business Owners Policies (2.6% of 2018 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.

Personal Umbrella (1.0% of 2018 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 write policies at standard rates with limits of $1,000 to $5,000.

Dwelling Fire (1.2% of 2018 direct written premiums). We underwrite dwelling fire insurance, which is a limited form of a homeowner's policy for non-owner occupied residences. We write all forms of dwelling fire coverage at standard rates with qualifying risks eligible for preferred lower rates.

Commercial Umbrella (0.1% of 2018 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 also was impacted by terrorism, and we have filed and received approval for a number of terrorism endorsements, 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

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Terrorism Risk Insurance Program Reauthorization Act of 2007 and the Terrorism Risk Insurance Program Reauthorization of 2015. See "Reinsurance," discussed below.

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 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 to cancel any coverage bound, in accordance with applicable law. In total, our independent agents numbered 899 and had 1,120 offices (some agencies have more than one office) and approximately 8,878 customer service representatives during 2018.

Voluntary Agents. In 2018, we obtained approximately 91.6% 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, 2018, we had agreements with 742 voluntary agents. Our voluntary agents are located in all regions of Massachusetts, New Hampshire and Maine.

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 prior year performance of our agents. 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 6.1% of our direct written premiums in 2018.

Massachusetts law guarantees that CAR provides motor vehicle insurance coverage to all qualified applicants. Under the 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 the Commercial Automobile Program (the “Commercial Automobile Program”). CAR has appointed Safety and three other servicing carriers to process ceded commercial automobile insurance. Safety was reappointed for this program beginning January 1, 2017 for an additional five-year term. Approximately $171,100 of ceded premium is spread equitably among the four servicing carriers. Subject to the review of the Commissioner of the Division of Insurance of Massachusetts (“the Commissioner”), 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 reappointed Safety as one of the two servicing carriers for this program beginning January 1, 2017 for an additional five-year term. Approximately $10,500 of ceded premium was spread equitably between the two servicing carriers.

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We are assigned independent agents by CAR who can submit commercial business to us in the Commercial Automobile Program and the Taxi/Limo Program, and we classify those agents as Exclusive Representative Producers (“ERPs”).

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.

	Years Ended December 31,								
	2018			2017			2016		
Line of Business	Exposures	Change		Exposures	Change		Exposures	Change	
Private passenger automobile:									
Voluntary agents	425,783	(2.0)	%	434,236	(2.8)	%	446,939	(3.5)	%
MAIP	8,150	(17.6)		9,896	(10.0)		11,000	22.1	
Total private passenger automobile	433,933	(2.3)		444,132	(3.0)		457,939	(3.0)	
Commercial automobile:									
Voluntary agents	63,652	2.0		62,419	1.8		61,315	0.5	
ERP	11,214	(9.3)		12,364	24.8		9,907	30.4	
Total commercial automobile	74,866	0.1		74,783	5.0		71,222	3.8	
Other:									
Homeowners	159,352	(0.6)		160,313	(1.0)		161,890	(0.5)	
Business owners	9,100	(4.2)		9,497	(8.6)		10,385	2.2	
Personal umbrella	22,934	(1.3)		23,232	(3.0)		23,952	(0.5)	
Dwelling fire	6,833	(4.0)		7,116	(2.1)		7,270	(1.5)	
Commercial umbrella	674	(0.4)		677	(2.5)		694	0.6	
Total other	198,893	(1.0)		200,835	(1.6)		204,191	(0.4)	
Total	707,692	(1.7)		719,750	(1.9)		733,352	(1.6)	
Total voluntary agents	688,328	(1.3)		697,490	(2.1)		712,445	(2.3)	

In 2018, 61.7% of the private passenger automobile exposures we insure had an other than private passenger policy with us, compared to 60.3% and 58.4% in 2017 and 2016, respectively. In addition, 81.9% of our homeowners' policyholders had a matching automobile policy with us in 2018 compared to 81.7% in 2017 and 81.9% in 2016.

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, New Hampshire and Maine 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;
- 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, digital 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 2018, 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 20% 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 customers 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 applicable state insurance department’s review, we set rates for all of our products using our own loss experience, industry loss cost data, residual market deficits, catastrophe modeling and prices charged by our competitors. We have three pricing segments for most products, utilizing Safety Insurance for standard rate, Safety Indemnity for preferred rates and Safety P&C for ultra preferred rates.

Massachusetts Residual Automobile Insurance Markets. CAR establishes the rates for personal automobile policies assigned to carriers through the MAIP. In accordance with Massachusetts law, insurers may only charge MAIP policyholders the lower of the MAIP rate or the company's competitive voluntary market rate. CAR also sets rates for commercial automobile policies, including taxi/limousine/car service policies, reinsured through the CAR residual market pool. 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. We are one of four servicing carriers in CAR’s Commercial Automobile Program and one of two servicing carriers in CAR’s Taxi/Limo Program.

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. We generally require any new voluntary agent to commit to transfer a portfolio to us consisting of at least 300 policies.

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Policy Processing. 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 and Maine).

Rate Pursuit. We aggressively monitor all insurance transactions to make sure we receive the correct premium for the risk insured. We accomplish this by verifying pricing criteria. For automobile policies, we verify proper classification of drivers, the make, model, and age of insured vehicles, and the availability of discounts. We also verify that operators are properly listed and classified, assignment of operators to vehicles, and vehicle garaging. In our homeowners and dwelling fire lines, we use third party software to evaluate property characteristics and we conduct property inspections. We have a premium audit program in our business owners program, as well as other loss control reviews for additional commercial lines of business.

Product Management. The Product Management department 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 also is responsible for updating producer materials 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 department also provides product training and general marketplace education for the organization.

Legal and Regulatory Compliance. The Legal and Regulatory Compliance department provides legal and compliance support to all business units within the company. The department serves as the primary liaison with regulators, government, industry trade associations and residual market mechanisms. The department also provides legal support to all areas of the company, including general corporate matters and vendor contracting. The department monitors legal and regulatory changes affecting the enterprise and provides guidance on how to comply with those changes. The department additionally reviews business unit operations to identify and address compliance vulnerabilities.

Data Governance. The Data Governance department uses Safety’s data assets to support decision-making in areas including underwriting, pricing, claims, reserving, reinsurance and assessing catastrophe risks. Data analytics are used to analyze and estimate exposures, loss trends and other risks, and are leveraged to improve company business performance and customer satisfaction.

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 continuously improve the customer experience making it easier for independent agents and policyholders to transact business with us;
- to enable agents to efficiently provide their clients with a high level of service; and
- to maintain and support a secure computing environment.

We believe that our technology initiatives have increased revenue and decreased costs while at the same time improving the customer experience of both our agents and policyholders. 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

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from our internal operations to our independent agents. We also believe that these initiatives have contributed to an overall increases in productivity and customer satisfaction.

Internal Applications (Intranet)

Our employees access our proprietary and vendor supplied 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 the claims process. 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 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 $340 per windshield claim.

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 and vendor supplied 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 systems help us to limit our bad debt expense. Our bad debt expense as a percentage of direct written premiums was 0.1% in both 2018 and 2017.

Innovation Lab. In 2018 Safety Insurance established an Innovation Lab. The purpose of the Innovation Lab is to foster a culture of innovative thinking, monitor the InsureTech landscape and provide Safety and our Independent Agents with the tools and processes necessary to continuously improve the customer experiences and remain competitive in both the current and future insurance marketplace.

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 downloads to most major agency management systems and data imports from Boston Software's WinRater (Massachusetts) and Vertafore's PL Rater (New Hampshire and Maine). 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.

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We additionally 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 65% of our bodily injury claims in 2018. 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. 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 unit has five dedicated employees including four 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.

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.

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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, 2018 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 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 $422,423 to a high of $498,216 as of December 31, 2018. The Company's net loss and LAE reserves, based on our actuaries' best estimate, were set at $476,321 as of December 31, 2018. 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.

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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, 2018, 2017 and 2016.

	Years Ended December 31,		
	2018	2017	2016
Reserves for losses and LAE at beginning of year	$ 574,054	$ 560,321	$ 553,977
Less receivable from reinsurers related to unpaid losses and LAE	(83,085)	(83,724)	(68,261)
Net reserves for losses and LAE at beginning of year	490,969	476,597	485,716
Incurred losses and LAE, related to:			
Current year	542,001	545,671	538,881
Prior years	(56,488)	(41,784)	(45,448)
Total incurred losses and LAE	485,513	503,887	493,433
Paid losses and LAE related to:			
Current year	340,927	325,049	328,046
Prior years	159,234	164,466	174,506
Total paid losses and LAE	500,161	489,515	502,552
Net reserves for losses and LAE at end of period	476,321	490,969	476,597
Plus receivable from reinsurers related to unpaid losses and LAE	108,398	83,085	83,724
Reserves for losses and LAE at end of period	$ 584,719	$ 574,054	$ 560,321

The following table represents the development of reserves, net of reinsurance, for calendar years 2008 through 2018. 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, 2018.

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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.

	As of and for the Year Ended December 31,								
	2018	2017	2016	2015	2014	2013	2012	2011	2010
Reserves for losses and LAE originally estimated:	$ 476,321	$ 490,969	$ 476,597	$ 485,716	$ 420,767	$ 394,668	$ 371,657	$ 352,098	$ 351,244
Cumulative amounts paid as of:									
One year later		159,234	164,466	174,506	174,506	133,288	124,855	130,204	128,854
Two years later			231,473	250,306	189,367	178,411	175,822	181,739	176,774
Three years later				290,287	223,465	207,626	199,741	211,578	205,171
Four years later					241,589	223,743	213,847	223,941	219,310
Five years later						231,346	221,363	231,433	224,354
Six years later							223,829	233,137	226,644
Seven years later								233,905	227,147
Eight years later									226,928
Nine years later									
Ten years later									

	As of and for the Year Ended December 31,								
	2018	2017	2016	2015	2014	2013	2012	2011	2010
Reserves re-estimated as of:									
One year later		$ 434,481	$ 434,813	$ 440,268	$ 390,452	$ 357,300	$ 342,767	$ 334,788	$ 314,561
Two years later			391,630	406,253	348,660	328,182	308,028	309,096	293,480
Three years later				376,201	313,100	295,788	283,592	282,441	273,332
Four years later					287,131	274,214	263,787	268,759	254,652
Five years later						255,368	250,064	255,925	245,869
Six years later							236,373	248,353	238,404
Seven years later								239,476	235,047
Eight years later									229,623
Nine years later									
Ten years later									
Cumulative (redundancy) deficiency 2018		(56,488)	(84,967)	(109,515)	(133,636)	(139,300)	(135,284)	(112,622)	(121,621)

	As of and for the Year Ended December 31,								
	2018	2017	2016	2015	2014	2013	2012	2011	2010
				$ 553,977	$ 482,012	$ 455,014	$ 423,842	$ 403,872	$ 404,391

Gross liability-end of year	$ 584,719	$ 574,054	$ 560,321						
Reinsurance recoverables	108,398	83,085	83,724	68,261	61,245	60,346	52,185	51,774	53,147
Net liability-end of year	476,321	490,969	476,597	485,716	420,767	394,668	371,657	352,098	351,244
Gross estimated liability-latest		520,768	496,242	444,921	358,863	312,758	281,985	279,178	263,790
Reinsurance recoverables-latest		86,287	61,429	38,668	45,763	38,544	31,921	30,825	28,743
Net estimated liability-latest		434,481	434,813	406,253	313,100	274,214	250,064	248,353	235,047

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 2018 estimate for a previously incurred loss was $150 and the loss was reserved at $100 in 2014, the $50 deficiency (later estimate minus original estimate) would be included in the cumulative (redundancy) deficiency in each of the years 2014-2018 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.

The table shows that we have substantially benefited in the current and prior years from releasing redundant reserves. In the years ended December 31, 2018, 2017, and 2016 we decreased loss reserves related to prior years by $56,488, $41,784 and $45,448, respectively. Reserves and development are discussed further in Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations, Executive Summary and Overview.

As a result of our focus on core business lines since our founding in 1979, we believe we have no specific exposure to asbestos or environmental pollution liabilities.

Reinsurance

Reinsurance involves an insurance company transferring (ceding) a portion of its exposure on insurance underwritten by it to another insurer (reinsurer). The reinsurer assumes a portion of the exposure in return for a share of the premium. Reinsurance does not legally discharge an insurance company from its primary liability for the full amount of the policies, but it does make the reinsurer liable to the company for the reinsured portion of any loss realized.

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 are selective in choosing our reinsurers, seeking only those companies that we consider to be financially stable and adequately capitalized. In an effort to minimize exposure to the insolvency of a reinsurer, we continually evaluate and review the financial condition of our reinsurers. Most of our reinsurers have an A.M. Best rating of "A+" (Superior) or "A" (Excellent).

We maintain reinsurance coverage to help lessen the effect of losses from catastrophic events, maintaining coverage that during 2018 protected us in the event of a "137-year storm" (that is, a storm of a severity expected to occur once in a 137-year period). We use various software products to measure our exposure to catastrophe losses and the probable maximum loss to us for catastrophe losses such as hurricanes. The models include estimates for our share of the catastrophe losses generated in the residual market for property insurance by the Massachusetts Property Insurance Underwriting Association ("FAIR Plan"). In 2018, we purchased four layers of excess catastrophe reinsurance providing $615,000 of coverage for property losses in excess of $50,000 up to a maximum of $665,000. Our reinsurers' co-participation is 50.0% of $50,000 for the 1st layer, 80.0% of $50,000 for the 2nd layer, 80.0% of $250,000 for the 3rd layer, and 80.0% of $265,000 for the 4th layer.

For 2019, we have purchased four layers of excess catastrophe reinsurance providing $615,000 of coverage for property losses in excess of $50,000 up to a maximum of $665,000. Our reinsurers' co-participation is 50.0% of $50,000 for the 1st layer, 80.0% of $50,000 for the 2nd layer, 80.0% of $250,000 for the 3rd layer and 80% of $265,000 for the 4th layer. As a result of the changes to the models, our catastrophe reinsurance in 2019 protects us in the event of a "139-year storm."

We also have casualty excess of loss reinsurance for large casualty losses occurring in our automobile, homeowners, dwelling fire, business owners, and commercial package lines of business in excess of $2,000 up to a maximum of $10,000. We have property excess of loss reinsurance coverage for large property losses, with coverage in excess of $2,000 up to a maximum of $20,000, for our homeowners, business owners, and commercial package policies. In addition, we have liability excess of loss reinsurance for umbrella large losses in excess of $1,000 up to a maximum of $10,000. We also have various reinsurance agreements with Hartford Steam Boiler Inspection and Insurance Company, of which the primary contract is a quota share agreement under which we cede 100% of the premiums and losses for the equipment breakdown coverage under our business owner policies and commercial package policies.

Our reinsurance program excludes coverage for acts of terrorism. The Terrorism Risk Insurance Act of 2002 ("TRIA") was signed into law on November 26, 2002, and expired December 31, 2005. The Terrorism Risk Insurance Extension Act of 2005 was signed into law on December 22, 2005, and expired December 31, 2007. The Terrorism Risk Insurance Extension Act of 2007 ("TRIEA") was signed into law on December 26, 2007 which reauthorized TRIA for seven years, expanded the definition of an "Act of Terrorism" while expanding the private sector role and reducing the federal share of compensation for insured losses under the program. TRIA expired on December 31, 2014, but on January 12, 2015 Congress reauthorized TRIA retroactive to January 1, 2015 with the program now lasting through 2020. The intent of this legislation is to provide federal assistance to the insurance industry for the needs of commercial insurance policyholders with the potential exposure for losses due to acts of terrorism. The TRIEA provides reinsurance for certified acts of terrorism.

