

AMERICAN SAFETY INSURANCE HOLDINGS LTD
Form 10-K
March 16, 2009
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, 2008

Commission file number 1-14795

AMERICAN SAFETY INSURANCE HOLDINGS, LTD.

(Exact name of registrant as specified in its charter)

Bermuda

Not applicable

(State of incorporation
or organization)

(I.R.S. Employer
Identification No.)

31 Queen Street

2nd Floor

Hamilton, Bermuda

HM 11

(Address of principal executive offices)

(Zip Code)

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

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

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

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

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

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

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 and (2) has been subject to such filing requirements for the past 90 days. Yes X No ___

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

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer.

Large Accelerated Filer ☐

Accelerated Filer ☒

Non-accelerated Filer ☐

Smaller reporting company ☐

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

Yes ☐ No ☒

The aggregate market value of registrant's voting common stock held by non-affiliates based upon the closing sales price as reported by the New York Stock Exchange as of June 30, 2008 was \$150,911,802.

The number of shares of registrant's common stock outstanding on March 11, 2009 was 10,313,804.

Documents Incorporated by Reference: Part III of this Form 10-K incorporates by reference certain information from Registrant's Proxy Statement for the 2009 Annual General Meeting of the Shareholders (the "2009 ProxyStatement").

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AMERICAN SAFETY INSURANCE HOLDINGS, LTD.

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PART I

Item 1. Business

In this Report, the terms “we,” “our,” “us,” “Company” and “American Safety Insurance” refer to American Safety Insurance Holdings, Ltd. and, unless the context requires otherwise, includes our subsidiaries and non-subsidiary affiliates.

We maintain a web site at www.amsafety.com that contains additional information regarding the Company. Under the caption “Investor Relations - SEC Filings” on our website, we provide access, free of charge, to our filings with the Securities and Exchange Commission (“SEC”), including Forms 3, 4 and 5 filed by our officers and directors as soon as reasonably practical after electronically filing such material with the SEC.

Cautionary Statement Regarding Forward-looking Statements

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the U.S. federal securities laws. We intend these forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in the United States securities laws. In some cases, these statements can be identified by the use of forward-looking words such as “may”, “should”, “could”, “anticipate”, “estimate”, “expect”, “plan”, “believe”, “predict”, “potential”, and “intend”. Forward-looking statements contained in this report include information regarding our expectations with respect to pricing and other market conditions, our growth prospects, the amount of our acquisition costs, the amount of our net losses and loss reserves, the projected amount of our capital expenditures, managing interest rate risks, valuations of potential interest rate shifts and measurements of potential losses in fair market values of our investment portfolio. Forward-looking statements only reflect our expectations and are not guarantees of performance. These statements involve risks, uncertainties and assumptions. Actual events or results may differ materially from our expectations. Important factors that could cause actual events or results to be materially different from our expectations include (1) actual claims exceeding our loss reserves, (2) the failure of any of the loss limitation methods we employ, (3) the effects of emerging claims and coverage issues, (4) inability to collect reinsurance recoverables, (5) the loss of one or more key executives, (6) a decline in our ratings with rating agencies, (7) loss of business provided to us by our major brokers, (8) changes in governmental regulations or tax laws, (9) increased competition, (10) general economic conditions, (11) changes in the political environment of certain countries in which we operate or underwrite business, and (12) the other matters set forth under Item 1A, “Risk Factors” included in this report. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

Who We Are

We are a Bermuda-based specialty insurance and reinsurance company that provides customized products and solutions to small and medium-sized businesses in industries that we believe are underserved by the standard market. For over twenty years we have developed specialized coverages and alternative risk transfer products not generally available to our customers in the standard market because of the unique characteristics of the risks involved and the associated needs of the insureds. We specialize in underwriting these products for insureds with certain environmental, products liability, construction, healthcare and property risks, as well as developing programs for other specialty classes of risks and providing third party reinsurance. See Part II – Other Information, Item 1A for risks facing the Company.

We were formed in 1986 as a captive insurance company in Bermuda and began our operations providing insurance solutions to environmental remediation businesses in the U.S. at a time when insurance coverage for these risks was virtually unavailable in the standard market. Since then, we have continued to identify opportunities in other industry sectors underserved by the standard carriers where we believe we can achieve favorable returns on equity. We capitalize on these opportunities by (i) leveraging our strong

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relationships with agents and brokers, which we refer to as producers, who we believe have a recognized commitment to the specialty market, (ii) charging adequate premium for the risks we underwrite and the services we offer due to the limited availability of coverages for these risks and (iii) mitigating our loss exposure through customized policy terms, specialized underwriting and proactive loss control and claims management.

In Bermuda, we assume third party and intercompany reinsurance premiums through our reinsurance subsidiary, American Safety Reinsurance, Ltd. (“American Safety Re”). American Safety Assurance, Ltd. (“American Safety Assurance”) is our Bermuda-based segregated account captive, which serves as a risk sharing vehicle for program managers and insureds by allowing them to assume a portion of their underwriting risks. During 2007, we acquired Ordinance Holdings, Limited, a Bermuda corporation, further diversifying our operations to provide actuarial consulting and brokerage services. Our Bermuda subsidiaries also facilitate the allocation of risk among our insurance subsidiaries and provide us with greater flexibility in managing our capital.

In the U.S. we insure and place risks through our two insurance subsidiaries, American Safety Casualty Insurance Company (“American Safety Casualty”) and American Safety Indemnity Company (“American Safety Indemnity”), as well as through American Safety Assurance (Vermont), Inc. (“ASA(VT)”), a sponsored captive insurance company, and American Safety Risk Retention Group, Inc. (“American Safety RRG”), a non-subsidiary affiliate that is a variable interest entity consolidated in our financial statements in accordance with generally accepted accounting principles (GAAP). The Company acquired the LTC Group of companies in February, 2008, now known as ASI Healthcare, which provides insurance and risk management solutions for the long-term care industry. Our subsidiaries, American Safety Insurance Services, Inc. (“ASI Services”) and American Safety Administrative Services, Inc. (“ASAS”) provide a range of insurance management and administrative services for our operations and our subsidiary American Safety Claims Services, Inc. (“ASCS”) provides claims services for American Safety Casualty, American Safety Indemnity and American Safety RRG.

Our Markets

We actively participate in the excess and surplus lines (“E&S”), the alternative risk transfer (“ART”) and assumed reinsurance markets.

Excess and Surplus Lines

Excess and surplus lines insurers provide coverage for difficult-to-place risks that do not fit the underwriting criteria of insurance companies operating in the standard insurance market. In the standard insurance market, policies must be written by insurance companies that are licensed to transact business as admitted carriers by the state insurance regulators in the state in which the policy is issued. Standard insurance market policy rates and forms are highly regulated and coverages are largely uniform. In contrast, excess and surplus lines insurers are less restricted by these rate and form filing regulations, thereby providing them with more flexibility over the premiums they can charge and the policy terms and conditions they can offer.

Included in our description of the excess and surplus lines market is the specialty admitted market. Insurance carriers operating in the specialty admitted market underwrite complex risks similar to excess and surplus lines carriers, but are licensed by the insurance regulators in the states in which they operate as admitted insurance companies. Although they are admitted in the jurisdictions in which they operate, specialty admitted carriers are typically less restricted by policy rate and form regulations than standard admitted carriers due to the complexity of the risks being underwritten, the absence of standard market coverage, or the nature of the coverages provided. Some insureds with complex insurance needs require coverage from an admitted insurance company due to regulatory, legal, marketing or other factors. We currently underwrite specialty admitted policies in our environmental business line in California, Illinois,

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New Jersey and Texas. We also write a small portion of our program business on a specialty admitted basis. All of our surety bonds are written on an admitted basis in accordance with standard industry practice.