In addition to the above mentioned reinsurance programs and as described in more detail above under The Massachusetts Property and Casualty Insurance Market, 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, 2018, the FAIR Plan purchased $2,000,000 of catastrophe reinsurance for property losses with retention of $100,000.

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At December 31, 2018, we also had $133,751 due from CAR comprising of loss and loss adjustment expense reserves, unearned premiums and reinsurance recoverables.

On March 10, 2005, our Board of Directors (the "Board") adopted a resolution that prohibits Safety from purchasing finite reinsurance (reinsurance that transfers only a relatively finite or limited amount of risk to the reinsurer) without approval by the Board. To date, the Company has never purchased a finite reinsurance contract.

Competition

The property and casualty insurance business is highly competitive and many of our competitors have substantially greater financial and other resources than we do. We compete with both large national writers and smaller regional companies. Our competitors include companies which, like us, serve the independent agency market, as well as companies which sell insurance directly to customers. Direct writers may have certain competitive advantages over agency writers, including increased name recognition, loyalty of the customer base to the insurer rather than to an independent agency and potentially, lower cost structures. A material reduction in the amount of business independent agents sell would adversely affect us. Further, we and others compete on the basis of the commissions and other cash and non-cash incentives provided to agents.

Although historically, a number of national insurers that are much larger than we are have chosen not to compete in a material way in the Massachusetts private passenger automobile market, since 2008, several new companies have entered the market. These companies include some that would be able to sustain significant losses in order to acquire market share, as well as others which use distribution methods that compete with the independent agent channel. There can be no assurance that we will be able to compete effectively against these companies in the future.

Our principal competitors within the Massachusetts private passenger automobile insurance market are MAPFRE SA, Government Employees Insurance Company and Liberty Mutual Insurance Company, which held 24.7%, 11.9% and 9.1% market shares based on automobile exposures, respectively, in 2018 according to CAR.

As of November 2018 we became the largest writer of commercial automobile insurance in Massachusetts with a market share of 15.7%. Other principal competitors in the Massachusetts commercial automobile insurance market are MAPFRE SA, Arbella Mutual Insurance Company and The Travelers Indemnity Insurance Company, which held 15.5%, 10.8% and 7.3% market shares based on automobile exposures, respectively, according to CAR. This includes our share of residual market business as one of four servicing carriers in CAR's Commercial Automobile Program and one of two servicing carriers in CAR's Taxi/Limo Program.

We are the third largest writer of homeowners insurance business in Massachusetts, with a market share of 7.2% in 2017. Our principal competitors within the Massachusetts homeowners insurance market are MAPFRE SA, Liberty Mutual and Chubb, which held 13.5%, 10.7% and 6.6% market shares respectively in 2017 (according to S&P Global Market Intelligence).

Employees

At December 31, 2018, we employed 627 employees. Our employees are not covered by any collective bargaining agreement. Management considers our relationship with our employees to be good.

Investments

Investment income is an important source of revenue for us and the return on our investment portfolio has a material effect on our net earnings. Our investment objective is to focus on maximizing total returns while investing conservatively. We maintain a high-quality investment portfolio consistent with our established investment policy. As of December 31, 2018, our portfolio of fixed maturity investments was comprised principally of investment grade

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corporate fixed maturity securities, U.S. government and agency securities, and asset-backed securities. The portion of our non-investment grade portfolio of fixed maturity investments is primarily comprised of variable rate secured and senior bank loans and high yield bonds.

According to our investment guidelines, no more than 2.0% of our portfolio may be invested in the securities of any one issuer (excluding U.S. government-backed securities). This one issuer must be rated "A" or above by Moody's. In addition, no more than 0.5% of our portfolio may be invested in securities of any one issuer rated "Baa," or the lowest investment grade assigned by Moody's. Of the less than 15.0% of our portfolio invested in senior bank loans and high yield bonds at December 31, 2018, no more than 5.0% may be invested in the securities of any one issuer, no more than 10.0% may be invested in any issuers total outstanding debt issue, and a maximum of 10.0% may be invested in securities unrated or rated "B-" or below by Moody's. We continually monitor the mix of taxable and tax-exempt securities in an attempt to maximize our total after-tax return. Since 1986, we have utilized the services of a third-party investment manager.

The following table reflects the composition of our investment portfolio as of December 31, 2018 and 2017.

	As of December 31,			
	2018		2017	
	Estimated Fair Value	% of Portfolio	Estimated Fair Value	% of Portfolio
U.S. Treasury Securities	$ 1,777	0.1 %	$ 1,791	0.1 %
Obligations of states and political subdivisions	266,198	20.0	403,084	30.8
Residential mortgage-backed securities (1)	297,023	22.3	222,766	17.0
Commercial mortgage-backed securities	60,336	4.5	39,369	3.0
Other asset-backed securities	61,076	4.6	72,613	5.6
Corporate and other securities	475,452	35.7	432,403	33.1
Subtotal, fixed maturity securities	1,161,862	87.2	1,172,026	89.6
Equity securities (2)	148,011	11.0	111,867	8.6
Other invested assets (3)	23,481	1.8	23,162	1.8
	$ 1,333,354	100.0 %	$ 1,307,055	100.0 %

(1) Residential mortgage-backed securities consists primarily of obligations of U.S. Government agencies including collateralized mortgage obligations and mortgage-backed securities 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 common stock, preferred stock, mutual funds and interests in mutual funds held to fund the Company's executive deferred compensation plan.

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

The principal risks inherent in holding mortgage-backed securities and other pass-through securities are prepayment and extension risks, which affect the timing of when cash flows will be received. When interest rates decline, mortgages underlying mortgage-backed securities tend to be prepaid more rapidly than anticipated, causing early repayments. When interest rates rise, the underlying mortgages tend to be prepaid at a slower rate than anticipated, causing the principal repayments to be extended. Although early prepayments may result in acceleration of income from recognition of any unamortized discount, the proceeds typically are reinvested at a lower current yield, resulting in a net reduction of future investment income. In addition, in the current market environment, such investments can also contain liquidity risks.

The Company invests in bank loans which are primarily investments in senior secured floating rate loans that banks have made to corporations. The loans are generally priced at an interest rate spread over the floating rate feature; this asset class provides protection against rising interest rates. However, this asset class is subject to default risk since these investments are typically below investment grade.

Equity risk is the risk that we will incur economic losses due to adverse changes in equity prices. Our exposure to changes in equity prices results from our holdings of common stock, preferred stock, mutual funds and interests in mutual funds held to fund the executive deferred compensation plan. We continuously evaluate market conditions and

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we expect in the future to purchase additional equity securities. We principally manage equity price risk through industry and issuer diversification and asset allocation techniques.

The following table reflects our investment results for each of the three-year period ended December 31, 2018, 2017 and 2016.

	Years Ended December 31,		
	2018	2017	2016
Average cash and invested securities (at cost)	$ 1,317,380	$ 1,268,728	$ 1,231,358
Net investment income (1)	$ 43,788	$ 38,758	$ 38,413
Net effective yield (2)	3.3 %	3.1 %	3.1 %

(1) After investment expenses, excluding realized investment gains or losses.

(2) Net investment income for the period divided by average invested securities and cash for the same period.

As of December 31, 2018, our portfolio of fixed maturity investments was comprised principally of investment grade corporate fixed maturity securities, U.S. government and agency securities, and asset-backed securities. The portion of our non-investment grade portfolio of fixed maturity investments is primarily comprised of variable rate secured, senior bank loans and high yield bonds.

The composition of our fixed income security portfolio by rating is presented in the following table.

	As of December 31,			
	2018		2017	
	Estimated Fair Value	Percent	Estimated Fair Value	Percent
U.S. Treasury securities and obligations of U.S. Government agencies	$ 298,800	25.7 %	$ 222,766	19.0 %
Aaa/Aa	299,725	25.8	411,794	35.1
A	214,263	18.4	239,015	20.4
Baa	175,890	15.1	142,176	12.1
Ba	58,050	5.0	51,205	4.4
B	81,415	7.0	75,673	6.5
Caa/Ca	7,660	0.7	7,087	0.6
D	-	-	248	-
Not rated	26,059	2.3	22,062	1.9
Total	$ 1,161,862	100.0 %	$ 1,172,026	100.0 %

Ratings are generally assigned upon the issuance of the securities and are subject to revision on the basis of ongoing evaluations. Ratings in the table are as of the date indicated.

The Securities Valuation Office of the National Association of Insurance Commissioners (the "SVO") evaluates all public and private bonds purchased as investments by insurance companies. The SVO assigns one of six investment categories to each security it reviews. Category 1 is the highest quality rating and Category 6 is the lowest. Categories 1 and 2 are the equivalent of investment grade debt as defined by rating agencies such as Standard & Poor's Ratings Services and Moody's, while Categories 3-6 are the equivalent of below investment grade securities. SVO ratings are reviewed at least annually. At December 31, 2018, 72.8% of our available for sale fixed maturity investments were rated Category 1 and 13.2% were rated Category 2, the two highest ratings assigned by the SVO.

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The following table indicates the composition of our fixed income security portfolio (at carrying value) by time to maturity as of December 31, 2018.

	As of December 31, 2018		
	Estimated Fair Value	Percent	
Due in one year or less	$ 32,467	2.8	%
Due after one year through five years	280,060	24.1	
Due after five years through ten years	287,379	24.7	
Due after ten years through twenty years	140,107	12.1	
Due after twenty years	3,414	0.3	
Asset-backed securities (1)	418,435	36.0	
Totals	$ 1,161,862	100.0	%

(1) Actual maturities of asset-backed securities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Prepayment rates are influenced by a number of factors that cannot be predicted with certainty, including: the relative sensitivity of the underlying mortgages or other collateral to changes in interest rates; a variety of economic, geographic and other factors; and the repayment priority of the securities in the overall securitization structures.

Ratings

A.M. Best, which rates insurance companies based on factors of concern to policyholders, currently assigns Safety Insurance an "A (Excellent)" rating. Our "A" rating was reaffirmed by A.M. Best on April 18, 2018. Such rating is the third highest rating of 13 ratings that A.M. Best assigns to solvent insurance companies, which currently range from "A++ (Superior)" to "D (Very Vulnerable)." Publications of A.M. Best indicate that the "A" rating is assigned to those companies that in A.M. Best's opinion have a strong ability to meet their obligations to policyholders over a long period of time. In evaluating a company's financial and operating performance, A.M. Best reviews the Company's profitability, leverage and liquidity, as well as its book of business, the adequacy and soundness of its reinsurance, the quality and estimated fair value of its assets, the adequacy of its loss reserves, the adequacy of its surplus, its capital structure, the experience and competence of its management and its market presence. A.M. Best's ratings reflect its opinion of an insurance company's financial strength, operating performance and ability to meet its obligations to policyholders and are not evaluations directed to purchasers of an insurance company's securities.

In assigning Safety Insurance's rating, A.M. Best recognized its solid risk-adjusted capitalization, conservative operating strategy, and long-standing agency relationships. A.M. Best also noted among our positive attributes our favorable investment leverage, our disciplined underwriting approach, and our expertise in the closely managed Massachusetts automobile insurance market. A.M. Best cited other factors that partially offset these positive attributes, including our concentration of business in the Massachusetts private passenger automobile market which exposes our business to regulatory actions.

Supervision and Regulation

Introduction. Our principal operations are conducted through the Insurance Subsidiaries which are subject to comprehensive regulation by state insurance departments, primarily through our domestic regulator, the Massachusetts Division of Insurance, of which the Commissioner is the senior official. The Commissioner is appointed by the Governor. We are subject to the authority of the Commissioner in many areas of our business under Massachusetts law, including:

- our licenses to transact insurance;
- the rates and policy forms we may use;
- our financial condition including the adequacy of our reserves and provisions for unearned premium;
- the solvency standards that we must maintain;
- the type and size of investments we may make;

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- the prescribed or permitted statutory accounting practices we must use; and
- the nature of the transactions we may engage in with our affiliates.

In addition, the Commissioner periodically conducts financial and market conduct examinations of all licensees domiciled in Massachusetts. Our most recent financial and market conduct examinations were for the five-year period ending December 31, 2013. The Division had no material findings as a result of these examinations.

We are also required to be licensed by the insurance department in each state in which we do business, as well as to comply with the various laws and regulations of those jurisdictions, including those governing our use of rates and policy forms in those states.

Insurance Holding Company Regulation. Our principal operating subsidiaries are insurance companies, and therefore we are subject to certain laws in Massachusetts regulating insurance holding company systems. These laws require that we file a registration statement with the Commissioner that discloses the identity, financial condition, capital structure and ownership of each entity within our corporate structure and any transactions among the members of our holding company system. In some instances, we must provide prior notice to the Commissioner for material transactions between our insurance company subsidiaries and other affiliates in our holding company system. These holding company statutes also require, among other things, prior approval of the payment of extraordinary dividends or distributions and any acquisition of a domestic insurer and that we file an annual Enterprise Risk Management report with the Commissioner.

Insurance Regulation Concerning Dividends. We rely on dividends from the Insurance Subsidiaries for our cash requirements. The insurance holding company law of Massachusetts requires notice to the Commissioner of any dividend to the shareholders of an insurance company. The Insurance Subsidiaries may not make an "extraordinary dividend" until thirty days after the Commissioner has received notice of the intended dividend and has not objected in such time. As historically administered by the Commissioner, this provision requires the prior approval by the Commissioner of an extraordinary dividend. An extraordinary dividend is defined as any dividend or distribution that, together with other distributions made within the preceding twelve months exceeds the greater of 10.0% of the insurer's surplus as of the preceding December 31, or the insurer's net income for the twelve-month period ending the preceding December 31, in each case determined in accordance with statutory accounting practices. Under Massachusetts law, an insurer may pay cash dividends only from its unassigned funds, also known as its earned surplus, and the insurer's remaining surplus must be both reasonable in relation to its outstanding liabilities and adequate to its financial needs. At December 31, 2018, the statutory surplus of Safety Insurance was $646,820 and its net income for 2018 was $86,734. A maximum of $86,734 will be available during 2019 for such dividends without prior approval of the Commissioner.

Acquisition of Control of a Massachusetts Domiciled Insurance Company. Massachusetts law requires advance approval by the Commissioner of any change in control of an insurance company that is domiciled in Massachusetts. That law presumes that control exists where any person, directly or indirectly, owns, controls, holds the power to vote or holds proxies representing 10.0% or more of our outstanding voting stock. Even persons who do not acquire beneficial ownership of more than 10.0% of the outstanding shares of our common stock may be deemed to have acquired control if the Commissioner determines that control exists in fact. Any purchaser of shares of

common stock representing 10.0% or more of the voting power of our capital stock will be presumed to have acquired control of the Insurance Subsidiaries unless, following application by that purchaser the Commissioner determines that the acquisition does not constitute a change of control or is otherwise not subject to regulatory review. These requirements may deter, delay or prevent transactions affecting the control of or the ownership of our common stock, including transactions that could be advantageous to our stockholders.