The property and casualty insurance industry has historically been a cyclical industry consisting of both “hard market” periods and “soft market” periods. The excess and surplus lines market historically has tended to move in response to the underwriting cycles in the standard insurance market. Hard market periods are characterized by shortages of underwriting capacity, limited availability of capital, less competition and higher premium rates. Typically, during hard markets, as rates increase and coverage terms become more restrictive, business shifts from the standard insurance market to the excess and surplus lines market as standard insurance market carriers rely on traditional underwriting techniques and focus on their core business lines. In soft markets, business shifts from the excess and surplus lines market to the standard insurance market as standard insurance market carriers tend to loosen underwriting standards and seek to expand market share by moving into business lines traditionally characterized as “surplus lines.”

During the past five years, we believe the property and casualty insurance market has softened significantly and the number of insurers competing for premium in the excess and surplus lines market has increased. These competitors include several start-up companies as well as larger standard market insurers looking to capture market share by moving from the admitted market to the excess and surplus lines market. This increased competition has caused rates to decline in targeted markets, in some cases, significantly. Despite this softening trend, we believe there are profitable business opportunities from which we can benefit, resulting from our diversification into new geographic locations and lines of business.

Alternative Risk Transfer

The ART market, provides insurance, reinsurance and risk management products for insureds who want more control over the claims administration process, who pay high insurance premiums or are unable to find adequate insurance coverage. The ART market originated during the 1980’s when obtaining various types of commercial liability insurance coverages was difficult for businesses in certain industries due to the nature of their operations or the industries in which they operated. To meet the risk management or insurance needs of these businesses new alternative risk transfer solutions were developed, such as captive insurance companies and risk retention groups. Captive insurance companies are risk sharing vehicles, the assets of which are contributed by one interest or a group of related interests so as to provide insurance coverage for their business operations. Risk retention groups are companies owned by their insureds that, while being licensed only in the state of their formation, are able to write insurance in all states through the Federal Liability Risk Retention Act. These alternative risk transfer arrangements blend risk transfer and risk retention mechanisms and, along with self-insurance, form the ART market.

The ART market grew substantially through 2006 with the creation of additional captives and risk retention groups. According to A.M. Best, net premiums written in the ART market grew approximately 47% between 2000 and 2006, for a cumulative annual growth rate (“CAGR”) of 8%. During this time, the ART market expanded to include a wider range of risk sharing vehicles, and benefited from more favorable regulation in certain jurisdictions in the U.S. The ART market has responded effectively to the strategic needs of insureds for better financial management, improved claims handling, more effective risk management, customized insurance programs and access to reinsurance markets. However, in 2007 net premiums written in the ART market fell 15% from 2006. The five year change was 3.9% and the five year CAGR was down to 1%.

The ART market has traditionally been inversely correlated to the standard market’s underwriting cycle, expanding in hard market periods and retracting in soft market periods. We believe, however, that this correlation has become less meaningful in recent years as ART solutions have become more accessible and better managed, evidenced by a sharp increase in the number of captive formations and more domestic and offshore domiciles, such as Vermont and Bermuda, offering regulatory environments conducive to captive formations and operations. While this continued growth has contributed to the competitive environment in

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the ART market, customers in certain industries continue to experience difficulty obtaining adequate and affordable coverages that meet their needs in the non-ART markets.

Assumed Reinsurance

Reinsurance is an arrangement in which the reinsurer agrees to indemnify an insurance or reinsurance company, known as the ceding company, against all or a portion of the insurance risks underwritten by the ceding company under one or more reinsurance contracts. Reinsurance can provide a ceding company with several benefits, including a reduction in net liability on individual risks or classes of risks, and catastrophe protection from large or multiple losses. Reinsurance also provides a ceding company with additional underwriting capacity by permitting it to accept larger risks. Reinsurance, however, does not discharge the ceding company from its liability to policyholders. Rather, reinsurance serves to indemnify a ceding company for losses payable by the ceding company to its policyholders.

During soft insurance markets, ceding companies tend to retain more of their risk, resulting in less premium ceded to reinsurers. As this trend continues, the reinsurers reduce rates to attract ceding companies. Although there has been increased competition and pricing pressure, we have been able to identify opportunities in attractively priced areas primarily with small specialty insurers, captives, risk retention groups and program managers.

Our Products

Our core product segments are excess and surplus lines, alternative risk transfer and assumed reinsurance:

Excess and Surplus Lines. We provide the following excess and surplus lines products:

- *Environmental.* We underwrite various types of environmental risks including smaller market and middle market environmental contractors and consultants and environmental impairment liability. We do not provide coverage for manufacturers or installers of products containing asbestos, but instead insure the contractors that remediate asbestos. For the year ended December 31, 2008, we had gross premiums written of \$48.3 million and net premiums written of \$34.4 million in our environmental business line, representing 18.5% and 19.1% of our total gross and net premiums written, respectively.

The environmental risks we underwrite are as follows:

- *Environmental Contractor and consultant risks.* This area focuses on general liability coverage for environmental contractors and consultants, targeted at two distinct markets:

- § ProStar – an online submission, rating and quoting system focuses on smaller environmental contractors and consultants, generally with annual revenues below \$3.0 million. ProStar totaled \$20.6 million, or 42.5%, of our total environmental gross premiums written for the year ended December 31, 2008.

§ Middle Market – product focuses on environmental contractors and consultants with annual revenues above \$3 million. Middle market totaled \$22.4 million, or 46.5%, of our total environmental gross premiums written for the year ended December 31, 2008.

- *Environmental Impairment Liability.* This segment targets fixed site pollution liability business such as manufacturers, real estate and waste facilities. Gross premiums written for environmental

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impairment liability for the year ended December 31, 2008 totaled \$5.3 million, or 11.0% of total environmental gross premiums written.

- *Construction.* We underwrite various types of residential and commercial construction risks. Our construction insurance coverages consist mostly of primary general and excess general liability coverages. For the year ended December 31, 2008, we had gross premiums written of \$34.6 million and net premiums written of \$26.6 million in our construction business line, representing 13.3% and 14.8% of our total gross premiums written and net premiums written, respectively.

The construction risks we underwrite include:

- o *Residential Construction.* We provide coverage for contractors involved with the construction and remodeling of residential properties. The types of residential contractors we insure primarily include graders, framers, concrete workers, drywall installers and general contractors. For the year ended December 31, 2008, residential construction represented 60% of our total construction gross premiums written.
- o *Commercial Construction.* The commercial contractors we insure primarily include framers (predominantly for apartments), concrete workers and graders. Many of the commercial contractors we insure derive a portion of their revenues from residential construction work. For the year ended December 31, 2008, commercial construction represented 38% of our total construction gross premiums written.
- o *Other.* Also included in our construction business line are other excess and surplus lines coverages, including general liability for building owners and equipment dealers. The gross premiums written associated with these excess and surplus lines policies represented 2% of our total construction gross premiums written for the year ended December 31, 2008.
- *Products Liability.* In 2006, the Company began to write selected general and products liability business, offering both primary and excess products to small and middle market manufacturers and distributors of medium hazard products. For the year ended December 31, 2008, products liability represented 2.6% and 3.1% of our total gross premiums written and net premiums written, respectively. The Company does not intend to write certain high severity classes of risks such as invasive medical products, pharmaceuticals and nutraceuticals.
- *Excess.* The Company's excess product is focused primarily in the construction and products liability areas. In 2006, the Company expanded its excess liability product to write over other carriers' primary policies and offer umbrella liability coverage. The Company also increased the available policy limits up to \$10 million. For the year ended December 31, 2008, excess represented 2.8% and 0.6% of our total gross premiums written and net premiums written, respectively.
- *Property.* In 2007, the Company added an underwriting team in New Jersey, allowing it to write property with a focus on fire exposed premises liability risks, primarily within areas of the eastern U.S. that do not have a high exposure to catastrophes. For the year ended December 31, 2008, property represented 3.0% and 3.3% of our total gross premiums written and net premiums written, respectively.

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- *Surety.* Surety is a contract under which an insurer guarantees certain obligations of a second party to a third party. We are listed as an acceptable surety on federal bonds, commonly known as a "Treasury-listed" or "T-listed" surety, primarily providing contract performance and payment bonds to environmental contractors and construction contractors in 47 states and the District of Columbia. For the year ended December 31, 2008, we had gross premiums written of \$11.2 million and net premiums written of \$8.3 million in our surety business line, representing 4.3% and 4.6% of our gross premiums written and net premiums written, respectively.
- *Healthcare.* ASI Healthcare provides insurance and risk management solutions for the long-term care industry. For the year ended December 31, 2008, we had gross premiums written of \$12.2 million and net premiums written of \$8.0 million in our healthcare business line, representing 4.7% and 4.4% of our gross premiums written and net premiums written, respectively.

Alternative Risk Transfer. We provide the following alternative risk transfer products:

- *Specialty Programs.* Working with third party program managers, reinsurance intermediaries and reinsurers, we target small and medium-sized businesses with homogenous groups of specialty risks where the principal insurance requirements are general, professional or pollution liability. In 2007, we expanded our capabilities by adding property as an available coverage. We outsource the underwriting and program administration duties for these programs to program managers with established underwriting expertise in the specialty program area. Our specialty programs consist primarily of casualty insurance coverages for construction contractors, pest control operators, small auto dealers, real estate brokers, restaurant and tavern owners, bail bondsmen and parent/teacher associations. During 2008, we added four (4) new programs for a total of fifteen (15) active programs at December 31, 2008.

We differentiate ourselves from our program competitors primarily in two ways. First, we typically require the underwriters of the business and the program managers to share in the risk and profits of the business they produce by assuming a portion of the premiums and the losses on the coverage being offered, which is secured by collateral. Our Bermuda segregated account captive, American Safety Assurance, or our Vermont sponsored captive, ASA(VT), can be utilized to facilitate the risk sharing position of the program manager by providing a vehicle for the program manager to collateralize its portion of the risk. The requirement to share a portion of the risk encourages the program manager to focus on underwriting profitability rather than solely on the production of commission income through premium volume. Second, we choose to focus on smaller programs where there are fewer competitors, thereby allowing us to obtain terms and conditions more favorable to us. In 2008 we had gross premiums written of \$79.2 million and net premiums written of \$43.8 million in our specialty programs business line, representing 30.4% and 24.4% of our total gross and net premiums written, respectively. We also earn fee income on the specialty program business that we write.

- *Fully funded.* Fully funded policies allow us to meet the needs of insureds that, due to the nature of their businesses, pay high insurance premiums or are unable to find adequate insurance coverage. Typically, our insureds are required to maintain insurance coverage to operate their business and the fully funded product allows these insureds to provide evidence of insurance, yet at the same time maintain more control over insurance costs and handling of claims. Our fully funded product accomplishes this by giving our insureds the ability to fund their liability exposures via a self-insurance vehicle, such as our segregated account captive, American Safety Assurance, or our sponsored captive, ASA(VT), or through another captive vehicle established by the insured. We do not assume underwriting risk on these policies, but instead earn a fee for providing the policies. Policy limits are set based on the requirements of the insured, and the insured funds the entire aggregate limit through cash, trust accounts or irrevocable letters of credit, or a combination. These amounts are accounted for as a liability. The aggregate policy limit caps the total damages payable under the policy, including all

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defense costs. We write fully funded general and professional liability policies for businesses operating primarily in the healthcare and construction industries. During 2008, we generated \$1.7 million in fees from fully funded business.

Assumed Reinsurance.

In 2007 the Company began to write assumed reinsurance through our subsidiary, American Safety Re, focusing on casualty reinsurance for risk retention groups, captives and small specialty insurance companies. During 2008, the Company's assumed reinsurance gross premiums written increased by 250% compared to 2007. The increase was attributable to the Company's focus on growing assumed reinsurance premiums by adding underwriting staff, including a Chief Underwriting Officer, and the full year impact of 2007 headcount additions. Assumed reinsurance premium written in 2008 totaled \$53.0 million, or 20.4% of total gross premiums written, and \$45.9 million, or 25.5% of net written premium. Treaties entered into during 2008 included medical malpractice, professional liability for accountants and lawyers, commercial auto liability, general liability for small grocery stores and assisted living facilities, and small participations in construction and property catastrophe treaties. For the year ended December 31, 2008, gross premiums written as a percentage of total assumed reinsurance gross premiums written were 1.6%, 20.6% and 77.8% for facultative, excess of loss and quota share, respectively.

Runoff Lines.

When certain business lines do not meet our profit or production expectations, we take corrective actions, which may include exiting those business lines. When we exit a business line, we no longer renew or write any new policies in that business line, although we do continue to service existing policies until they expire and administer any claims associated with those policies. The business lines we have exited since 2002 are:

- *Workers' Compensation.* In 1994 we began writing workers' compensation insurance for environmental contractors. During 2003, we placed this business line into runoff due to unfavorable loss experience as well as the high expenses associated with servicing this business line. The claims associated with this business line are being administered by a third party. At December 31, 2008, we were carrying net reserves of \$7.9 million related to this business line.
- *Excess Liability Insurance for Municipalities.* We began writing excess liability insurance for municipalities in 2000. During 2003, we placed this business line into runoff due to a lack of premium production and difficulty in obtaining affordable reinsurance coverage. At December 31, 2008, we were carrying net reserves of \$5.8 million related to this business line.
- *Commercial Lines.* Prior to 2002, when the Company placed this business line into runoff, the Company wrote commercial lines insurance primarily for habitational and manufacturing risks. At December 31, 2008, we were carrying net reserves of \$0.3 million related to this business line.

Our Competition

The property and casualty insurance and reinsurance markets are highly competitive with respect to a number of factors, including overall financial strength of a given carrier, ratings of companies by rating agencies, premium rates, policy terms and conditions, services offered,

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reputation and commission rates. We believe competition in the sectors of the market we target is fragmented and not dominated by one or more competitors. We frequently encounter competition from other companies that insure or reinsure risks in business lines that may encompass the specialty markets in which we operate, as well as from standard insurance carriers as they try to gain market share. The companies with which we compete vary by the industries we target and the types of coverage we offer.

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We believe our “A” (Excellent) rating from A.M. Best, focus on underserved markets, strong relationships with producers and versatile corporate structure are competitive advantages for us and are important factors in providing opportunities for growth.

Rating

On October 29, 2008, A.M. Best, the most widely recognized insurance and reinsurance company rating agency, once again affirmed its rating of “A” (Excellent) with a stable outlook on a group basis of American Safety Insurance, including our Bermuda reinsurance subsidiary, our two U.S. insurance subsidiaries, and our U.S. non-subsidary risk retention group affiliate. An “A” (Excellent) rating is the third highest of fifteen ratings assigned by A.M. Best to companies that have, in the opinion of A.M. Best, an excellent ability to meet their ongoing obligations to policyholders.

Some policyholders are required to obtain insurance coverage from insurance companies that have an “A-” (Excellent) or higher rating from A.M. Best. Additionally, many producers are prohibited from placing insurance or reinsurance with companies that are rated below “A-” (Excellent) by A.M. Best. A.M. Best assigns ratings that represent an independent opinion of a company’s ability to meet its obligations to policyholders that is of concern primarily to policyholders and producers, and its rating and outlook should not be considered an investment recommendation.

We have also been assigned a financial size category of Class VIII by A.M. Best. A financial size category of Class VIII is assigned by A.M. Best to companies with adjusted policyholder surplus of \$100 million to \$250 million, which, on a statutory basis of accounting, is the amount remaining after all liabilities, including loss reserves, are subtracted from all admitted assets.