Protection Against Insurer Insolvency. Massachusetts law requires that insurers licensed to do business in Massachusetts participate in the Massachusetts Insurers Insolvency Fund ("Insolvency Fund"). The Insolvency Fund must pay any claim up to $300 of a policyholder of an insolvent insurer if the claim existed prior to the declaration of insolvency or arose within sixty days after the declaration of insolvency. Members of the Insolvency Fund are assessed the amount the Insolvency Fund deems necessary to pay its obligations and expenses in connection with handling covered claims. Subject to certain exceptions, assessments are made in the proportion that each member's net written premiums for the prior calendar year for all property and casualty lines bore to the corresponding net written premiums

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for Insolvency Fund members for the same period. As a matter of Massachusetts law, insurance rates and premiums include amounts to recoup any amounts paid by insurers for the costs of the Insolvency Fund. By statute, no insurer in Massachusetts may be assessed in any year an amount greater than two percent of that insurer's direct written premium for the calendar year prior to the assessment. We account for allocations from the Insolvency Fund as underwriting expenses. CAR also assesses its members as a result of insurer insolvencies. Because CAR is not able to recover an insolvent company's share of the net CAR losses from the Insolvency Fund, CAR must increase each of its member's shares of the deficit in order to compensate for the insolvent carrier's inability to pay its deficit assessment. It is anticipated that there will be future assessments from time to time relating to various insolvencies.

The Insurance Regulatory Information System. The Insurance Regulatory Information System ("IRIS") was developed to help state insurance regulators identify companies that may require special financial attention. IRIS consists of a statistical phase and an analytical phase whereby financial examiners review annual statements and financial ratios. The statistical phase consists of 13 key financial ratios based on year-end data that are generated annually from the database of the National Association of Insurance Commissioners ("NAIC"). Each ratio has an established "usual range" of results. These ratios assist state insurance departments in executing their statutory mandate to oversee the financial condition of insurance companies.

A ratio result falling outside the usual range of IRIS ratios is not considered a failing result; rather, unusual values are viewed as part of the regulatory early monitoring system. Furthermore, in some years, it may not be unusual for financially sound companies to have several ratios with results outside the usual ranges. Generally, an insurance company will become subject to regulatory scrutiny if it falls outside the usual ranges of four or more of the ratios. In 2018, 2017, and 2016 all our ratios for all our Insurance Subsidiaries were within the normal range.

Risk-Based Capital Requirements. The NAIC has adopted a formula and model law to implement risk-based capital requirements for most property and casualty insurance companies, which are designed to determine minimum capital requirements and to raise the level of protection that statutory surplus provides for policyholder obligations. The risk-based capital formula for property and casualty insurance companies measures three major areas of risk facing property and casualty insurers:

- underwriting, which encompasses the risk of adverse loss developments and inadequate pricing;
- declines in asset values arising from market and/or credit risk; and
- off-balance sheet risk arising from adverse experience from non-controlled assets, guarantees for affiliates or other contingent liabilities and reserve and premium growth.

Under Massachusetts law, insurers having less total adjusted capital than that required by the risk-based capital calculation will be subject to varying degrees of regulatory action, depending on the level of capital inadequacy.

The risk-based capital law provides for four levels of regulatory action. The extent of regulatory intervention and action increases as the level of total adjusted capital to risk-based capital falls. The first level, the company action level, as defined by the NAIC, requires an insurer to submit a plan of corrective actions to the Commissioner if total adjusted capital falls below 200% of the risk-based capital amount. The regulatory action level, as defined by the NAIC requires an insurer to submit a plan containing corrective actions and requires the Commissioner to perform an examination or other analysis and issue a corrective order if total adjusted capital falls below 150.0% of the risk-based capital amount. The authorized control level, as defined by the NAIC, authorizes the Commissioner to take whatever regulatory actions he or she considers necessary to protect the best interest of the policyholders and creditors of the insurer which may include the actions necessary to cause the insurer to be placed under regulatory control, i.e., rehabilitation or liquidation, if total adjusted capital falls below 100.0% of the risk-based capital amount. The fourth action level is the mandatory control level, as defined by the NAIC, which requires the Commissioner to place the insurer under regulatory control if total adjusted capital falls below 70.0% of the risk-based capital amount.

The formulas have not been designed to differentiate among adequately capitalized companies that operate with higher levels of capital. Therefore, it is inappropriate and ineffective to use the formulas to rate or to rank these

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companies. At December 31, 2018, our Insurance Subsidiaries had total adjusted capital in excess of amounts requiring company or regulatory action at any prescribed risk-based capital action level.

Own Risk Solvency Assessment. On January 11, 2017, the Division adopted the National Association of Insurance Commissioners' Own Risk Solvency Assessment ("ORSA") Act requiring the Company to file its assessment on an annual basis. ORSA is an internal process undertaken by an insurer or insurance group to assess the adequacy of its risk management and current and prospective solvency positions under normal and severe stress scenarios. We have completed this filing for the 2018 period.

Executive Officers and Directors

The table below sets forth certain information concerning our directors and executive officers as of the date of this annual report.

Name	Age (1)	Position	Years Employed by Safety
George M. Murphy	52	President, Chief Executive Officer	30
William J. Begley, Jr.	64	Vice President, Chief Financial Officer and Secretary	33
James D. Berry	59	Vice President - Underwriting	37
John P. Drago	52	Vice President - Marketing	24
David E. Krupa	58	Vice President - Property Claims	36
Ann M. McKeown	52	Vice President - Insurance Operations	29
Paul J. Narciso	55	Vice President - Casualty Claims	28
Stephen A. Varga	51	Vice President - Management Information Systems	26
David F. Brussard	67	Chairman of the Board, Director	-
Frederic H. Lindeberg	78	Director	-
Peter J. Manning	80	Director	-
David K. McKown	81	Director	-
Thalia M. Meehan	57	Director	-

(1) As of February 15, 2019

George M. Murphy, CPCU, was appointed President and Chief Executive Officer of the Company effective April 1, 2016. He previously was the Vice President of Marketing since October 1, 2005. Mr. Murphy was appointed to the Board of Directors and to the Investment Committee in February 2016. Mr. Murphy has been employed by the Insurance Subsidiaries for over 30 years. Mr. Murphy is also on the Board of Trustees of the Insurance Library Association of Boston.

William J. Begley, Jr. was appointed Chief Financial Officer, Vice President and Secretary of the Company on March 4, 2002. Mr. Begley has been employed by the Insurance Subsidiaries for over 33 years. Mr. Begley also serves on the Audit Committee and Investment Committee of Guaranty Fund Management Services, and is a member

of the Board of Directors of the Massachusetts Insurers Insolvency Fund.

James D. Berry, CPCU, was appointed Vice President of Underwriting of the Company in July 2015, and was named as Secretary of the Insurance Subsidiaries at that time. Prior to that, he served as the Vice President of Insurance Operations since October 2005. Mr. Berry has been employed by the Insurance Subsidiaries for over 37 years and has directed the Company's Massachusetts Private Passenger line of business since 2001. Mr. Berry is the Chairman of the Board of Directors of the FAIR Plan and previously served as the Chairman of that organizations Executive Committee. He has served on several committees of CAR including Market Review and Defaulted Brokers and also served on Computer Sciences Corporation Series II and Exceed advisory councils. He also serves on the Executive Committee of the In Control Family Foundation, and is the Chairman of that organizations Finance Committee.

John P. Drago was appointed Vice President of Marketing on February 1, 2016. Mr. Drago has been employed by the Insurance Subsidiaries for over 24 years and most recently served as Director of Marketing.

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David E. Krupa, CPCU, was appointed Vice President of Property Claims of the Company on March 4, 2002. Mr. Krupa has been employed by the Insurance Subsidiaries for over 36 years. Mr. Krupa was first employed by the Company in 1982 and held a series of management positions in the Claims Department before being appointed Vice President in 1990. Mr. Krupa has served on the Auto Damage Appraisers Licensing Board of Massachusetts and on several claims committees both at the Automobile Insurers Bureau of Massachusetts and CAR.

Ann M. McKeown was appointed Vice President of Insurance Operations of the Company on July 1, 2015. Ms. McKeown has been employed by the Insurance Subsidiaries for over 29 years wherein she has held management positions in the Underwriting, Information Technology, and Insurance Operations departments. Ms. McKeown has served on the MAIP Steering and Operations Committees of CAR.

Paul J. Narciso was appointed Vice President of Casualty Claims of the Company on August 2013. Mr. Narciso has held various adjusting and claims management positions with the Company since 1990. Mr. Narciso has 32 years of claim experience having worked at two national carriers prior to joining Safety. He currently serves on the Governing Board of the Massachusetts Insurance Fraud Bureau and the Claims Subcommittee at Commonwealth Automobile Reinsurers.

Stephen A. Varga was appointed Vice President of Management Information Systems of the Company on August 2014. Mr. Varga has held various information technology positions with the Company since 1992 and most recently served as Senior Director of MIS.

David F. Brussard was appointed Chairman of the Board in March 2004 and has served as a director of the Company since October 2001. Mr. Brussard served as President and Chief Executive Officer of the Company from June 2001 until March 31, 2016. Mr. Brussard was also appointed Chairman of the Investment Committee on February 22, 2017.

Frederic H. Lindeberg has served as a director of the Company since August 2004. Mr. Lindeberg has had a consulting practice providing taxation, management and investment counsel since 1991, focusing on finance, real estate, manufacturing and retail industries. Mr. Lindeberg retired in 1991 as Partner-In-Charge of various KPMG tax offices, after 24 years of service where he provided both accounting and tax counsel to various clients. Mr. Lindeberg is an attorney and certified public accountant. Mr. Lindeberg was formerly a director of Provident Senior Living Trust (PSLT) and TAL International (TAL) and formerly an adjunct professor at Penn State Graduate School of Business.

Peter J. Manning has served as a director of the Company since September 2003. Mr. Manning retired in 2003, as Vice Chairman Strategic Business Development of FleetBoston Financial, after 32 years with FleetBoston Financial Corporation (formerly BankBoston) where he also held the positions of Comptroller and Executive Vice President and Chief Financial Officer. Mr. Manning started his career with Coopers & Lybrand in 1962 prior to his 1972 employment with BankBoston.

David K. McKown has served as director of the Company since November 2002. Mr. McKown has been a Senior Advisor to Eaton Vance Management since 2000, focusing on business origination in real estate and asset-based loans. Mr. McKown retired in March 2000 having served as a Group Executive with BankBoston since 1993, where he focused on acquisitions and high-yield bank debt financings. Mr. McKown has been in the banking industry for 52 years, worked for BankBoston for over 32 years and had previously been the head of BankBoston's real estate department, corporate finance department, and a managing director of BankBoston's private equity

unit. Mr. McKown is currently a director of Global Partners L.P., and various privately held companies.

Thalia M. Meehan was appointed Director of the Company on July 3, 2017. Ms. Meehan has also been appointed to serve as a member of the Investment Committee of the Board. Ms. Meehan, a Chartered Financial Analyst, has over 30 years of experience in the investment sector. Ms. Meehan retired from Putnam Investments in 2016 with 27 years of experience and most recently served as a Team Leader and Portfolio Manager at Putnam Investments. Ms. Meehan currently serves on the Board of the Boston Women in Public Finance and was previously a member of the Municipal Securities Rulemaking Board Investor Advisory Group.

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ITEM 1A. RISK FACTORS

An investment in our common stock involves a number of risks. Any of the risks described below could result in a significant or material adverse effect on our results of operations or financial condition, and a corresponding decline in the market price of our common stock.

Because we are primarily a private passenger automobile insurance carrier, our business may be adversely affected by conditions in this industry.

Approximately 55.7% of our direct written premiums for the year ended December 31, 2018, were generated from private passenger automobile insurance policies. As a result of our focus on that line of business, negative developments in the economic, competitive or regulatory conditions affecting the private passenger automobile insurance industry could have a material adverse effect on our results of operations and financial condition. In addition, these developments would have a disproportionate effect on us, compared to insurers which conduct operations in multiple business lines.

Because we write insurance principally in Massachusetts, our business may be adversely affected by conditions in Massachusetts, including the impact of additional competitors.

Almost all of our direct written premiums are currently generated in Massachusetts. Our revenues and profitability are therefore subject to prevailing regulatory, economic, demographic, competitive and other conditions in Massachusetts. Changes in any of these conditions could make it more costly or difficult for us to conduct our business. The Massachusetts market has seen an increased level of competition, particularly in the private passenger automobile insurance line, due to prior changes in regulatory conditions. To date, we have not had a significant decrease in our private passenger automobile insurance business. However, further competition and adverse results could include loss of market share, decreased revenue, and/or increased costs.

We have exposure to claims related to severe weather conditions, which may result in an increase in claims frequency and severity.

We are subject to claims arising out of severe weather conditions, such as rainstorms, snowstorms and icestorms, that may have a significant effect on our results of operations and financial condition. The incidence and severity of weather conditions are inherently unpredictable. There is generally an increase in claims frequency and severity under the private passenger automobile insurance we write when severe weather occurs because a higher incidence of vehicular accidents and other insured losses tend to occur as a result of severe weather conditions. In addition, we have exposure to an increase in claims frequency and severity under the homeowners and other property insurance we write because property damage may result from severe weather conditions.

Because some of our insureds live near the Massachusetts coastline, we also have a potential exposure to losses from hurricanes and major coastal storms such as Nor'easters. Although we purchase catastrophe reinsurance to limit our exposure to natural catastrophes, in the event of a major catastrophe resulting in property losses to us in excess of $665,000 our losses would exceed the limits of this reinsurance in addition to losses from our co-participation retention of a portion of the risk up to $665,000.

Climate change may adversely impact our results of operations.

There are concerns that the increase in weather-related catastrophes and other losses incurred by the industry in recent years may be indicative of changing weather patterns. This change in weather patterns could lead to higher overall losses which we may not be able to recover, particularly in light of the current competitive environment, and higher

reinsurance costs. Climate change could also have an impact on issuers of securities in which we invest, resulting in realized and unrealized losses in future periods which could have a material adverse impact on our results of operations and/or financial position.

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If we are not able to attract and retain independent agents, it could adversely affect our business.

We market our insurance solely through independent agents. We must compete with other insurance carriers for the business of independent agents. Some of our competitors offer a larger variety of products, lower prices for insurance coverage or higher commissions. While we believe that the commissions and services we provide to our agents are competitive with other insurers, changes in commissions, services or products offered by our competitors could make it harder for us to attract and retain independent agents to sell our insurance products.

Established competitors with greater resources may make it difficult for us to market our products effectively and offer our products at a profit.

The property and casualty insurance business is highly competitive and many of our competitors have substantially greater financial and other resources than we do. We compete with both large national writers and smaller regional companies. Further, our competitors include other companies which, like us, serve the independent agency market, as well as companies which sell insurance directly to customers. Direct writers may have certain competitive advantages over agency writers, including increased name recognition, loyalty of the customer base to the insurer rather than to an independent agency and, potentially, lower cost structures. A material reduction in the amount of business independent agents sell would directly and negatively affect our profitability and our ability to compete with insurers that do not rely solely on the independent agency market to sell their products. Further, our Company and others compete on the basis of the commissions and other cash and non-cash incentives provided to agents. Although a number of national insurers that are much larger than we are do not currently compete in a material way in the Massachusetts personal auto market, if one or more of these companies decided to aggressively enter the market it could reduce our share of the Massachusetts market and thereby have a material adverse effect on us. These companies include some that would be able to sustain significant losses in order to acquire market share, as well as others which use distribution methods that compete with the independent agent channel. Progressive Corporation, GEICO and Allstate, large insurers that market directly to policyholders rather than through agents, along with other carriers have entered the Massachusetts private passenger automobile insurance market.

We may not be able to successfully alleviate risk through reinsurance arrangements which could cause us to reduce our premiums written in certain lines or could result in losses.