Distribution

The specific distribution channels we use vary by business line. We market our excess and surplus products primarily through approximately 250 producers in all 50 states and the District of Columbia. Our ART specialty program products are distributed through direct solicitation of program managers with established underwriting expertise in a specialty program area by dedicated business development professionals employed by ASI Services, Inc. In addition, reinsurance intermediaries and brokers serve as a distribution source of program business. Our fully funded and partially funded products are marketed primarily through retail brokers, particularly those with a sophisticated understanding of the ART market. Our assumed reinsurance subsidiary works through established reinsurance brokers in Bermuda, the United States and the United Kingdom. As of December 31, 2008, the Company has no individual producers that generate greater than 10% of gross premiums written.

Technology

We utilize two primary information processing systems that are an integral part of our operations. We seek to improve the efficiency of our operations by integrating data throughout the organization and by moving data entry functions closer to the source of the information by providing the producers of our environmental line access to our systems via the Internet. ProStar is an online electronic submission, rating and quoting system used to process new and renewal business submissions for smaller businesses with environmental risks. We also have integrated software packages that address underwriting, premium accounting, claims and forms processing functions and are a secure and consolidated collection of primary data that feeds a data warehouse for management reporting and analysis. Our information technology department consists of twenty-six full-time employees and is supported by third-party vendors who provide support our existing technology platform. We continue to review and reinvest in technology to improve our

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competitiveness and operational efficiency. Ultimately, we believe these investments in technology will enable us to increase premium volume without requiring significant additional staff.

Underwriting

Excess and Surplus Lines

Our underwriting staff handles the insurance underwriting functions for all excess and surplus lines products, with specific underwriting authority related to the experience and knowledge level of each underwriter. Risks that are perceived to be more difficult and complex are underwritten by experienced staff and reviewed by management. The principal factors we use for underwriting these risks include the professional experience of the insured, its operating history, its loss history and, in the case of renewals, its demonstrated commitment to effective loss control and risk management practices.

Most of our senior underwriters have approximately 20 years of underwriting experience and in excess of ten years of underwriting experience in the specialty areas we target. We differentiate ourselves from other companies by individually underwriting and pricing each risk, as opposed to the general classification pricing practices which are often performed by larger insurance companies. We seek to instill a culture of underwriting profitability over premium volume and our underwriters' incentive compensation is based on underwriting profits rather than premium growth. We also enforce an internal quality control standard through periodic audits of underwriter files. Underwriters meet monthly to discuss the status of renewal business with our claims personnel, who adjust claims reported under our policies.

An important part of the underwriting and risk control process is the use of customized policy forms and contract wording to limit our ultimate exposure on many of the specialty risks we insure and to adequately respond to evolving claims trends in our core product lines. These trends are often identified through monthly meetings among claims, loss control, actuarial and underwriting personnel. Policy terms and conditions are crafted in cooperation with legal counsel to limit or restrict coverage for certain high exposure risks. Standard, or admitted, carriers do not have the same flexibility to control policy language because they are more heavily regulated by the individual states in which they operate, and are generally required to use standard insurance forms previously approved by state regulators and that are broader in coverage.

Alternative Risk Transfer

We outsource the underwriting and program administration duties for specialty programs to program managers with established underwriting expertise in the specialty program area. We perform due diligence which involves detailed reviews of underwriting, policy pricing practices, claims handling, management expertise, information systems and distribution networks on every new program we develop. Based on the results of the due diligence, underwriting guidelines are developed that are specific to each program, and must be adhered to by program managers. We also perform an actuarial analysis on each program, to ensure that the business projections meet our profitability requirements, as well as to determine the appropriate level of risk participation by us and the program manager. After the program is implemented, we utilize our internal underwriting, claims, and audit personnel to conduct audits of each program's underwriting, actuarial, claim handling and insurance processing functions to ensure adherence to established guidelines and to assess the long-term profit potential of the program.

Assumed Reinsurance

American Safety Re in Bermuda has a professional staff that includes experienced actuaries and underwriters who selectively develop third party assumed reinsurance business. The Bermuda staff conducts a review of each reinsurance opportunity to determine whether or not it meets the Company's underwriting and profitability standards. The review includes an assessment of the underwriting experience

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of the ceding company, risk management controls in place, the nature of the business to be ceded and an actuarial analysis. Coverage terms are proposed on opportunities that meet our underwriting standards and are crafted in a manner that we believe will generate an adequate return on our capital at risk. The Bermuda staff also utilizes third parties to perform underwriting and claims audits as deemed necessary to further assess the underwriting and claims practices of the ceding company.

Claims Management

Excess and Surplus Lines

The specialty risks that we underwrite are complex and the claims reported by our insureds often involve coverage issues, or may result in litigation that requires handling by a claims professional with specialized knowledge and claims management expertise. Accordingly, we employ experienced claims professionals with broad backgrounds, many with more than 20 years of experience in resolving the types of claims that typically arise from the specialty risks we underwrite. We believe our claims management approach, which is focused on achieving a favorable financial outcome through prompt case evaluation and proactive litigation management practices, combined with our industry expertise, is integral to controlling our losses and loss adjustment expenses. We also utilize the knowledge and expertise that we gain through the claims management process to enhance our underwriting and marketing activities through frequent interaction among the claims, actuarial and underwriting staffs.

We have established claims management best practices, which emphasize the thorough investigation of claims, prompt settlement of valid claims, aggressive defense against claims we believe to be without merit and the establishment of adequate reserves. We have a quality assurance unit that is responsible for establishing and maintaining claims handling best practices and monitoring the uniform and consistent application of these practices. This is accomplished primarily through audits of claims files as well as broader departmental audits, as necessary. The audit process includes an evaluation of all facets of the claims management process including investigation, litigation and reserving. These audits are used to measure both departmental and individual performance and identify areas for improvement.

We have a claims committee, comprised of claims adjusting staff, claims management and legal, that meets on a bi-weekly basis to discuss high exposure and complex claims, address litigation management strategies, coverage issues and the setting of reserves above established authority levels.

Alternative Risk Transfer

Claims management plays an important role in achieving our profitability goals in our alternative risk transfer segment. We use our internal claims personnel as well as TPAs to handle the majority of the claims arising from policies written in our alternative risk transfer segment. In some cases, the program manager responsible for the development and management of a particular program has established claims management expertise in the business line written under the program and will manage the claims for the program. By utilizing TPAs, we gain immediate access to the required claims handling expertise in the unique business lines we underwrite. Our selected TPAs undergo a pre-qualification process and are regularly audited. We select TPAs with claims personnel experienced in handling claims for the types of risks typical of our specialty programs and fully funded accounts.

Our internal claims staff is responsible for both selecting the TPAs as well as ensuring the quality of claims adjudication by the TPAs. Our internal program claims staff pre-qualifies TPAs based on a process that considers, among other characteristics, expertise in a particular business

line, reserving philosophy, litigation management philosophy and management controls.

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Once a TPA is qualified and selected, it is given limited reserve and settlement authority. We approve every claim in excess of a TPA's established settlement authority. Additionally, all coverage issues or disputes are required to be reported to our internal staff. To ensure that the TPAs we employ meet our performance standards, we conduct regular on-site claims audits. Recommendations arising from the claims audits are communicated to the TPA and an agreed upon action plan is implemented where required. Compliance with the action plan is monitored by our staff to ensure acceptable resolution to all recommendations.

Assumed Reinsurance

Reinsurers rely on the ceding company to manage claims and the appropriate losses are ceded to the reinsurer in accordance with the coverage terms. We monitor ceded losses to ensure that they are ceded properly under the reinsurance agreement and, when appropriate, utilize outside services if there are coverage disputes or if losses are not consistent with the terms of the agreement. Claim audits are performed by third parties on an as-needed basis.

Loss Control

We believe that loss control can provide value to our underwriters as part of their risk selection process, and to our insureds in the improvement of their risk management practices. Our loss control services assist insureds and our underwriters with regulatory compliance monitoring, the identification and analysis of risk exposures and the selection and implementation of effective risk management practices. Loss control services are utilized by our environmental and construction underwriting units as part of their account evaluation and maintenance process. Loss control reports are generated on selected individual accounts and reviewed by underwriters as part of their underwriting evaluation. Our loss control services for individual accounts include an initial assessment of regulatory policies and procedures, risk management practices and targeted physical inspections performed by outside professional loss control services companies.

Our inspection process includes an office interview with the insured's management to assess the written policies and procedures as well as the overall corporate approach toward risk management processes. In our environmental business line, we have developed specific work standards or "guidelines" to which insureds must adhere. In our construction business line, we review standard contracts utilized for projects as part of our risk management analysis. A jobsite survey is also performed to assess the implementation and adherence to company, state and federal regulations.

Ceded Reinsurance

Reinsurance is a contractual arrangement under which one insurer (the ceding company) transfers to another insurer (the reinsurer) a portion of the liabilities that the ceding company has assumed under an insurance policy it has issued. A ceding company may purchase reinsurance for any number of reasons, including obtaining, through the transfer of a portion of its liabilities, greater underwriting capacity than its own capital resources would otherwise support, to stabilize its underwriting results, to protect against catastrophic loss and to enter into or withdraw from a business line. Reinsurance can be written on either a quota share basis (where premiums and losses are shared proportionally) or excess of loss basis (where losses are covered if they exceed a certain amount), under a treaty (involving more than one policy) or facultative (involving only one policy) reinsurance agreement.

We evaluate each of our ceded reinsurance contracts at inception to determine if there is sufficient risk transfer to allow the contract to be accounted for as reinsurance under current accounting guidance. At December 31, 2008 all ceded contracts are accounted for as risk transferring

contracts.

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Our philosophy is to utilize reinsurance for asset protection against business and capital risks where economically appropriate and to maximize our use of capital. A description of our 2008 reinsurance structure is as follows:

Effective September 1, 2008 the Company renewed its excess of loss reinsurance treaty on our casualty lines of business. The cost of the reinsurance provided by the renewal varies based on premium and the area of coverage. The excess of loss reinsurance treaty expires on October 1, 2009. The renewal provides four areas of coverage on essentially an as expiring basis, summarized as follows:

Casualty Lines – \$4.5 million excess of \$500,000, with 92.5% of the risk ceded to reinsurers and covering casualty lines including construction, products liability, specialty programs and the casualty portion of property package business. The environmental coverage is \$4.5 million in excess of \$500,000, with 62.5% of the risk ceded to the reinsurers. The treaty also provides excess coverages of \$6.0 million excess of \$5.0 million atop the environmental lines layer with 100% of the risk ceded to the reinsurers.

Umbrella and Excess - \$5 million quota share placed on a cessions basis for umbrella and excess business with 87.75% of the risk ceded to reinsurers on policies written over primary general liability policies and with 78% of the risk ceded on policies written over other insurers' policies.

Effective September 1, 2008, the Company renewed the treaty providing protection from claims associated with bad faith allegations, improper claims handling and multiple insured being involved in the same occurrence. This reinsurance provides limits of \$5.0 million per occurrence, subject to an aggregate limit of \$15 million.

Effective May 1, 2008, the Company entered a consolidated surety reinsurance treaty providing \$7.5 million of limits with \$1 million per loss retention by the Company. Coverage extends to all of the Company's surety operations. The surety reinsurance treaty expires May 1, 2009.

Effective September 1, 2007 the Company entered a consolidated property reinsurance treaty providing \$10 million of limits with a \$500,000 per occurrence retention by the Company. The treaty also provides protection for multiple losses arising out of one occurrence, with limits totaling \$20.5 million across all layers. Loss adjustment expense is provided on a prorated basis in addition to the treaty limits shown above. The renewal date of this treaty has been extended to April 1, 2009.

For the period of July 1, 2007 through September 1, 2008, the Company was covered under an excess of loss reinsurance treaty on our casualty lines of business. Under this treaty the Company retains the first \$500,000 of a loss and has a 10% participation in the \$4.5 million excess of \$500,000 layer for its environmental, construction and products liability line of business, as well as the general liability portion of its property line of business. The Company retains the first \$250,000 of a loss on certain of its program lines of business, participates in 50% of the next \$250,000 and 10% of the \$4.5 million in excess of \$500,000. The treaty provides that the Company retain a 10% quota share on the first \$5 million of loss on the excess line of business and provides coverage on policies up to a \$10 million limit.

Prior to the reinsurance treaties mentioned above, our reinsurance structure was as follows:

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Environmental. Our reinsurance treaty for environmental products operates on an excess of loss basis with a maximum retention on a per occurrence basis of \$837,500. The balance of the risk, up to \$10.2 million in excess of the Company's retention, is ceded to unaffiliated reinsurers.

Construction. Effective July 1, 2005 we discontinued purchasing reinsurance on the primary general liability portion of our construction business line.

Excess and Products Liability. Effective July 1, 2006 we entered into a quota share reinsurance agreement for the excess and products liability business with a maximum retention of \$1.0 million per occurrence.

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Specialty Programs. The majority of our program business is reinsured under separate quota share and excess of loss reinsurance treaties that were purchased for each program.

Surety. Effective June 1, 2006 the surety treaty was not renewed based on our belief that retaining this exposure will enhance our financial results and returns on capital.

Other. We also purchase reinsurance coverage on certain products that protects us from claims associated with bad faith allegations, improper claims handling and multiple insureds being involved in the same occurrence. This reinsurance provides limits of \$5.0 million per occurrence, subject to an aggregate limit of \$15.0 million.

For the year ended December 31, 2008, we ceded \$80.5 million of premium (30.9% of gross premiums written) to unaffiliated third party reinsurers, as compared to \$68.4 million of premium (31.3% of gross premiums written) in 2007. Ceded reinsurance premiums from the specialty programs business line were 44.0% of the 2008 amount and 49.5% of the 2007 amount. We monitor the reinsurance market and will increase or decrease our reliance on reinsurance depending on Company needs, available coverage and rates.

Our Reinsurers

While reinsurance obligates the reinsurer to reimburse us for a portion of our losses, it does not relieve us of our primary liability to our insureds. If our reinsurers are either unwilling or unable to pay some or all of the claims made by us on a timely basis, we bear the financial exposure. We have written reinsurance security procedures that establish financial requirements for reinsurance companies that must be met prior to reinsuring any of the business we write. Among these requirements is a stipulation that reinsurance companies must have an A.M. Best rating of at least "A-" (Excellent) and a financial size category of Class VIII or greater at the time of writing any reinsurance, unless sufficient collateral has been provided at the time we enter into our reinsurance agreement. The A.M. Best ratings of reinsurers are subject to change in the future, and may cause one or more of our reinsurers to be below our stated requirements. A financial size category of Class VIII is assigned by A.M. Best to companies with adjusted policyholder surplus of \$100 million to \$250 million, which, on a statutory basis of accounting, is the amount remaining after all liabilities, including loss reserves, are subtracted from all admitted assets. We have also established an internal reinsurance security committee, consisting of members of senior management, which meets quarterly to discuss and monitor our reinsurance coverage and the financial security of our reinsurers.