In order to reduce risk, to increase our underwriting capacity, and mitigate the volatility of losses on our financial condition and operations, we purchase reinsurance. The availability and the cost of reinsurance protection are subject to market conditions, which are outside of our control. As a result, we may not be able to successfully alleviate risk through these arrangements. For example, if reinsurance capacity for homeowner's risks were reduced as a result of terrorist attacks, climate change or other causes, we might seek to reduce the amount of homeowners business we write. As a result, the Company may not be able to successfully purchase reinsurance and transfer a portion of the Company’s risk through reinsurance arrangements. In addition, we are subject to credit risk with respect to our reinsurance because the ceding of risk to reinsurers does not relieve us of our liability to our policyholders. A significant reinsurer's insolvency or inability to make payments under the terms of a reinsurance treaty could have a material adverse effect on our results of operations and financial condition.

As a holding company, Safety Insurance Group, Inc. is dependent on the results of operations of the Safety Insurance Company.

Safety Insurance Group, Inc. is a company and a legal entity separate and distinct from Safety Insurance Company, our principal operating subsidiary. As a holding company without significant operations of its own, the principal sources of Safety Insurance Group, Inc.'s funds are dividends and other distributions from Safety Insurance Company. Our rights to participate in any distribution of assets of Safety Insurance Company are subject to prior claims of

policyholders, creditors and preferred shareholders, if any, of Safety Insurance Company (except to the extent that our rights, if any, as a creditor are recognized). Consequently, our ability to pay debts, expenses and cash dividends to our shareholders may be limited. The ability of Safety Insurance Company to pay dividends is subject to limits under Massachusetts insurance law. Further, the ability of Safety Insurance Group, Inc. to pay dividends, and our subsidiaries'

ability to incur indebtedness or to use the proceeds of equity offerings, will be subject to limits under our revolving credit facility.

We are subject to comprehensive government regulation and our ability to earn profits may be restricted by these regulations.

General Regulation. We are subject to regulation by the state insurance department of each state in which we do business. In each jurisdiction, we must comply with various laws and regulations, including those involving:

- approval or filing of premium rates and policy forms;
- limitation of the right to cancel or non-renew policies in some lines;
- requirements to participate in residual markets;
- licensing of insurers and agents; and
- regulation of the right to withdraw from markets or terminate involvement with agencies;

We also are subject to enhanced regulation by our domestic regulator, the Massachusetts Division of Insurance, from which we must obtain prior approval for certain corporate actions. Among other things, we must comply with laws and regulations governing:

- transactions between an insurance company and any of its affiliates;
- the payment of dividends;
- the acquisition of an insurance company or of any company controlling an insurance company;
- solvency standards;
- minimum amounts of capital and surplus which must be maintained;
- limitations on types and amounts of investments;
- restrictions on the size of risks which may be insured by a single company;
- deposits of securities for the benefit of policyholders; and
- reporting with respect to financial condition.

In addition, insurance department examiners from Massachusetts perform periodic financial and market conduct examinations of insurance companies. Such regulation is generally intended for the protection of policyholders rather than security holders.

Massachusetts, New Hampshire and Maine require that all licensed property and casualty insurers bear a portion of the losses suffered by some insureds as a result of impaired or insolvent insurance companies by participating in each state's insolvency fund. Members of the state's insolvency fund are assessed a proportionate share of the obligations and expenses of the fund in connection with an insolvent insurer. These assessments are made by the fund to cover the cost of paying eligible claims of policyholders of these insolvent insurers. Similarly, assessments are made by each state's commercial automobile insurance residual market mechanism to recover the shares of net losses that would have been assessed to the insolvent companies but for their insolvencies. In addition, Massachusetts has established an underwriting association in order to ensure that property insurance is available for owners of high risk property who are not able to obtain insurance from private insurers. The losses of this underwriting association, the Massachusetts Property Insurance Underwriting Association, are shared by all insurers that write property and casualty insurance in Massachusetts. We are assessed from time to time to pay these losses. The effect of these assessments could reduce our profitability in any given period and limit our ability to grow our business.

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Because we are unable to predict with certainty changes in the political, economic or regulatory environments of the states in which we operate in the future, there can be no assurance that existing insurance-related laws and regulations will not become more restrictive in the future or that new restrictive laws will not be enacted and, therefore, it is not possible to predict the potential effects of these laws and regulations on us.

We may enter new markets and there can be no assurance that our diversification strategy will be effective.

Although we intend to concentrate on our core businesses in Massachusetts, New Hampshire, and Maine, we also may seek to take advantage of prudent opportunities to expand our core businesses into other states where we believe the independent agent distribution channel is strong. As a result of a number of factors, including the difficulties of finding appropriate expansion opportunities and the challenges of operating in an unfamiliar market, we may not be successful in this diversification. Additionally, in order to carry out any such strategy we would need to obtain the appropriate licenses from the insurance regulatory authority of any such state.

Our failure to maintain a commercially acceptable financial strength rating would significantly and negatively affect our ability to implement our business strategy successfully.

A.M. Best has currently assigned Safety Insurance an "A (Excellent)" rating. An "A" rating is A.M. Best's third highest rating, out of 13 possible rating classifications for solvent companies. An "A" rating is assigned to insurers that in A.M. Best's opinion have a strong ability to meet their ongoing obligations to policyholders. Moreover, an "A" rating is assigned to companies that have, on balance, excellent balance sheet strength, operating performance and business profile when compared to the standards established by A.M. Best. A.M. Best bases its ratings on factors that concern policyholders and not upon factors concerning investor protection. Such ratings are subject to change and are not recommendations to buy, sell, or hold securities. An important factor in an insurer's ability to compete effectively is its A.M. Best rating. Our A.M. Best rating is lower than those of some of our competitors. Any future decrease in our rating could affect our competitive position.

Our losses and loss adjustment expenses may exceed our reserves, which could significantly affect our business.

The reserves for losses and loss adjustment expenses that we have established are estimates of amounts needed to pay reported and unreported claims and related expenses based on facts and circumstances known to us as of the time we established the reserves. Reserves are based on historical claims information, industry statistics and other factors. The establishment of appropriate reserves is an inherently uncertain process. If our reserves are inadequate and are strengthened, we would have to treat the amount of such increase as a charge to our earnings in the period that the deficiency is recognized. As a result of these factors, there can be no assurance that our ultimate liability will not materially exceed our reserves and have a negative effect on our results of operations and financial condition.

Due to the inherent uncertainty of estimating reserves, it has been necessary, and may over time continue to be necessary, to revise estimated future liabilities as reflected in our reserves for claims and policy expenses. The historic development of reserves for losses and loss adjustment expenses may not necessarily reflect future trends in the development of these amounts. Accordingly, it is not appropriate to extrapolate redundancies or deficiencies based on historical information.

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If we lose key personnel, our ability to implement our business strategy could be delayed or hindered.

The loss of key personnel could prevent us from fully implementing our business strategy and could significantly and negatively affect our financial condition and results of operations. As we continue to grow, we will need to recruit and retain additional qualified management personnel, and our ability to do so will depend upon a number of factors, such as our results of operations and prospects and the level of competition then prevailing in the market for qualified personnel.

Market fluctuations and changes in interest rates can have significant and negative effects on our investment portfolio.

Our results of operations depend in part on the performance of our invested assets. As of December 31, 2018, based upon fair value measurement, 86.9% of our investment portfolio was invested in fixed maturity securities, 11.1% in equity securities and 2.0% in other invested assets. Certain risks are inherent in connection with debt securities including loss upon default and price volatility in reaction to changes in interest rates and general market factors.

We have a significant investment portfolio and adverse capital market conditions, including but not limited to volatility and credit spread changes, will impact the liquidity and value of our investments, potentially resulting in higher realized or unrealized losses. Values of our investments can also be impacted by reductions in price transparency and changes in investor confidence and preferences, potentially resulting in higher realized or unrealized losses. If the carrying value of our investments exceeds the fair value, and the decline in fair value is deemed to be other-than-temporary, we will be required to write down the value of our investments, which could materially harm our results of operations and financial condition.

Indebtedness under our revolving credit agreement has the option to bear interest based on LIBOR, which may be subject to regulatory guidance and/or reform that could impact our current or future debt agreements.

The U.K. Financial Conduct Authority, which regulates LIBOR, has announced that it intends to stop encouraging or requiring banks to submit LIBOR rates after 2021 and it is unclear if LIBOR will cease to exist or if new methods of calculating LIBOR will evolve. If LIBOR ceases to exist or if the methods of calculating LIBOR change from their current form, interest rates on future indebtedness may be adversely affected or we may need to renegotiate the terms of our credit agreement to replace LIBOR with the new standard that is established, if any, or to otherwise agree with the trustees or agents on a new means of calculating interest.

There are anti-takeover provisions contained in our organizational documents and in laws of the State of Delaware and the Commonwealth of Massachusetts that could impede an attempt to replace or remove our management or prevent the sale of our company, which could diminish the value of our common stock.

Our certificate of incorporation, bylaws and the laws of Delaware contain provisions that may delay, deter or prevent a takeover attempt that shareholders might consider in their best interests. For example, our organizational documents provide for a classified board of directors with staggered terms, prevent shareholders from taking action by written consent, prevent shareholders from calling a special meeting of shareholders, provide for supermajority voting requirements to amend our certificate of incorporation and certain provisions of our bylaws and provide for the filling of vacancies on our board of directors by the vote of a majority of the directors then in office. These provisions will render the removal of the incumbent board of directors or management more difficult. In addition, these provisions may prevent shareholders from receiving the benefit of any premium over the market price of our common stock offered by a bidder in a potential takeover. Even in the absence of a takeover attempt, the existence of these provisions may adversely affect the prevailing market price of our common stock if they are viewed as discouraging takeover attempts in the future.

The Massachusetts insurance law prohibits any person from acquiring control of us, and thus indirect control of the Insurance Subsidiaries., without the prior approval of the Commissioner. That law presumes that control exists where any person, directly or indirectly, owns, controls, holds the power to vote or holds proxies representing 10.0% or more of

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our outstanding voting stock. Even persons who do not acquire beneficial ownership of more than 10.0% of the outstanding shares of our common stock may be deemed to have acquired such control if the Commissioner determines that such control exists in fact. Therefore, any person seeking to acquire a controlling interest in us would face regulatory obstacles which could delay, deter or prevent an acquisition that shareholders might consider in their best interests.

Section 203 of the General Corporation Law of Delaware, the jurisdiction in which the Company is organized, may affect the ability of an "interested stockholder" to engage in certain business combinations including mergers, consolidations or acquisitions of additional shares, for a period of three years following the time that the stockholder becomes an interested stockholder. An interested stockholder is defined to include persons owning directly or indirectly 15.0% or more of the outstanding voting stock of the corporation.

Future sales of shares of our common stock by our existing shareholders in the public market, or the possibility or perception of such future sales, could adversely affect the market price of our stock.

Investors currently known to be the beneficial owners of greater than 5.0% of our outstanding common stock hold approximately 56.5% of the common stock of Safety Insurance Group, Inc. on a fully diluted basis. No prediction can be made as to the effect, if any, that future sales of shares by our existing shareholders, or the availability of shares for future sale, will have on the prevailing market price of our common stock from time to time. Sales of substantial amounts of our common stock in the public market by our existing shareholders, or the possibility or perception that such sales could occur, could cause the prevailing market prices for our common stock to decrease. If such sales reduce the market price of our common stock, our ability to raise additional capital in the equity markets may be adversely affected.

Our business depends on the uninterrupted operation of our systems and business functions, including our information technology, telecommunications and other business systems. Our business continuity and disaster recovery plans may not sufficiently address all contingencies.

Our business is highly dependent upon our ability to execute, in an efficient and uninterrupted fashion, necessary business functions, such as processing new and renewal business, providing customer service, and processing and paying claims. A shut-down of or inability to access our facility, a power outage, or a failure of one or more of our information technology, telecommunications or other systems could significantly impair our ability to perform such functions on a timely basis. If sustained or repeated, such a business interruption, systems failure or service denial could result in a deterioration in the level of service we provide to our agents and policyholders. We have established a business continuity plan in an effort to ensure the continuation of core business operations in the event that normal business operations could not be performed due to a catastrophic event. While we continue to test and assess our business continuity plan to ensure it meets the needs of our core business operations and addresses multiple business interruption events, there is no assurance that core business operations could be performed upon the occurrence of such an event, which may result in a material adverse effect on our financial position and results of operations.

We outsource certain business and administrative functions to third parties and may do so increasingly in the future. If we fail to develop and implement our outsourcing strategies or our third-party providers fail to perform as anticipated, we may experience operational difficulties, increased costs and a loss of business that may have a material adverse effect on our results of operations or financial condition.

Our business could be materially and adversely affected by a security breach or other attack involving our computer systems or the systems of one or more of our agents and vendors.

Our highly automated and networked organization is subject to cyber-terrorism and a variety of other cyber-security threats. These threats come in a variety of forms, such as viruses and malicious software. Such threats can be difficult to prevent or detect, and if experienced, could interrupt or damage our operations, harm our reputation or have a material effect on our operations. Our technology and telecommunications systems are highly integrated and connected with other networks. Cyber-attacks involving these systems could be carried out remotely and from multiple sources and could interrupt, damage or otherwise adversely affect the operations of these critical systems. Cyber-attacks could result

in the modification or theft of data, the distribution of false information or the denial of service to users. We obtain, utilize and maintain data concerning individuals and organizations with which we have a business relationship. Threats to data security can emerge from a variety of sources and change in rapid fashion, resulting in the ongoing need to expend resources to secure our data in accordance with customer expectations and statutory and regulatory requirements.

We could be subject to liability if confidential customer information is misappropriated from our technology systems. Despite the implementation of security measures, these systems may be vulnerable to physical break-ins, computer viruses, programming errors, attacks by third parties or similar disruptive problems. Any well-publicized compromise of security could deter people from entering into transactions that involve transmitting confidential information to our systems, which could have a material adverse effect on our business and reputation. We rely on services and products provided by many vendors. In the event that one or more of our vendors fails to protect personal information of our customers, claimants or employees, we may incur operational impairments, or could be exposed to litigation, compliance costs or reputational damage. We maintain cyber-liability insurance coverage to offset certain potential losses, subject to policy limits, such as liability to others, costs of related crisis management, data extortion, applicable forensics and certain regulatory defense costs, fines and penalties.

We believe that we have established and implemented appropriate security measures to provide reasonable assurance that our information technology systems are secure and appropriate controls and procedures to enable us to identify and respond to unauthorized access to such systems. While we have not experienced material cyber-incidents to date, the occurrence and effects of cyber-incidents may remain undetected for an extended period. We periodically engage third parties to evaluate and test the adequacy of our security measures, controls and procedures. Despite these security measures, controls and procedures, disruptions to and breaches of our information technology systems are possible.

ITEM 1B. UNRESOLVED STAFF COMMENTS

As of the date of this report, the Company had no unresolved comments from the Commission staff regarding its periodic or current reports under the Exchange Act.

ITEM 2. PROPERTIES

We conduct most of our operations in approximately 75 thousand square feet of leased space at 20 Custom House Street in downtown Boston, Massachusetts. Our lease was extended for an additional eleven year term starting on January 1, 2018 and will expire on December 31, 2028.

ITEM 3. LEGAL PROCEEDINGS

Our Insurance Subsidiaries are parties to a number of lawsuits arising in the ordinary course of their insurance business. We believe that the ultimate resolution of these lawsuits will not, individually or in the aggregate, have a material adverse effect on our financial condition.