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To protect against our reinsurers' inability to satisfy their contractual obligations to us, our reinsurance contracts stipulate a collateral requirement for reinsurance companies that do not meet the financial strength and size requirements described above. These collateral requirements can be met through the issuance of unconditional letters of credit, the establishment and funding of escrow accounts for our benefit or cash advances paid into a trust account. Collateral may also include our retention of amounts that we owe reinsurers for premium in the ordinary course of business. The following table is a listing of our largest reinsurers ranked by reinsurance recoverables and includes the collateral posted by these reinsurance companies as of December 31, 2008:

<u>Reinsurers</u>	Financial		Total	Collateral at	Net Exposure at
	A.M. Best	Size	Recoverables		
	Rating (1)	Category(1)	at	December 31,	December 31,
			December 31,	2008	2008
			2008(3)		
(dollars in thousands)					
Berkley Insurance Company	A+	XV	\$ 23,863	\$ -	\$ 23,863
Partner Reinsurance Company, US	A+	XV	21,689	1,166	20,523
Folksamerica Reinsurance Company	A-	X	19,325	917	18,408
QBE Reinsurance Corporation	A	IX	16,287	1,218	15,069
Alea Group of Companies	N/R	N/R	12,827	2,958	9,869
SUA Insurance Company	B+	VII	11,304	14,611	-
Aspen Insurance UK Limited	A	XV	10,147	-	10,147
American Constantine (2)	N/R	N/R	9,427	8,259	1,168
Swiss Reinsurance America Corp	A+	XV	9,185	41	9,144
Wyndham Insurance Company (SAC) Ltd.	N/R	N/R	8,418	7,867	551
Max Reinsurance, Ltd.	A-	XIV	7,788	9,555	-
Lloyd's Syndicate #4472-FRW	A	XV	6,741	663	6,078
Munich Reinsurance America, Ltd	A-	XV	6,716	1,225	5,491
Transatlantic Reinsurance Company	A	XV	6,017	93	5,924
DaimlerChrysler Insurance Co.	B++	VII	5,939	3,549	2,390
Other, net			<u>63,700</u>	<u>43,528</u>	<u>20,172</u>
Total			\$239,373	\$95,650	\$148,797
Less Valuation Allowance			<u>3,800</u>		<u>3,800</u>
Net Reinsurance Recoverable			<u>\$235,573</u>		<u>\$144,997</u>

- (1) The A.M. Best rating is as of February 23, 2009.
- (2) Constitutes a captive supporting risk positions assumed by program managers on certain specialty programs.
- (3) Total recoverables includes recoverable amounts for paid losses, case reserves, incurred but not reported reserves and ceded unearned premiums.

For more information on the financial exposure we bear with respect to our reinsurers, see "Risk Factors."

Selected Operating Information

Gross Premiums Written

The following table sets forth our gross premiums written and percentage of total gross premiums by business line for the years ended December 31, 2008, 2007, and 2006 (dollars in thousands):

	Years Ended December 31,					
	<u>2008</u>		<u>2007</u>		<u>2006</u>	
Excess & Surplus Lines						
Environmental	\$ 48,275	18.5%	\$ 47,891	21.9 %	\$51,805	21.6%
Construction	34,575	13.3	59,533	27.4	96,918	40.5
Products Liability	6,780	2.6	5,730	2.6	2,344	1.0
Excess	7,235	2.8	6,322	2.9	3,946	1.6
Property	7,752	3.0	3,117	1.4	-	-
Surety	11,248	4.3	6,438	2.9	4,004	1.7
Healthcare	<u>12,238</u>	<u>4.7</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total	128,103	49.2	129,031	59.1	159,017	66.4
Alternative Risk Transfer						
Specialty Programs	79,249	30.4	68,097	31.2	80,590	33.6
Assumed Re	53,032	20.4	21,242	9.7	-	-
Runoff	-	-	-	-	-	-
Total	\$260,384	100.0%	\$218,370	100.0%	\$239,607	100.0%

Net Premiums Written

The following table sets forth our net premiums written and the percentage of total net premiums by business line for the years ended December 31, 2008, 2007, and 2006 (dollars in thousands):

	Years Ended December 31,			
	<u>2008</u>	<u>2007</u>	<u>2006</u>	
Excess & Surplus Lines				
Environmental	\$ 34,372	\$ 31,444	\$ 37,746	24.0%
Construction	26,649	50,502	92,530	58.8
Products Liability	5,549	3,746	1,524	1.1
Excess	1,088	578	670	0.4
Property	5,900	2,145	-	-
Surety	8,333	6,084	3,042	1.9

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Healthcare	<u>7.9554.4</u>	<u>-</u>	<u>-</u>		<u>-</u>	<u>-</u>
Total	89,84650.0	94,49962.9		135,512	86.2	
Alternative Risk Transfer						
Specialty						
Programs						
	43,84924.4	34,26022.9		21,756	13.8	
Assumed Re	45,91325.5	21,24214.2		-	-	
Runoff	<u>257</u>	<u>0.1</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total	\$ 179,865100.0%	\$ 150,001100.0%		\$157,268	100.0%	

Combined Ratio.

The combined ratio is a standard measure of a property and casualty company's performance in managing its losses and expenses. Underwriting results are generally considered profitable when the combined ratio is less than 100%. On a GAAP basis, the combined ratio is determined by adding losses and loss adjustment expenses, acquisition expenses and other underwriting expenses, less amounts recorded as fee income, and dividing the sum of those numbers by net premiums earned. Our GAAP combined ratio was 106.0% in 2008, 97.4% in 2007, and 97.5% in 2006. See "Management's Discussion and Analysis" for further explanation of the increase in the combined ratio.

The combined ratio of an insurance or reinsurance company measures only the underwriting results and not necessarily the profitability of the overall company. Our reported combined ratio may fluctuate from time to time depending on our mix of business and may not reflect the overall profitability of the Company.

Losses and Loss Adjustment Expense Reserves

We are required to maintain reserves to cover the unpaid portion of our ultimate liability for losses and loss adjustment expenses with respect to (i) reported claims and (ii) incurred but not reported (IBNR) claims. A full actuarial analysis is performed to estimate our unpaid losses and loss adjustment expenses under the terms of our contracts and agreements. In evaluating whether the reserves are adequate for unpaid losses and loss adjustment expenses, it is necessary to project future losses and loss adjustment expense payments. It is probable that the actual future losses and loss adjustment expenses will not develop exactly as projected and may vary significantly from the projections. See "Risk Factors" for a further explanation of this risk. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" for additional information regarding our historical losses and loss adjustment expenses.

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

In establishing reserves, we employ several methods in determining our ultimate losses: (i) the expected loss ratio method; (ii) the loss development method based on paid and reported losses; and (iii) the Bornhuetter-Ferguson method based on expected loss ratios, paid losses and reported losses. The expected loss ratio method incorporates industry expected losses which are adjusted for our historical loss experience. The loss development method relies on industry payment and reporting patterns to develop our estimated losses. The Bornhuetter-Ferguson method is a combination of the other two methods, using expected loss ratios to produce expected losses, then applying loss payment and reporting patterns to our expected losses to produce our expected IBNR losses. The establishment of appropriate loss reserves is an inherently uncertain process and there can be no assurances our ultimate liabilities will not vary materially from our reserves.

All of the methods used, as described above, are generally accepted actuarial methods and rely in part on loss reporting and payment patterns while considering the long term nature of some of the coverages and inherent variability in projected results from year-to-year. The patterns used are generally based on industry data with supplemental consideration given to our experience as deemed warranted. Industry data is also relied upon as part of the actuarial analysis, and is used to provide the basis for reserve analysis on newer business lines. Provisions for inflation are implicitly considered in the reserving process. Our reserves are carried at the total estimate for ultimate expected losses and loss adjustment expenses, without any discount to reflect the time value of money. Reserve calculations are reviewed regularly by management and periodically by regulators. Our in-house actuarial department reviews the reserve

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adequacy of our major lines on a quarterly basis. A full actuarial analysis is performed by our in-house actuarial department on an annual basis. In addition, an independent third party actuarial firm annually performs a full actuarial analysis, assessing the adequacy of statutory reserves established by our management. A statutory actuarial opinion is filed by management in states in which our insurance and reinsurance subsidiaries and our non-subsidiary risk retention group affiliate are licensed. "Statutory reserves" are reserves established to provide for future obligations with respect to all insurance policies as determined in accordance with statutory accounting principles ("SAP"), the rules and procedures prescribed or permitted by state insurance regulatory authorities for recording transactions and preparing financial statements. Based upon the practices and procedures employed by us described above, management believes that our reserves are adequate.

As of December 31, 2008 our net reserves totaled \$393.3 million. Approximately \$287.2 million, or 73.0%, of our net reserves, related to our excess and surplus lines segment, \$51.2 million, or 13.0%, of our net reserves were attributable to our alternative risk transfer segment, \$40.9 million or 10.4% of our net reserves were related to our assumed reinsurance segment and the balance of our net reserves, \$14.0 million, or 3.6%, was allocated to our runoff segment.

The net carried reserves at December 31, 2008, 2007 and 2006 were as follows (dollars in thousands):

	Years ended December 31,		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Excess & Surplus Lines			
Environmental	\$ 72,983	\$ 62,930	\$ 51,317
Construction	200,156	197,974	179,284
Products Liability	5,015	2,583	424
Excess	1,642	1,170	726
Healthcare	1,863	-	-
Property	2,228	268	-
Surety	<u>3,320</u>	<u>914</u>	<u>174</u>
Total Excess & Surplus	287,207	265,839	231,925
Alternative Risk Transfer			
Specialty Programs	51,163	41,719	27,445
Assumed Reinsurance	40,913	6,453	-
Runoff	<u>14,026</u>	<u>15,287</u>	<u>19,157</u>
Total	\$393,309	\$329,298	\$278,527

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

Years Ended December 31,

<u>2008</u>	<u>2007</u>	<u>2006</u>
--------------------	--------------------	--------------------

(dollars in thousands)

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Gross reserves, beginning of year	\$504,779	\$439,670	\$393,493
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Ceded reserves, beginning of year	<u>175,481</u>	<u>161,146</u>	<u>159,515</u>
Net reserves, beginning of year	<u>329,298</u>	<u>278,524</u>	<u>233,978</u>
Incurred related to:			
Current accident year	104,752	88,973	89,731
Prior accident years	<u>5,394</u>	<u>2,212</u>	<u>2,598</u>
Total incurred	110,146	91,185	92,329
Claim payments related to:			
Current accident year ⁽¹⁾	1,011	4,008	5,959
Prior accident years	<u>45,124</u>	<u>36,403</u>	<u>41,824</u>
Total claim payments	46,135	40,411	47,783
Net reserves, end of year	393,309	329,298	278,524
Ceded reserves, end of year	<u>193,338</u>	<u>175,481</u>	<u>161,146</u>
Gross reserves, end of year	\$586,647	\$504,779	\$ 439,670

⁽¹⁾ 2008 activity is reduced by \$8,377 related to an assumed loss portfolio transfer completed during 2008.

The net prior year reserve development for 2008, 2007 and 2006 occurred in the following business lines:

Years Ended December 31,

<u>2008</u>	<u>2007</u>	<u>2006</u>
(dollars in thousands)		

Excess and Surplus Lines

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Environmental	\$ 5,202	\$ 4,066	\$ 56
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Construction

- (728)

2,425

Surety

____-

(267)

(224)

5,202

3,071

2,257

Specialty Programs

(1,913)

(115)

641

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Runoff	<u>2,105</u>	<u>(744)</u>	<u>(300)</u>
Total	\$ 5,394	\$ 2,212	\$ 2,598

The 2008 prior year adverse reserve development primarily relates to increased paid and case reserves in accident years 2002 through 2006 for environmental contractors business written in New York. The adverse development in the runoff line relates to increased estimates of workers' compensation claims related to site cleanup activities following the terrorist attack in New York on 9/11. The adverse development is partially offset by decreases in specialty programs primarily related to the pest control program.

The 2007 prior year adverse reserve development for the environmental line primarily relates to increased case reserves on 2004 claims for environmental contractors in New York. This development was partially offset by decreases in construction, surety and runoff business lines reserves. The specialty programs' prior year benefit is offset by \$0.4 million of prior year reserve development related to a commutation of a reinsurance treaty with a former program manager.

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The 2006 prior year development in the construction line primarily relates to development in layers that were previously reinsured, but the reinsurance treaty was commuted in 2005. The development in the specialty programs line primarily relates to an increase in certain case reserves on policies written in 2004 and 2005. This development is partially offset by reserve reductions in our surety and runoff lines.

The following table shows the gross, ceded and net development of the reserves for unpaid losses and loss adjustment expenses from 1998 through 2008 for our primary insurance and reinsurance subsidiaries and our non-subsidary risk retention group affiliate. The top line of the table shows the liabilities at the balance sheet date for each of the indicated years and reflects the estimated amounts for losses and loss adjustment expenses for claims arising in that year and all prior years that are unpaid at the balance sheet date, including IBNR losses. In the gross and ceded sections of the table, the second line shows the re-estimated amount of previously recorded liabilities based on experience as of the end of each succeeding year. The lower portion of the table in the net section shows the cumulative amounts subsequently paid as of successive years with respect to the liabilities. The estimates change as more information becomes known about the frequency and severity of claims for individual years. A redundancy (deficiency) exists when the re-estimated liabilities at each December 31 is less (greater) than the prior liability estimate. The cumulative redundancy (deficiency) depicted in the table, for any particular calendar year, represents the aggregate change in the initial estimates over all subsequent calendar years.

Years Ended December 31, (1)

(dollars in thousands)

	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Gross reserves	\$14,701	\$20,413	\$50,509	\$137,391	\$179,164	\$230,104	\$321,038	\$393,493	\$439,673	\$504,779	\$586,647
Re-estimated at 12/31/08	13,961	31,645	124,434	264,599	325,013	392,090	436,160	476,831	497,434	535,440	
Cumulative redundancy (deficiency) on gross reserves	740	(11,232)	(73,925)	(127,208)	(145,849)	(161,986)	(115,122)	(83,338)	(57,761)	(30,661)	
Ceded reserves	1,841	6,065	27,189	89,657	109,543	115,061	136,998	159,515	161,146	175,481	193,338
Re-estimated at 12/31/08	3,538	15,353	90,953	170,982	184,286	216,605	216,516	224,025	208,622	200,748	
Cumulative deficiency on ceded reserves	(1,697)	(9,288)	(63,764)	(81,325)	(74,743)	(101,544)	(79,518)	(64,510)	(47,476)	(25,267)	
Net reserves for unpaid losses and loss adjustment expenses	12,860	14,348	23,320	47,734	69,621	115,043	184,040	233,978	278,527	329,298	393,309
Net Reserves re-estimated at December 31:											
1 year later	12,298	15,498	24,837	49,469	74,857	129,445	186,646	236,576	280,739	334,692	
2 years later	12,967	15,541	26,853	53,912	93,943	144,083	193,597	251,775	288,812		
3 years later	12,677	16,452	29,242	67,072	106,264	148,386	216,849	252,806			
4 years later	13,054	16,510	28,708	75,899	109,016	171,037	219,644				
5 years later	11,995	16,208	30,235	78,072	136,423	175,485					
6 years later	11,697	16,503	32,987	89,762	140,726						
7 years later	12,018	16,442	33,445	93,617							
8 years later	11,617	16,269	33,480								
9 years later	10,412	16,293									
10 years later	10,423										
Cumulative redundancy (deficiency) on net reserves	2,437	(1,945)	(10,160)	(45,883)	(71,105)	(60,442)	(35,604)	(18,828)	(10,285)	(5,394)	
Cumulative amount of net liability paid through December 31:											
1 year later	3,612	5,243	10,514	15,406	17,873	21,939	31,967	41,821	36,406	45,125	
2 years later	6,565	9,616	15,865	28,577	35,642	48,426	70,241	74,163	76,794		
3 years later	9,058	11,060	22,750	38,290	55,094	77,685	96,786	106,874			
4 years later	9,086	13,558	24,131	47,756	72,668	94,761	122,570				
5 years later	9,895	13,646	25,739	56,123	83,599	112,380					
6 years later	9,816	14,173	27,992	60,193	97,479						
7 years later	10,301	14,584	30,081	68,862							