On December 15, 2015, the Company filed for arbitration with a reinsurer in regards to the reinsurance recoverable resulting from the 2015 winter storm losses that are admissible under our contract. On January 8, 2018, the Company received a final order from a panel of arbitrators which resulted in the reinsurer paying a $9,200 settlement for all paid and outstanding losses.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable

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PART II.

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

As of February 15, 2019, there were 25 holders of record of the Company's common stock, par value $0.01 per share, and we estimate another 9,283 held in "Street Name."

2018	High	Low
First quarter	$ 80.45	$ 71.35
Second quarter	$ 88.85	$ 74.75
Third quarter	$ 98.40	$ 86.40
Fourth quarter	$ 89.31	$ 78.42

2017	High	Low
First quarter	$ 73.85	$ 68.60
Second quarter	$ 72.40	$ 66.10
Third quarter	$ 76.50	$ 68.20
Fourth quarter	$ 83.25	$ 78.30

The closing price of the Company's common stock on February 15, 2019 was $89.93 per share. The Company’s common stock trades on the NASDAQ stock exchange under the symbol SAFT.

During 2018 and 2017, the Company’s Board of Directors declared four quarterly cash dividends to shareholders, which were paid and accrued in the amounts of $49,330 and $45,689, respectively. On February 15, 2019, the Company's Board of Directors declared a quarterly cash dividend of $0.80 per share to shareholders of record on March 1, 2019 payable on March 15, 2019. The Company plans to continue to declare and pay quarterly cash dividends in 2019, depending on the Company's financial position and the regularity of its cash flows.

The Company relies on dividends from its Insurance Subsidiaries for a portion of its cash requirements. The payment by the Company of any cash dividends to the holders of common stock therefore depends on the receipt of dividend payments from its Insurance Subsidiaries. The payment of dividends by the Insurance Subsidiaries is subject to limitations imposed by Massachusetts law, as discussed in Item 1—Business, Supervision and Regulation, Insurance Regulation Concerning Dividends, and also in Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations, Liquidity and Capital Resources.

The information called for by Item 201 (d) of Regulation S-K regarding securities authorized for issuance under equity compensation plans will be contained in the Company's Proxy Statement for its Annual Meeting of Shareholders, to be held on May 22, 2019 in Boston, MA, which the Company intends to file with the U.S. Securities and Exchange Commission within 120 days after December 31, 2018 (the Company's fiscal year end), and such information is incorporated herein by reference.

For information regarding our share repurchase program, refer to Item 8—Financial Statements and Supplementary Data, Note 12, Share Repurchase Program, of this Form 10-K.

COMMON STOCK PERFORMANCE GRAPH

Set forth below is a line graph comparing the dollar change in the cumulative total shareholder return on the Company's Common Stock, for the period beginning on December 31, 2013 and ending on December 31, 2018 with the cumulative total return of the NASDAQ Stock Market Index and a peer group comprised of five selected property & casualty insurance companies over the same period. The peer group consists of Protective Insurance Corp., Mercury General Corp., State Auto Financial Corp., Selective Insurance Group, Inc., and Donegal Group, Inc. The graph shows

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the change in value of an initial one hundred dollar investment over the period indicated, assuming re-investment of all dividends.

Comparative Cumulative Total Returns since December 31, 2013 Among
Safety Insurance Group, Inc.,
Property & Casualty Insurance Peer Group and the NASDAQ Stock Market Index

The foregoing performance graph and data shall not be deemed "filed" as part of this Form 10-K for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that section and should not be deemed incorporated by reference into any other filing of the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent the Company specifically incorporates it by reference into such filing.

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ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth our selected historical consolidated financial data as of and for each of the five years ended December 31, 2018, 2017, 2016, 2015 and 2014.

The selected historical consolidated financial data for the years ended December 31, 2018, 2017, and 2016, and as of December 31, 2018 and 2017 have been derived from the financial statements of Safety Insurance Group, Inc. included in this annual report which have been audited. The selected historical consolidated financial data for the years ended December 31, 2015 and 2014 and as of December 31, 2016, 2015 and 2014 has been derived from Safety Insurance Group, Inc.'s consolidated financial statements not included in this annual report, which have been audited.

We have prepared the selected historical consolidated financial data in conformity with U. S. generally accepted accounting principles.

The selected financial data presented below should be read in conjunction with Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and the accompanying notes included in this Form 10-K in order to more fully understand the historical consolidated financial data.

	Years Ended December 31,				
	2018	2017	2016	2015	2014
Direct written premiums	$ 843,675	$ 827,316	$ 811,559	$ 785,730	$ 765,685
Net written premiums	$ 786,912	$ 781,054	$ 766,470	$ 746,180	$ 734,914
Net earned premiums	$ 781,587	$ 774,420	$ 755,760	$ 738,164	$ 716,875
Net investment income	43,788	38,758	38,413	40,534	42,303
Earnings from partnership investments	6,915	2,082	3,185	2,387	878
Net realized gains (losses) on investments	3,226	6,036	5,559	(469)	197
Change in net unrealized gains on equity investments	(16,324)	—	-	-	-
Net impairment losses on investments	(228)	(256)	(798)	(796)	-
Finance and other service income	17,533	18,073	17,703	18,133	18,544
Total revenue	836,497	839,113	819,822	797,953	778,797
Losses and loss adjustment expenses	485,513	503,887	493,433	612,569	476,366
Underwriting, operating and related expenses	246,643	248,436	233,017	213,939	219,023
Interest expense	90	90	90	90	90
Total expenses	732,246	752,413	726,540	826,598	695,479
Income (loss) before income taxes	104,251	86,700	93,282	(28,645)	83,318
Income tax expense (credit)	21,056	24,313	28,697	(14,792)	23,964
Net income (loss)	$ 83,195	$ 62,387	64,585	(13,853)	59,354
Earnings (loss) per weighted average common					

share:					
Basic	$ 5.48	$ 4.13	$ 4.29	$ (0.93)	$ 3.93
Diluted	$ 5.43	$ 4.10	$ 4.27	$ (0.93)	$ 3.91
Cash dividends paid per common share	$ 3.20	$ 3.00	$ 2.80	$ 2.80	$ 2.60
Number of shares used in computing earnings (loss) per share:					
Basic	15,080,269	15,010,751	14,946,453	14,866,607	14,963,047
Diluted	15,229,898	15,135,348	15,032,263	14,866,607	15,052,745

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	Years Ended December 31,				
	2018	2017	2016	2015	2014
Balance Sheet Data:					
Total cash and investment securities	$ 1,370,936	$ 1,348,763	$ 1,300,558	$ 1,256,937	$ 1,298,716
Total assets	1,856,240	1,807,279	1,758,246	1,703,869	1,675,719
Losses and loss adjustment expense reserves	584,719	574,054	560,321	553,977	482,012
Total liabilities	1,137,596	1,106,263	1,087,520	1,059,370	967,436
Total shareholders' equity	718,644	701,016	670,726	644,499	708,283
GAAP Ratios:					
Loss ratio (1)	62.1 %	65.1 %	65.3 %	83.0 %	66.5 %
Expense ratio (1)	31.6	32.1	30.8	29.0	30.6
Combined ratio (1)	93.7 %	97.2 %	96.1 %	112.0 %	97.1 %

(1) The loss ratio is the ratio of losses and loss adjustment expenses to net earned premiums. The expense ratio, when calculated on a GAAP basis, is the ratio of underwriting expense to net earned premiums. The combined ratio is the sum of the loss ratio and the expense ratio. Please refer to Insurance Ratios under Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations for further discussion on our GAAP ratios.

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ITEM 7. 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"), Safety Asset Management Corporation ("SAMC"), and Safety Management Corporation, which is SAMC's holding company.

We are a leading provider of private passenger and commercial automobile insurance in Massachusetts. In addition to private passenger automobile insurance (which represented 55.7% of our direct written premiums in 2018), we offer a portfolio of other insurance products, including commercial automobile (16.5% of 2018 direct written premiums), homeowners (22.9% of 2018 direct written premiums), dwelling fire, umbrella and business owner policies (totaling 4.9% of 2018 direct written premiums). Operating exclusively in Massachusetts, New Hampshire and Maine 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 899 in 1,120 locations throughout these three states during 2018. We have used these relationships and our extensive knowledge of the market to become the fourth largest private passenger automobile carrier and the largest commercial automobile carrier in Massachusetts, capturing an approximate 9.0% and 15.7% share, respectively, of the Massachusetts private passenger and commercial automobile markets in 2018, according to statistics compiled by CAR based on automobile exposures. We are the third largest homeowners insurance carrier in Massachusetts, with a market share of 7.2% in 2017. Our principal competitors within the Massachusetts homeowners insurance market are MAPFRE SA, Liberty Mutual Insurance and Chubb, which held 13.5%, 10.7% and 6.6% market shares respectively

in 2017 (according to S&P Global Market Intelligence).

Our Insurance Subsidiaries began writing insurance in New Hampshire during 2008 and Maine in 2016. The table below shows the amount of direct written premiums and number of policies written in each state during the years ended December 31, 2018, 2017, and 2016.

	Years Ended December 31,		
Direct Written Premiums	2018	2017	2016
Massachusetts	$ 813,857	$ 799,427	$ 785,376
New Hampshire	29,159	27,637	26,128
Maine	659	252	55
Total	$ 843,675	$ 827,316	$ 811,559

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Recent Trends and Events

Losses and loss adjustment expenses incurred for the year ended December 31, 2018 decreased by $18,374, or 3.6%, to $485,513 from $503,887 for the comparable 2017 period.

We define a "catastrophe" as an event that produces pre-tax losses before reinsurance in excess of $1,000 and involves multiple first-party policyholders, or an event that produces a number of claims in excess of a preset, per-event threshold of average claims in a specific area, occurring within a certain amount of time following the event. Catastrophes are caused by various natural events including high winds, winter storms, tornadoes, hailstorms, and hurricanes. The nature and level of catastrophes in any period cannot be reliably predicted.

Catastrophe losses incurred by the type of event are shown in the following table.

	Years Ended December 31,		
Event	2018	2017	2016
Windstorms and hailstorms	$ 14,426	$ 6,700	$ -
Icestorms and snowstorms	-	-	9,495
Total losses incurred (1)	$ 14,426	$ 6,700	$ 9,495

(1) Total losses incurred include losses plus defense and cost containment expenses and excludes adjusting and other claims settlement expenses.

The following rate changes have been filed and approved by the insurance regulators of Massachusetts and New Hampshire in 2018 and 2017. Our Massachusetts private passenger automobile rates include a 13% commission rate for agents.

Line of Business	Effective Date	Rate Change
New Hampshire Homeowner	December 1, 2018	2.3%
New Hampshire Private Passenger Automobile	December 1, 2018	2.0%
Massachusetts Homeowner	November 1, 2018	2.6%
Massachusetts Private Passenger Automobile	September 1, 2018	2.3%
Massachusetts Commercial Automobile	June 1, 2018	3.7%
New Hampshire Commercial Automobile	March 1, 2018	4.6%
New Hampshire Homeowner	December 1, 2017	3.9%
New Hampshire Private Passenger Automobile	December 1, 2017	4.2%
Massachusetts Homeowner	November 1, 2017	3.8%

Massachusetts Private Passenger Automobile	July 15, 2017	3.6%
Massachusetts Commercial Automobile	April 1, 2017	3.8%
New Hampshire Commercial Automobile	March 1, 2017	6.1%

Statutory Accounting Principles

Our results are reported in accordance with GAAP, which differ from amounts reported in accordance with statutory accounting principles ("SAP") as prescribed by insurance regulatory authorities, which in general reflect a liquidating, rather than going concern concept of accounting. Specifically, under GAAP:

- Policy acquisition costs such as commissions, premium taxes and other variable costs incurred which are directly related to the successful acquisition of a new or renewal insurance contract are capitalized and amortized on a pro rata basis over the period in which the related premiums are earned, rather than expensed as incurred, as required by SAP.

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

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

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

· The differing treatment of income and expense items results in a corresponding difference in federal income tax expense. Changes in deferred income taxes are reflected as an item of income tax benefit or expense, rather than recorded directly to surplus as regards policyholders, as required by SAP. Admittance testing may result in a charge to unassigned surplus for non-admitted portions of deferred tax assets. Under GAAP reporting, a valuation allowance may be recorded against the deferred tax asset and reflected as an expense.

Insurance Ratios

The property and casualty insurance industry uses the combined ratio as a measure of underwriting profitability. The combined ratio is the sum of the loss ratio (losses and loss adjustment expenses incurred as a percent of net earned premiums) plus the expense ratio (underwriting 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 presented in the following table for the periods indicated.

	Years Ended December 31,					
	2018		2017		2016	
GAAP ratios:						
Loss ratio	62.1	%	65.1	%	65.3	%
Expense ratio	31.6		32.1		30.8	
Combined ratio	93.7	%	97.2	%	96.1	%

Share-Based Compensation

On April 2, 2018, the Company's Board of Directors adopted the Safety Insurance Group, Inc. 2018 Long-Term Incentive Plan ("the 2018 Plan"), which was subsequently approved by our shareholders at the 2018 Annual Meeting of Shareholders. The 2018 Plan enables the grant of stock awards, performance shares, cash-based performance units, other stock-based awards, stock options, stock appreciation rights, and stock unit awards, each of which may be granted separately or in tandem with other awards. Eligibility to participate includes officers, directors, employees and other individuals who provide bona fide services to the Company. The 2018 Plan supersedes the Company's 2002 Management Omnibus Incentive Plan ("the 2002 Incentive Plan").

The 2018 Plan establishes an initial pool of 350,000 shares of common stock available for issuance to our employees and other eligible participants.

The maximum number of shares of common stock between both the 2018 Plan and 2002 Incentive Plan with respect to which awards may be granted is 2,850,000. No further grants will be allowed under the 2002 Incentive Plan and there have been no grants issued under the 2018 Plan during the current year. At December 31, 2018, there were 350,000 shares available for future grant. Grants outstanding under the Plans as of December 31, 2018, were comprised of 194,305 restricted shares.

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Grants made under the Incentive Plan during the years 2014 through 2018 were as follows.

Type of Equity Awarded	Effective Date	Number of Awards Granted	Fair Value per Share		Vesting Terms
RS - Service	March 11, 2014	24,426	$ 54.35	(1)	3 years, 30%-30%-40%
RS - Performance	March 11, 2014	27,928	$ 58.09	(1)	3 years, cliff vesting (3)
RS	March 11, 2014	4,000	$ 54.35	(1)	No vesting period (2)
RS - Service	March 24, 2014	20,588	$ 53.64	(1)	5 years, 20% annually
RS - Service	July 15, 2014	1,767	$ 50.94	(1)	3 years, 30%-30%-40%
RS - Performance	July 15, 2014	1,975	$ 55.70	(1)	3 years, cliff vesting (3)
RS - Service	February 24, 2015	24,076	$ 61.68	(1)	3 years, 30%-30%-40%
RS - Service	February 24, 2015	17,321	$ 61.68	(1)	5 years, 20% annually
RS - Performance	February 24, 2015	35,932	$ 63.73	(1)	3 years, cliff vesting (3)
RS	February 24, 2015	4,000	$ 61.68	(1)	No vesting period (2)
RS - Service	July 1. 2015	1,546	$ 58.21	(1)	3 years, 30%-30%-40%
RS - Performance	July 1. 2015	1,790	$ 61.45	(1)	3 years, cliff vesting (3)
RS - Service	February 23, 2016	24,479	$ 56.07	(1)	3 years, 30%-30%-40%
RS - Service	February 23, 2016	17,077	$ 56.07	(1)	5 years, 20% annually
RS - Performance	February 23, 2016	34,626	$ 60.72	(1)	3 years, cliff vesting (3)
RS	February 23, 2016	4,000	$ 56.07	(1)	No vesting period (2)
RS	March 31, 2016	1,000	$ 57.06	(1)	No vesting period (2)
RS - Performance	April 1, 2016	10,000	$ 61.38	(1)	3 years, cliff vesting (3)
RS - Service	February 22, 2017	19,120	$ 73.55	(1)	3 years, 30%-30%-40%
RS - Service	February 22, 2017	16,106	$ 73.55	(1)	5 years, 20% annually
RS - Performance	February 22, 2017	29,829	$ 74.96	(1)	3 years, cliff vesting (3)
RS	February 22, 2017	4,000	$ 73.55	(1)	No vesting period (2)
RS	July 1, 2017	1,000	$ 68.30	(1)	No vesting period (2)
RS - Service	February 26, 2018	34,451	$ 75.05	(1)	3 years, 30%-30%-40%
RS - Performance	February 26, 2018	31,668	$ 75.05	(1)	3 years, cliff vesting (3)
RS	February 26, 2018	5,000	$ 75.05	(1)	No vesting period (2)
RS - Performance	August 1, 2018	164	$ 92.30	(1)	No vesting period (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) Board of Director members must maintain stock ownership equal to at least four times their annual cash retainer. This requirement must be met within five years of becoming a director.

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

(4) The shares represent a true-up of previously awarded performance-based restricted share awards. The updated shares were calculated based on the attainment of pre-established performance objectives.

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 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, 2018, we have purchased four layers of excess catastrophe reinsurance providing $615,000 of coverage for property losses in excess of $50,000 up to a maximum of $665,000. Our reinsurers' co-participation is 50.0% of $50,000 for the 1st layer, 80.0% of $50,000 for the 2nd layer, 80.0% of $250,000 for the 3rd layer and 80.0% of $265,000 for the 4th layer. As a result of the changes to the models, and our revised reinsurance program, our catastrophe reinsurance in 2018 protects us in the event of a "137-year storm" (that is, a storm of a severity expected to occur once in a 137-year period). Most of our reinsurers have an A.M. Best rating of "A+" (Superior) or "A" (Excellent).

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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 commercial 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 buys reinsurance to reduce their exposure to catastrophe losses. On July 1, 2018, the FAIR Plan purchased $2,000,000 of catastrophe reinsurance for property losses with retention of $100,000.

On December 15, 2015, the Company filed for arbitration with a reinsurer in regards to the reinsurance recoverable resulting from the 2015 winter storm losses that are admissible under our contract. The total amount of recoverable in dispute, which was based on our total incurred loss, was $20,918 as of December 31, 2017. On January 8, 2018 the Company received a final order from the panel of arbitrators in which the reinsurer would pay the Company $9,200 for settlement of all paid and outstanding losses. This amount has been collected. The remaining unrecovered amount of $11,718 was expensed in 2017.

We also had $133,751 due from CAR comprising of loss and loss adjustment expense reserves, unearned premiums and reinsurance recoverables.

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.

Non-GAAP Measures

Management has included certain non-generally accepted accounting principles (“non-GAAP”) financial measures in presenting the Company’s results. Management believes that these non-GAAP measures better explain the Company’s results of operations and allow for a more complete understanding of the underlying trends in the Company’s business. These measures should not be viewed as a substitute for those determined in accordance with generally accepted accounting principles (“GAAP”). In addition, our definitions of these items may not be comparable to the definitions used by other companies.

Non-GAAP operating income and non-GAAP operating income per diluted share consist of our GAAP net income adjusted by the net realized gains (losses), net impairment losses on investments, changes in net unrealized gains (losses) on equity securities and taxes related thereto. The adjustment for net unrealized gains and losses on equity securities is only applicable for 2018 due to the adoption of the accounting standard update referenced in Item 8 – Financial Statements and Supplemental Data, Note 2, Recent Accounting Pronouncements, of this Form 10-K. Net income and earnings per diluted share are the GAAP financial measures that are most directly comparable to non-GAAP operating income and non-GAAP operating income per diluted share, respectively. A reconciliation of the GAAP financial measures to these non-GAAP measures is included in the 2018 financial highlights below.

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Results of Operations

The following table shows certain of our selected financial results.

	Years Ended December 31,		
	2018	2017	2016
Direct written premiums	$ 843,675	$ 827,316	$ 811,559
Net written premiums	$ 786,912	$ 781,054	$ 766,470
Net earned premiums	$ 781,587	$ 774,420	$ 755,760
Net investment income	43,788	38,758	38,413
Earnings from partnership investments	6,915	2,082	3,185
Net realized gains on investments	3,226	6,036	5,559
Change in net unrealized gains on equity investments	(16,324)	—	—
Net impairment losses on investments	(228)	(256)	(798)
Finance and other service income	17,533	18,073	17,703
Total revenue	836,497	839,113	819,822
Loss and loss adjustment expenses	485,513	503,887	493,433
Underwriting, operating and related expenses	246,643	248,436	233,017
Interest expense	90	90	90
Total expenses	732,246	752,413	726,540
Income before income taxes	104,251	86,700	93,282
Income tax expense	21,056	24,313	28,697
Net income	$ 83,195	$ 62,387	$ 64,585
Earnings per weighted average common share:			
Basic	$ 5.48	$ 4.13	$ 4.29
Diluted	$ 5.43	$ 4.10	$ 4.27
Cash dividends paid per common share	$ 3.20	$ 3.00	$ 2.80
Reconciliation of Net Income to Non-GAAP Operating Income:			
Net income	$ 83,195	$ 62,387	$ 64,585
Exclusions from net income:			
Net realized gains on investments	(3,226)	(6,036)	(5,559)
Change in net unrealized gains on equity investments	16,324	-	-
Net impairment losses on investments	228	256	798
Income tax (expense) benefit	(2,798)	2,023	1,666
Non-GAAP Operating income	$ 93,723	$ 58,630	$ 61,490
Net income per diluted share	$ 5.43	$ 4.10	$ 4.27
Exclusions from net income:			
Net realized gains on investments	(0.21)	(0.40)	(0.37)
Change in net unrealized gains on equity investments	1.07	-	-
Net impairment losses on investments	0.01	0.02	0.05
Income tax (expense) benefit	(0.18)	0.12	0.11

Non-GAAP Operating income per diluted share	$ 6.12	$ 3.84	$ 4.06

YEAR ENDED DECEMBER 31, 2018 COMPARED TO YEAR ENDED DECEMBER 31, 2017

Direct Written Premiums. Direct written premiums for the year ended December 31, 2018 increased by $16,359, or 2.0%, to $843,675 from $827,316 for the comparable 2017 period. The 2018 increase occurred primarily in our commercial automobile and homeowners business lines.

Net Written Premiums. Net written premiums for the year ended December 31, 2018 increased by $5,858, or 0.8%, to $786,912 from $781,054 for the comparable 2017 period.

Net Earned Premiums. Net earned premiums for the year ended December 31, 2018 increased by $7,167, or 0.9%, to $781,587 from $774,420 for the comparable 2017 period.

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

	Year Ended December 31,	
	2018	2017
Written Premiums		
Direct	$ 843,675	$ 827,316
Assumed	32,403	34,214
Ceded	(89,166)	(80,476)
Net written premiums	$ 786,912	$ 781,054
Earned Premiums		
Direct	$ 836,759	$ 818,804
Assumed	32,196	32,502
Ceded	(87,368)	(76,886)
Net earned premiums	$ 781,587	$ 774,420

Net Investment Income. Net investment income for the year ended December 31, 2018 increased by $5,030, or 13.0%, to $43,788 from $38,758 for the comparable 2017 period. The increase is a result of fixed maturity amortization and an increase in the average invested asset balance compared to the prior year. Net effective annual yield on the investment portfolio was 3.3% for the year ended December 31, 2018 compare to 3.1% for the year ended December 31, 2017. Our duration was 3.6 years at December 31, 2018, compared to 3.7 years at December 31, 2017.

Earnings from Partnership Investments. Earnings from partnership investments were $6,915 for the year ended December 31, 2018 compared to $2,082 for the year ended December 31, 2017. The 2018 increase was related to investment appreciation and cash proceeds received as return on capital.

Net Realized Gains on Investments. Net realized gains on investments were $3,226 for the year ended December 31, 2018 compared to $6,036 for the comparable 2017 period.

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

As of December 31, 2018

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (3)		Estimated Fair Value
			Non-OTTI Unrealized Losses	OTTI Unrealized Losses (4)	
U.S. Treasury securities	$ 1,807	$ —	$ (30)	$ —	$ 1,777
Obligations of states and political subdivisions	262,772	5,098	(1,672)	—	266,198
Residential mortgage-backed securities (1)	300,387	1,477	(4,841)	—	297,023
Commercial mortgage-backed securities	60,897	337	(898)	—	60,336
Other asset-backed securities	61,310	95	(329)	—	61,076
Corporate and other securities	488,240	1,775	(14,563)	—	475,452
Subtotal, fixed maturity securities	1,175,413	8,782	(22,333)	—	1,161,862
Equity securities (2)	142,948	15,419	(10,356)	—	148,011
Other invested assets (5)	23,481	—	—	—	23,481
Totals	$ 1,341,842	$ 24,201	$ (32,689)	$ —	$ 1,333,354

(1) Residential mortgage-backed securities consists 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 common stock, preferred stock, mutual funds and interests in mutual funds held to fund the Company’s executive deferred compensation plan.

(3) Our investment portfolio included 958 securities in an unrealized loss position at December 31, 2018.

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

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

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The composition of our fixed income security portfolio by rating was as follows:

	As of December 31, 2018		
	Estimated Fair Value	Percent	
U.S. Treasury securities and obligations of U.S. Government agencies	$ 298,800	25.7	%
Aaa/Aa	299,725	25.8	
A	214,263	18.4	
Baa	175,890	15.1	
Ba	58,050	5.0	
B	81,415	7.0	
Caa/Ca	7,660	0.7	
Not rated	26,059	2.3	
Total	$ 1,161,862	100.0	%

Ratings are generally assigned upon the issuance of the securities and are subject to revision on the basis of ongoing evaluations. Ratings in the table are as of the date indicated.

As of December 31, 2018, our portfolio of fixed maturity investments was principally comprised of investment grade corporate fixed maturity securities, U.S. government and agency securities, and asset-backed securities. The portion of our non-investment grade portfolio of fixed maturity investments is primarily comprised of variable rate secured and senior bank loans and high yield bonds.

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

	As of December 31, 2018					
	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	$ —	$ —	$ 1,777	$ 30	$ 1,777	$ 30
Obligations of states and political subdivisions	80,856	707	16,049	965	96,905	1,672
Residential mortgage-backed securities	64,101	694	138,572	4,147	202,673	4,841
	22,652	270	13,117	628	35,769	898

Commercial mortgage-backed securities						
Other asset-backed securities	33,866	112	23,532	217	57,398	329
Corporate and other securities	288,786	10,149	87,546	4,414	376,332	14,563
Subtotal, fixed maturity securities	490,261	11,932	280,593	10,401	770,854	22,333
Equity securities	71,439	9,955	2,072	401	73,511	10,356
Total temporarily impaired securities	$ 561,700	$ 21,887	$ 282,665	$ 10,802	$ 844,365	$ 32,689

The unrealized losses in our fixed income and equity portfolio as of December 31, 2018 were reviewed for

potential other-than-temporary asset impairments. The Company held three debt securities at December 31, 2018 with a material (20% or greater) unrealized loss for four or more consecutive quarters that additionally had certain qualitative

factors that led to an impairment assessment. The Company recognized OTTI of $228 and $256 for the year ended December 31, 2018 and 2017, respectively, which consisted entirely of credit losses related to fixed maturity securities.

Specific qualitative analysis was also performed for securities appearing on our “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 majority of unrealized losses recorded on the investment portfolio at December 31, 2018 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. Given our current level of liquidity, the fact that we do not intend to sell these securities, and that it is more likely than not that we will not be required to sell these securities prior to recovery of the cost basis of these securities, these decreases in values are viewed as being temporary.

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For information regarding fair value measurements of our investment portfolio, refer to Item 8—Financial Statements and Supplementary Data, Note 14, Fair Value of Financial Instruments, of this Form 10-K.

Net Impairment Losses on Investments. Net impairment losses on investments were $228 and $256 for the year ended December 31, 2018 and December 31, 2017.

Finance and Other Service Income. Finance and other service income include revenues from premium installment charges, which we recognize when earned, and other miscellaneous income and fees. Finance and other service income decreased by $540, or 3.0%, to $17,533 for the year ended December 31, 2018 from $18,073 for the comparable 2017 period.

Losses and Loss Adjustment Expenses. Losses and loss adjustment expenses incurred for the year ended December 31, 2018 decreased by $18,374, or 3.6%, to $485,513 from $503,887 for the comparable 2017 period.

Our GAAP loss ratio for the year ended December 31, 2018 and 2017 was 62.1% and 65.1%, respectively. Our GAAP loss ratio excluding loss adjustment expenses was 54.0% and 57.5% for the year ended December 31, 2018 and 2017, respectively. Total prior year favorable development included in the pre-tax results for the year ended December 31, 2018 was $56,488, compared to $41,784, for the comparable 2017 period.

Underwriting, Operating and Related Expenses. Underwriting, operating and related expenses for the year ended December 31, 2018 decreased by $1,793, or 0.7%, to $246,643 from $248,436 for the comparable 2017 period. Our GAAP expense ratio for the year ended December 31, 2018 decreased to 31.6% from 32.1% for the comparable 2017 period.

Interest Expenses. Interest expense was $90 for each of the years ended December 31, 2018 and 2017. The credit facility commitment fee included in interest expense was $75 for each of the years ended December 31, 2018 and 2017.

Income Tax Expense Our effective tax rates were 20.2% and 28.0% for the years ended December 31, 2018 and 2017, respectively. The U.S. Tax Cuts and Jobs Act (the “TCJA”) which became effective on December 22, 2017, reduced the corporate statutory tax rate from 35% to 21%. The effective rates for the years ended December 31, 2018 and 2017 were lower than the statutory rates primarily due to the effects of tax-exempt investment income.

Net Income. Net income for the year ended December 31, 2018 was $83,195 compared to a net income of $62,387 for the comparable 2017 period.

Non-GAAP Operating Income. Non-GAAP operating income as defined above was $93,723 for the year ended December 31, 2018 compared to $58,630 for the year ended December 31, 2017. The increase in Non-GAAP operating income was primarily the result of increases in net earned premiums, net investment income, earnings from partnership investments and benefits from lower statutory federal income tax rates.

YEAR ENDED DECEMBER 31, 2017 COMPARED TO YEAR ENDED DECEMBER 31, 2016

Direct Written Premiums. Direct written premiums for the year ended December 31, 2017 increased by $15,757, or 1.9%, to $827,316 from $811,559 for the comparable 2016 period. The 2017 increases occurred in our private passenger, commercial automobile and homeowners business lines which experienced increases of 3.3%, 2.3% and 4.0%, respectively, in average written premium per exposure. Written exposures increased by 5.0% in our commercial automobile line and decreased by 3.0% in our private passenger automobile line and 1.0% in our homeowners line, respectively.

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Net Written Premiums. Net written premiums for the year ended December 31, 2017 increased by $14,584 or 1.9%, to $781,054 from $766,470 for the comparable 2016 period. The 2017 increase was primarily due to the factors that increased direct written premiums.

Net Earned Premiums. Net earned premiums for the year ended December 31, 2017 increased by $18,660, or 2.5%, to $774,420 from $755,760 for the comparable 2016 period. The 2017 increase was primarily due to the factors that increased direct written premiums.

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

	Years Ended December 31,	
	2017	2016
Written Premiums		
Direct	$ 827,316	$ 811,559
Assumed	34,214	30,424
Ceded	(80,476)	(75,513)
Net written premiums	$ 781,054	$ 766,470
Earned Premiums		
Direct	$ 818,804	$ 796,366
Assumed	32,502	29,544
Ceded	(76,886)	(70,150)
Net earned premiums	$ 774,420	$ 755,760

Net Investment Income. Net investment income for the year ended December 31, 2017 increased by $345 or 0.9%, to $38,758 from $38,413 for the comparable 2016 period. Net effective annual yield on the investment portfolio was 3.1% for each of the years ended December 31, 2017 and December 31, 2016. Our duration was 3.7 years at December 31, 2017, compare to 4.3 years at December 31, 2016.

Earnings from Partnership Investments. Earnings from partnership investments were $2,082 for the year ended December 31, 2017 compared to $3,185 for the year ended December 31, 2016.

Net Realized Gains on Investments. Net realized gains on investments were $6,036 for the year ended December 31, 2017 compared to $5,559 for the comparable 2016 period.

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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 December 31, 2017				
			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	$ 1,809	$ —	$ (18)	$ —	$ 1,791
Obligations of states and political subdivisions	391,806	12,244	(966)	—	403,084
Residential mortgage-backed securities (1)	223,257	2,352	(2,843)	—	222,766
Commercial mortgage-backed securities	39,268	415	(314)	—	39,369
Other asset-backed securities	72,665	173	(225)	—	72,613
Corporate and other securities	427,892	6,962	(2,451)	—	432,403
Subtotal, fixed maturity securities	1,156,697	22,146	(6,817)	—	1,172,026
Equity securities (2)	90,481	21,995	(609)	—	111,867
Other invested assets (5)	23,162	—	—	—	23,162
Totals	$ 1,270,340	$ 44,141	$ (7,426)	$ —	$ 1,307,055

(1) Residential mortgage-backed securities consists 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 common stock, preferred stock, mutual funds and interests in mutual funds held to fund the Company's executive deferred compensation plan.

(3) Our investment portfolio included 367 securities in an unrealized loss position at December 31, 2017.

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

(5) Other invested assets are accounted for under the equity method which is used as a proxy for fair value.

The composition of our fixed income security portfolio by Moody's rating was as follows:

	As of December 31, 2017	
	Estimated Fair Value	Percent
U.S. Treasury securities and obligations of U.S. Government agencies	$ 222,766	19.0 %
Aaa/Aa	411,794	35.1
A	239,015	20.4
Baa	142,176	12.1
Ba	51,205	4.4
B	75,673	6.5
Caa/Ca	7,087	0.6
D	248	-
Not rated	22,062	1.9
Total	$ 1,172,026	100.0 %

Ratings are generally assigned upon the issuance of the securities and are subject to revision on the basis of ongoing evaluations. Ratings in the table are as of the date indicated.

As of December 31, 2017, our portfolio of fixed maturity investments was principally comprised of investment grade corporate fixed maturity securities, U.S. government and agency securities, and asset-backed securities. The portion of our non-investment grade portfolio of fixed maturity investments is primarily comprised of variable rate secured and senior bank loans and high yield bonds.

The following table illustrates the gross unrealized losses included in our investment portfolio and the fair value of those securities, aggregated by investment category. The table also illustrates the length of time that they have been in a continuous unrealized loss position as of December 31, 2017.

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	As of December 31, 2017					
	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	$ 1,791	$ 18	$ —	$ —	$ 1,791	$ 18
Obligations of states and political subdivisions	19,603	152	30,018	814	49,621	966
Residential mortgage-backed securities	126,713	1,724	39,638	1,119	166,351	2,843
Commercial mortgage-backed securities	5,457	30	8,027	284	13,484	314
Other asset-backed securities	25,769	167	18,270	58	44,039	225
Corporate and other securities	94,863	1,189	36,440	1,262	131,303	2,451
Subtotal, fixed maturity securities	274,196	3,280	132,393	3,537	406,589	6,817
Equity securities	4,730	361	2,420	248	7,150	609
Total temporarily impaired securities	$ 278,926	$ 3,641	$ 134,813	$ 3,785	$ 413,739	$ 7,426

We reviewed the unrealized losses in our fixed income and equity portfolio as of December 31, 2017 for potential other-than-temporary asset impairments. The Company held two debt securities at December 31, 2017 with a material (20.0% or greater) unrealized loss for four or more consecutive quarters that additionally had certain qualitative factors that led to an impairment charge. As a result of our analysis, the Company recognized OTTI of $256 for the year ended December 31, 2017, which consisted entirely of credit losses related to fixed maturity securities.

Specific qualitative analysis was performed for securities appearing on our “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.

Of the $7,426 gross unrealized losses as of December 31, 2017, $984 relates to obligations of U.S. Treasuries, states and political subdivisions. The remaining $6,442 of gross unrealized losses relates primarily to holdings of investment grade asset-backed, corporate, other fixed maturity and equity securities.

The majority of the unrealized losses recorded on the investment portfolio at December 31, 2017 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. Given our current level of liquidity, the fact that we do not intend to sell these securities, and that it is more likely than not that we will not be required to sell these securities prior to recovery of the cost basis of these securities, these decreases in values are viewed as being temporary.

For information regarding fair value measurements of our investment portfolio, refer to Item 8—Financial Statements and Supplementary Data, Note 14, Fair Value of Financial Instruments, of this Form 10-K.

Net Impairment Losses on Investments. Net impairment losses on investments were $256 and $798 for the year ended December 31, 2017 and December 31, 2016.

Finance and Other Service Income. Finance and other service income include revenues from premium installment charges, which we recognize when earned, and other miscellaneous income and fees. Finance and other service income increased by $370, or 2.1%, to $18,073 for the year ended December 31, 2017 from $17,703 for the comparable 2016 period.

Losses and Loss Adjustment Expenses. Losses and loss adjustment expenses incurred for the year ended December 31, 2017 increased by $10,454, or 2.1%, to $503,887 from $493,433 for the comparable 2016 period.

Our GAAP loss ratio for the years ended December 31, 2017 and 2016 was 65.1% and 65.3%, respectively. Our GAAP loss ratio excluding loss adjustment expenses was 57.5% and 56.8% for the years ended December 31, 2017 and 2016, respectively. Total prior year favorable development included in the pre-tax results for the year ended December 31, 2017 was $41,784, compared to $45,448, for the comparable 2016 period.

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Underwriting, Operating and Related Expenses. Underwriting, operating and related expenses for the year ended December 31, 2017 increased by $15,419, or 6.6%, to $248,436 from $233,017 for the comparable 2016 period. Our GAAP expense ratios for the year ended December 31, 2017 increased to 32.1% from 30.8% for the comparable 2016 period. The increase in underwriting, operating and related expense and the expense ratio is attributable to increases in contingent commissions and nonrecurring legal fees related to reinsurance arbitration.

Interest Expenses. Interest expense was $90 for each of the years ended December 31, 2017 and 2016. The credit facility commitment fee included in interest expense was $75 for each of the years ended December 31, 2017 and 2016.

Income Tax Expense (Credit). Our effective tax rates were 28.0% and 30.8% for the years ended December 31, 2017 and 2016, respectively. The effective rate in 2017 was lower than the statutory rate of 35.0% primarily due to adjustments for tax-exempt investment income and the impact of the re-measurement of the net deferred tax liability as a result of the enactment of the TCJA.

On December 22, 2017, the TCJA was enacted, which significantly amends the Internal Revenue Code of 1986. The TCJA, among other things, reduces the corporate tax rate from a statutory rate of 35% to 21%, imposes additional limitations on net operating losses and executive compensation, allows for the full expensing of certain capital expenditures, and enacts other changes impacting the insurance industry. The impact of the tax rate change has been recorded through the Statement of Operations for the year ended December 31, 2017.

Subsequent to the enactment of the TCJA, the SEC issued Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act ("SAB 118"). SAB 118 describes three scenarios associated with a company's status of accounting for income tax reform and provided a measurement period of one year to finalize provisional amounts. The measurement period provided in SAB 118 concluded on December 22, 2018 and accordingly the Company has finalized its accounting for the impact of the TCJA as of December 31, 2018. No material adjustments were recorded by the Company during the year ended December 31, 2018.

Net Income. Net income for the year ended December 31, 2017 was $62,387 compared to net income of $64,585 for the comparable 2016 period.

The TCJA modified the provisions applicable to the determination of the tax basis of unpaid loss reserves. These modifications impact the payment pattern and applicable interest rate. The TCJA instructed the Treasury to provide discount factors and other guidance necessary to determine the necessary transition adjustment. On December 19, 2018 the Treasury released Revenue Procedure 2019-06 which includes unpaid loss reserve discount factors for the

2018 accident year. The Revenue Procedure requires these factors to be used in the first taxable year beginning after December 31, 2017 and for use in calculating the TCJA transitional adjustment. The Company has applied Revenue Procedure 2019-06 for the year ended December 31, 2018. Because this information had not been released until December 19, 2018, we have applied the law existing prior to the enactment of the TCJA for the year ended December 31, 2017; accordingly these provisions had no effect on the net deferred tax liability as of December 31, 2017 or the total tax expense for the year ended December 31, 2017.

Liquidity and Capital Resources

As a holding company, Safety's assets consist primarily of the stock of our direct and indirect subsidiaries. Our principal source of funds to meet our obligations and pay dividends to shareholders, therefore, is dividends and other permitted payments from our subsidiaries, principally Safety Insurance. Safety is the borrower under our credit facility.

Safety Insurance's sources of funds primarily include premiums received, investment income and proceeds from sales and redemptions of investments. Safety Insurance's principal uses of cash are the payment of claims, operating expenses and taxes, the purchase of investments and payment of dividends to Safety.

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Net cash provided by operating activities was $127,691, $82,040, and $98,824 during the years ended December 31, 2018, 2017, and 2016, respectively. Our operations typically generate positive cash flows from operations as most premiums are received in advance of the time when claim and benefit payments are required. These positive operating cash flows are expected to continue to meet our liquidity requirements.

Net cash used for investing activities was $83,004, $14,924, and $84,252 for the years ended December 31, 2018, 2017, and 2016, respectively, as purchases of fixed maturity and equity securities exceeded proceeds from the sales, paydowns, calls and maturities of fixed maturity and equity securities.

Net cash used for financing activities was $48,813, $45,460, and $42,014 during the years ended December 31, 2018, 2017 and 2016, respectively. Net cash used for financing activities is primarily comprised of dividend payments to shareholders.

The Insurance Subsidiaries maintain a high degree of liquidity within their respective investment portfolios in fixed maturity and short-term investments. We do not anticipate the need to sell these securities to meet the Insurance Subsidiaries cash requirements. We expect the Insurance Subsidiaries to generate sufficient operating cash to meet all short-term and long-term cash requirements. However, there can be no assurance that unforeseen business needs or other items will not occur causing us to have to sell securities before their values fully recover; thereby causing us to recognize additional impairment charges in that time period.

Credit Facility

For information regarding our Credit Facility, please refer to Item 8—Financial Statements and Supplementary Data, Note 8, Debt, of this Form 10-K.

Recent Accounting Pronouncements

For information regarding Recent Accounting Pronouncements, please refer to Item 8—Financial Statements and Supplementary Data, Note 2, Summary of Significant Accounting Policies, of this Form 10-K.

Regulatory Matters

Our insurance company's subsidiaries are subject to various regulatory restrictions that limit the maximum amount of dividends available to be paid to their parent without prior approval of the Commissioner. The Massachusetts statute limits the dividends an insurer may pay in any twelve-month period, without the prior permission of the Commissioner, to the greater of (i) 10% of the insurer's surplus as of the preceding December 31 or (ii) the insurer's net income for the twelve-month period ending the preceding December 31, in each case determined in accordance with statutory accounting practices. Our Insurance Subsidiaries may not declare an "extraordinary dividend" (defined as any dividend or distribution that, together with other distributions made within the preceding twelve months, exceeds the limits established by Massachusetts statute) until thirty days after the Commissioner has received notice of the intended dividend and has not objected. As historically administered by the Commissioner, this provision requires the Commissioner's prior approval of an extraordinary dividend. Under Massachusetts law, an insurer may pay cash dividends only from its unassigned funds, also known as earned surplus, and the insurer's remaining surplus must be both reasonable in relation to its outstanding liabilities and adequate to its financial needs. At year-end 2018, the statutory surplus of Safety Insurance was $646,820, and its net income for 2018 was $86,734. As a result, a maximum of $86,734 is available in 2019 for such dividends without prior approval of the Commissioner. Under this Massachusetts statute, the Insurance Subsidiaries has restricted net assets in the amount of $560,086 at December 31, 2018. During the twelve months ended December 31, 2018, Safety Insurance recorded dividends to Safety of $45,271.

The maximum dividend permitted by law is not indicative of an insurer's actual ability to pay dividends, which may be constrained by business and regulatory considerations, such as the impact of dividends on surplus, which could affect an insurer's ratings or competitive position, the amount of premiums that can be written and the ability to pay future dividends.

Since the initial public offering of its common stock in November 2002, the Company has paid regular quarterly dividends to shareholders of its common stock. Quarterly dividends paid during 2018 and 2017 were as follows:

Declaration Date	Record Date	Payment Date	Dividend per Common Share	Total Dividends Paid and Accrued
February 15, 2017	March 1, 2017	March 15, 2017	$ 0.70	$ 10,674
May 3, 2017	June 1, 2017	June 15, 2017	$ 0.70	$ 10,665
August 2, 2017	September 1, 2017	September 15, 2017	$ 0.80	$ 12,183
November 1, 2017	December 1, 2017	December 15, 2017	$ 0.80	$ 12,167
February 15, 2018	March 1, 2018	March 15, 2018	$ 0.80	$ 12,326
May 2, 2018	June 1, 2018	June 15, 2018	$ 0.80	$ 12,295
August 1, 2018	September 4, 2018	September 14, 2018	$ 0.80	$ 12,312
October 31, 2018	December 3, 2018	December 14, 2018	$ 0.80	$ 12,397

On February 15, 2019, our Board approved and declared a quarterly cash dividend on our common stock of $0.80 per share to be paid on March 15, 2019 to shareholders of record on March 1, 2019. We plan to continue to declare and pay quarterly cash dividends in 2019, depending on our financial position and the regularity of our cash flows.

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 December 31, 2018, the Board of Directors had cumulatively authorized 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 us to repurchase any specific number of shares and may be modified, suspended or terminated at any time without prior notice. At December 31, 2018 and December 31, 2017, the Company had purchased 2,279,570 shares at a cost of $83,835.

Management believes that the current level of cash flow from operations provides us with sufficient liquidity to meet our operating needs over the next 12 months. We expect to be able to continue to meet our operating needs after the next 12 months from internally generated funds. Since our ability to meet our obligations in the long term (beyond such twelve-month period) is dependent upon such factors as market changes, insurance regulatory changes and economic conditions, no assurance can be given that the available net cash flow will be sufficient to meet our operating needs. We expect that we would need to borrow or issue capital stock if we needed additional funds, for example, to pay for an acquisition or a significant expansion of our operations. There can be no assurance that

sufficient funds for any of the foregoing purposes would be available to us at such time.

Off-Balance Sheet Arrangements

We have no material obligations under a guarantee contract meeting the characteristics identified in Accounting Standards Codification ("ASC") 460, Guarantees. We have no material retained or contingent interests in assets transferred to an unconsolidated entity. We have no material obligations, including contingent obligations, under contracts that would be accounted for as derivative instruments. We have no obligations, including contingent obligations, arising out of a variable interest in an unconsolidated entity held by, and material to, us, where such entity provides financing, liquidity, market risk or credit risk support to, or engages in leasing, hedging or research and development services with us. We have no direct investments in real estate and no holdings of mortgages secured by commercial real estate. Accordingly, we have no material off-balance sheet arrangements.

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Contractual Obligations

We have obligations to make future payments under contracts and credit-related financial instruments and commitments. At December 31, 2018, certain long-term aggregate contractual obligations and credit-related commitments are summarized as follows:

	Payments Due by Period				
	Within One Year	Two to Three Years	Four to Five Years	After Five Years	Total
Loss and LAE reserves	$ 286,512	$ 257,276	$ 35,083	$ 5,848	$ 584,719
Operating leases	4,044	8,025	7,897	20,064	40,030
Total contractual obligations	$ 290,556	$ 265,301	$ 42,980	$ 25,912	$ 624,749

As of December 31, 2018, the Company had loss and LAE reserves of $584,719, unpaid reinsurance recoverables of $108,398 and net loss and LAE reserves of $476,321. Our loss and LAE reserves are estimates as described in more detail under Critical Accounting Policies and Estimates. The specific amounts and timing of obligations related to case reserves, IBNR reserves and related LAE reserves are not set contractually, and the amounts and timing of these obligations are unknown. Nonetheless, based upon our cumulative claims paid over the last ten years, the Company estimates that its loss and LAE reserves will be paid in the period shown above. While management believes that historical performance of loss payment patterns is a reasonable source for projecting future claims payments, there is inherent uncertainty in this estimated projected settlement of loss and LAE reserves, and as a result these estimates will differ, perhaps significantly, from actual future payments. Our operations typically generate substantial positive cash flows from operations as most premiums are received in advance of the time when claim and benefit payments are required. These positive operating cash flows are expected to continue to meet our liquidity requirements, including any unexpected variations in the timing of claim settlements.

As part of the Company's investment activity, we have committed $80,000 to investments in limited partnerships. The Company has contributed $34,794 to these commitments as of December 31, 2018. As of December 31, 2018, the remaining committed capital that could be called is $46,898, which includes potential recallable capital distributions.

Critical Accounting Policies and Estimates

Loss and Loss Adjustment Expense Reserves.

Significant periods of time can elapse between the occurrence of an insured loss, the reporting to us of that loss and our final payment of that loss. To recognize liabilities for unpaid losses, we establish reserves as balance sheet

liabilities. Our reserves represent estimates of amounts needed to pay reported and unreported losses and the expenses of investigating and paying those losses, or loss adjustment expenses. Every quarter, we review our previously established reserves and adjust them, if necessary.

When a claim is reported, claims personnel establish a “case reserve” for the estimated amount of the ultimate payment. The amount of the reserve is primarily based upon an evaluation of the type of claim involved, the circumstances surrounding each claim and the policy provisions relating to the loss. The estimate reflects the informed judgment of such personnel based on general insurance reserving practices and on the experience and knowledge of the claims person. During the loss adjustment period, these estimates are revised as deemed necessary by our claims department based on subsequent developments and periodic reviews of the cases. When a claim is closed with or without a payment, the difference between the case reserve and the settlement amount creates a reserve deficiency if the payment exceeds the case reserve or a reserve redundancy if the payment is less than the case reserve.

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

not yet reported reserves quarterly. In addition, IBNR reserves can also be expressed as the total loss reserves required less the case reserves on reported claims.

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

In estimating all our loss reserves, we follow the guidance prescribed by Accounting Standards Codification ("ASC") 944, Financial Services – Insurance.

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

- Paid Loss Indications: This method projects ultimate loss estimates based upon extrapolations of historic paid loss trends. This method tends to be used on short tail lines such as automobile physical damage.
- Incurred Loss Indications: This method projects ultimate loss estimates based upon extrapolations of historic incurred loss trends. This method tends to be used on long tail lines of business such as automobile liability and homeowner's liability.
- Bornhuetter-Ferguson Indications: This method projects ultimate loss estimates based upon extrapolations of an expected amount of IBNR, which is added to current incurred losses or paid losses. This method tends to be used on small, immature, or volatile lines of business, such as our BOP and umbrella lines of business.
- Bodily Injury Code Indications: This method projects ultimate loss estimates for our private passenger and commercial automobile bodily injury coverage based upon extrapolations of the historic number of accidents and the historic number of bodily injury claims per accident. Projected ultimate bodily injury claims are then segregated into expected claims by type of injury (e.g. soft tissue injury vs. hard tissue injury) based on past experience. An ultimate severity, or average paid loss amounts, is estimated based upon extrapolating historic trends. Projected

ultimate loss estimates using this method are the aggregate of estimated losses by injury type.

Such techniques assume that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting our ultimate losses, total reserves and resulting IBNR reserves. It is possible that the final outcome may fall above or below these amounts as a result of a number of factors, including immature data, sparse data, or significant growth in a line of business. Using these methodologies our actuaries established a range of reasonably possible estimations for net reserves of approximately $422,423 to $498,216 as of December 31, 2018 compared to a range of $440,918 to $510,166 as of December 31, 2017. In general, the low and high values of the ranges represent reasonable minimum and maximum values of the indications based on the techniques described above.

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Our selected point estimate of net loss and LAE reserves based upon the analysis of our actuaries was $476,321 as of December 31, 2018 compared to $490,969 as of December 31, 2017.

The following tables present the point estimation of the recorded reserves and the range of estimations by line of business for net loss and LAE reserves as of December 31, 2018 and December 31, 2017.

	As of December 31, 2018		
Line of Business	Low	Recorded	High
Private passenger automobile	$ 195,940	$ 220,913	$ 224,789
Commercial automobile	87,797	96,161	99,854
Homeowners	70,788	82,215	88,210
All other	67,898	77,032	85,363
Total	$ 422,423	$ 476,321	$ 498,216

	As of December 31, 2017		
Line of Business	Low	Recorded	High
Private passenger automobile	$ 215,048	$ 244,057	$ 246,950
Commercial automobile	82,929	90,083	93,377
Homeowners	81,395	88,954	92,894
All other	61,546	67,875	76,945
Total	$ 440,918	$ 490,969	$ 510,166

The following table presents our total net reserves and the corresponding case reserves and IBNR reserves for each line of business as of December 31, 2018 and December 31, 2017.

	As of December 31, 2018		
Line of Business	Case	IBNR	Total
Private passenger automobile	$ 253,230	$ (32,354)	$ 220,876
CAR assumed private passenger auto	8	29	37
Commercial automobile	53,541	9,507	63,048
CAR assumed commercial automobile	17,713	15,400	33,113
Homeowners	70,113	2,965	73,078
FAIR Plan assumed homeowners	3,646	5,491	9,137
All other	45,748	31,284	77,032
Total net reserves for losses and LAE	$ 443,999	$ 32,322	$ 476,321

	As of December 31, 2017		
Line of Business	Case	IBNR	Total
Private passenger automobile	$ 254,804	$ (11,084)	$ 243,720

CAR assumed private passenger auto	22	315	337
Commercial automobile	53,570	8,603	62,173
CAR assumed commercial automobile	14,307	13,603	27,910
Homeowners	77,834	782	78,616
FAIR Plan assumed homeowners	3,174	7,164	10,338
All other	40,604	27,271	67,875
Total net reserves for losses and LAE	$ 444,315	$ 46,654	$ 490,969

At December 31, 2018 and 2017, our total IBNR reserves for our private passenger automobile line of business were comprised of $(53,519) and $(31,856) related to estimated ultimate decreases in the case reserves, including anticipated recoveries (i.e. salvage and subrogation), and $21,165 and $20,772 related to our estimation for not yet reported losses, respectively.

Our IBNR reserves consist of our estimate of the total loss reserves required less our case reserves. The IBNR reserves for CAR assumed commercial automobile business are 46.5% of our total reserves for CAR assumed commercial automobile business as of December 31, 2018 due to the reporting delays in the information we receive from CAR, as described further in the section on CAR Loss and Loss Adjustment Expense Reserves. Our IBNR reserves for FAIR Plan assumed homeowners are 60.1% of our total reserves for FAIR Plan assumed homeowners at December 31, 2018 due to similar reporting delays in the information we receive from FAIR Plan.

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The following tables present information by line of business for our total net reserves and the corresponding retained (i.e. direct less ceded) reserves and assumed reserves as of December 31, 2018 and 2017.

	As of December 31, 2018		
Line of Business	Retained	Assumed	Net
Private passenger automobile	$ 220,876		
CAR assumed private passenger automobile		$ 37	
Net private passenger automobile			$ 220,913
Commercial automobile	63,048		
CAR assumed commercial automobile		33,113	
Net commercial automobile			96,161
Homeowners	73,078		
FAIR Plan assumed homeowners		9,137	
Net homeowners			82,215
All other	77,032	—	77,032
Total net reserves for losses and LAE	$ 434,034	$ 42,287	$ 476,321

	As of December 31, 2017		
Line of Business	Retained	Assumed	Net
Private passenger automobile	$ 243,720		
CAR assumed private passenger automobile		$ 337	
Net private passenger automobile			$ 244,057
Commercial automobile	62,173		
CAR assumed commercial automobile		27,910	
Net commercial automobile			90,083
Homeowners	78,616		
FAIR Plan assumed homeowners		10,338	
Net homeowners			88,954
All other	67,875	-	67,875
Total net reserves for losses and LAE	$ 452,384	$ 38,585	$ 490,969

Residual Market Loss and Loss Adjustment Expense Reserves

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

Residual market deficits consist of premium ceded to the various residual markets less losses and LAE and is allocated among insurance companies based on a various formulas (the “Participation Ratio”) that take into consideration a company’s voluntary market share.

Because of the lag in the various residual market estimations, and in order to try to validate to the extent possible the information provided, we estimate the effects of the actions of our competitors in order to establish our Participation Ratio.

Although we rely to a significant extent in setting our reserves on the information the various residual markets provide, we are cautious in our use of that information, because of the delays in receiving data from the various residual markets. As a result, we have to estimate our Participation Ratio and these reserves are subject to significant judgments and estimates.

Sensitivity Analysis

Establishment of appropriate reserves is an inherently uncertain process. There can be no certainty that currently established reserves based on our key assumptions regarding frequency and severity in our lines of business, or our assumptions regarding our share of the CAR loss will prove adequate in light of subsequent actual experience. To

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the extent that reserves are inadequate and are strengthened, the amount of such increase is treated as a charge to earnings in the period that the deficiency is recognized. To the extent that reserves are redundant and are released, the amount of the release is a credit to earnings in the period the redundancy is recognized. For the twelve months ended December 31, 2018, a 1 percentage-point change in the loss and LAE ratio would result in a change in reserves of $7,817. Each 1 percentage-point change in the loss and loss expense ratio would have had a $6,175 effect on net income, or $0.41 per diluted share.

Our assumptions consider that past experience, adjusted for the effects of current developments and anticipated trends, are an appropriate basis for establishing our reserves. Our individual key assumptions could each have a reasonable possible range of plus or minus 5 percentage-points for each estimation, although there is no guarantee that our assumptions will not have more than a 5 percentage point variation. The following sensitivity tables present information for each of our primary lines of business on the effect each 1 percentage-point change in each of our key assumptions on unpaid frequency and severity could have on our retained (i.e., direct minus ceded) loss and LAE reserves and net income for the twelve months ended December 31, 2018. In evaluating the information in the table, it should be noted that a 1 percentage-point change in a single assumption would change estimated reserves by 1 percentage-point. A 1 percentage-point change in both our key assumptions would change estimated reserves within a range of plus or minus 2 percentage-points.

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	-1 Percent Change in Frequency	No Change in Frequency	+1 Percent Change in Frequency
Private passenger automobile retained loss and LAE reserves			
-1 Percent Change in Severity			
Estimated decrease in reserves	$ (4,418)	$ (2,209)	$ —
Estimated increase in net income	3,490	1,745	—
No Change in Severity			
Estimated (decrease) increase in reserves	(2,209)	—	2,209
Estimated increase (decrease) in net income	1,745	—	(1,745)
+1 Percent Change in Severity			
Estimated increase in reserves	—	2,209	4,418
Estimated decrease in net income	—	(1,745)	(3,490)
Commercial automobile retained loss and LAE reserves			
-1 Percent Change in Severity			
Estimated decrease in reserves	(1,261)	(630)	—
Estimated increase in net income	996	498	—
No Change in Severity			
Estimated (decrease) increase in reserves	(630)	—	630
Estimated increase (decrease) in net income	498	—	(498)
+1 Percent Change in Severity			
Estimated increase in reserves	—	630	1,261
Estimated decrease in net income	—	(498)	(996)
Homeowners retained loss and LAE reserves			
-1 Percent Change in Severity			
Estimated decrease in reserves	(1,462)	(731)	—
Estimated increase in net income	1,155	577	—
No Change in Severity			
Estimated (decrease) increase in reserves	(731)	—	731
Estimated increase (decrease) in net income	577	—	(577)
+1 Percent Change in Severity			
Estimated increase in reserves	—	731	1,462
Estimated decrease in net income	—	(577)	(1,155)
All other retained loss and LAE reserves			
-1 Percent Change in Severity			
Estimated decrease in reserves	(1,541)	(770)	—
Estimated increase in net income	1,217	608	—
No Change in Severity			
Estimated (decrease) increase in reserves	(770)	—	770
Estimated increase (decrease) in net income	608	—	(608)
+1 Percent Change in Severity			
Estimated increase in reserves	—	770	1,541
Estimated decrease in net income	—	(608)	(1,217)

Our estimated share of CAR loss and LAE reserves is based on assumptions about our Participation Ratio, the size of CAR, and the resulting deficit (similar assumptions apply with respect to the FAIR Plan). Our assumptions consider that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for establishing our CAR reserves. Each of our assumptions could have a reasonably possible range of plus or minus 5 percentage-points for each estimation.

The following sensitivity table presents information of the effect each 1 percentage-point change in our assumptions on our share of reserves for CAR and other residual markets could have on our assumed loss and LAE reserves and net income for the year ended December 31, 2018. In evaluating the information in the table, it should be noted that a 1 percentage-point change in our assumptions would change estimated reserves by 1 percentage-point.

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	-1 Percent Change in Estimation	+1 Percent Change in Estimation
CAR assumed private passenger automobile		
Estimated (decrease) increase in reserves	$ —	$ —
Estimated increase (decrease) in net income	—	—
CAR assumed commercial automobile		
Estimated (decrease) increase in reserves	(331)	331
Estimated increase (decrease) in net income	261	(261)
FAIR Plan assumed homeowners		
Estimated (decrease) increase in reserves	(91)	91
Estimated increase (decrease) in net income	72	(72)

Reserve Development Summary

The changes we have recorded in our reserves in the past illustrate the uncertainty of estimating reserves. Our prior year reserves decreased by $56,488, $41,784 and $45,448 for the years ended December 31, 2018, 2017, and 2016, respectively.

The following table presents a comparison of prior year development of our net reserves for losses and LAE for the years ended December 31, 2018, 2017 and 2016, respectively. Each accident year represents all claims for an annual accounting period in which loss events occurred, regardless of when the losses are actually reported, booked or paid. Our financial statements reflect the aggregate results of the current and all prior accident years.

	Years Ended December 31,		
Accident Year	2018	2017	2016