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8 years later	10,146	14,321	31,400
9 years later	11,900	14,564	
10 years later	11,855		

Net reserves December 31	12,860	14,348	23,320	47,734	69,621	115,043	184,040	233,978	278,527	329,298	393,309
Ceded Reserves	<u>1,841</u>	<u>6,065</u>	<u>27,189</u>	<u>89,657</u>	<u>109,543</u>	<u>115,061</u>	<u>136,998</u>	<u>159,515</u>	<u>161,146</u>	<u>175,481</u>	<u>193,338</u>
Gross Reserves	\$ 14,701	\$ 20,413	\$ 50,509	\$ 137,391	\$ 179,164	\$ 230,104	\$ 321,038	\$ 393,493	\$ 439,673	\$ 504,779	\$ 586,647

(1) Years ended December 31, 2001 through 2008 include the consolidated values of American Safety RRG, our non-subsiary affiliate.

Investments

The Company's investment portfolio is managed for the preservation of principal, with due consideration for operating income targets and the Company's overall asset/liability strategy.

Our investment portfolio is managed by an independent, nationally recognized investment management company that manages our investment portfolio pursuant to the investment policies and guidelines established by our Board of Directors. We have investment policies which limit the maximum duration and set target levels for the average duration of the entire portfolio. The duration target for our investment portfolio takes into account the need to manage a part of the portfolio to produce cash flow to cover operational needs while allowing flexibility to manage our assets. Our investment guidelines limit the percentage of our portfolio that is permitted to be invested in any asset class. The guidelines further limit the amount that may be invested by issuer quality rating. Additionally, we use specific criteria to judge the credit quality of our investments and use a variety of credit rating services to monitor these criteria. In conjunction with our investment policy, guidelines and strategy, we have invested predominantly in investment grade fixed income securities. Our investment portfolio consists primarily of government and government agency securities and high quality marketable corporate securities which are rated investment grade or better. We also invest in common equity securities that primarily track the S&P 500 and 600. Common equity securities represented 8.9% of our prior year-end shareholders' equity. At December 31, 2008, we had \$3.3 million invested in dividend paying preferred stocks.

Pursuant to our investment guidelines, we have general limitations on the type of investments that may be made, including, among others, prohibitions on investments in certain types of securities, credit quality limitations and duration requirements without prior approval from management or the Board of Directors. See "Risk Factors" for a description of risks associated with our investment portfolio.

At December 31, 2008 and 2007, the fair value of our cash and invested assets totaled approximately \$686.6 million and \$630.1 million, respectively, and were classified as follows:

<u>Type of Investment</u>	Fair Value At December 31, 2008	Amortized Cost At December 31, 2008	Percent of Amortized Cost Portfolio
	(dollars in thousands)		
Cash and short-term investments	\$ 92,903	\$ 92,903	13.5%
Fixed maturity securities:			
U.S. government securities	62,209	57,335	8.3
States of the U.S. and political subdivisions	41,591	41,804	6.1
Mortgage-backed securities	186,158	181,032	26.3
Commercial mortgage-backed securities	11,918	14,097	2.0
Asset-backed securities	16,095	17,006	2.5
Corporate securities	<u>251,939</u>	<u>256,141</u>	<u>37.1</u>
Subtotal	569,910	567,415	82.3
Common and preferred stocks	<u>23,824</u>	<u>29,210</u>	<u>4.2</u>
Total	\$ 686,637	\$689,528	100.0%

<u>Type of Investment</u>	Fair Value At December 31, 2007	Amortized Cost At December 31, 2007	Percent of Amortized Cost Portfolio
	(dollars in thousands)		
Cash and short-term investments	\$ 69,315	\$ 69,315	11.1%
Fixed maturity securities:			
U.S. Government Securities	86,135	84,567	13.5
States of the U.S. and political subdivisions	7,480	7,549	1.2
Mortgage-backed securities	182,088	181,129	29.0
Commercial mortgage-backed securities	15,476	15,457	2.4
Asset-backed securities	24,928	24,815	4.0
Corporate securities	<u>213,462</u>	<u>212,127</u>	<u>33.9</u>
Subtotal	529,569	525,644	84.0
Common and preferred stocks	<u>31,187</u>	<u>30,128</u>	<u>4.9</u>
Total	\$ 630,071	\$ 625,087	100.0%

The fair value of our fixed maturity securities portfolio, classified by rating, as of December 31, 2008 and 2007 were as follows:

<u>S&P's/Moody's Rating</u>	Fair Value at December 31, 2008	Amortized Cost at December 31, 2008	Percent of Fair Value Total
	(dollars in thousands)		
AAA/Aaa (including U.S. Treasuries of \$38,621)	\$308,344	\$299,951	54.1%
AA/Aa	45,530	45,319	8.0
A/A	184,287	188,762	32.4
BBB/Baa	30,991	32,681	5.4
Less than BBB/Baa (1)	<u>758</u>	<u>702</u>	<u>0.1</u>
Total	\$569,910	\$567,415	100.0%

<u>S&P's/Moody's Rating</u>	Fair Value at December 31, 2007	Amortized Cost at December	Percent of Fair Value Total
--	--	---	--

31, 2007
(dollars in thousands)

A A A / A a a (including U . S . Treasuries of \$35,720)	\$322,707	\$319,463	60.9%
AA/Aa	43,734	43,370	8.3
A/A	140,876	140,385	26.6
BBB/Baa	21,595	21,721	4.1
L e s s t h a n BBB/Baa ⁽¹⁾	<u>658</u>	<u>705</u>	<u>0.1</u>
Total	\$529,570	\$525,644	100.0%

⁽¹⁾ The less than BBB/Baa rated securities were rated investment grade at the time of investment.

The National Association of Insurance Commissioners (the “NAIC”) has a security rating system by which it assigns investments to classes called “NAIC designations” that are used by insurers when preparing their annual financial statements. The NAIC assigns designations to publicly traded as well as privately placed securities. The designations assigned by the NAIC range from class 1 to class 6, with a rating in class 1 being the highest quality. As of December 31, 2008, virtually all portfolios of our U.S.

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insurance subsidiaries were invested in securities rated in class 1 or class 2 by the NAIC, which are considered investment grade.

The weighted average maturity of our bond portfolio at December 31, 2008, was 6.55 years. The maturity distribution of our fixed maturity portfolio, as of December 31, 2008, based on stated maturity dates with no prepayment assumptions, was as follows:

<u>Maturity</u>	Fair	Amortized
	Value	Cost
	(dollars in thousands)	

Due in one year or less

\$ 18,609

\$ 18,548

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Due from one to five years	126,765	125,814
Due from five to ten years	169,975	173,702
Due after ten years	56,485	54,222
Mortgage and asset-backed securities	<u>198,076</u>	<u>195,129</u>
Total		\$569,910\$567,415

Our mortgage and asset-backed securities are subject to risks associated with the variable prepayments of the underlying mortgage loans. All of our mortgage-backed securities are fixed income securities issued by Fannie Mae, Freddie Mac or Ginnie Mae and are therefore guaranteed by the U.S. government. As a result, we do not believe that these investments present a significant exposure to sub-prime mortgage risks.

Our Non-Subsidiary Affiliate

The Risk Retention Act of 1986 (the “Risk Retention Act”) allowed companies with specialized liability insurance needs that could not be met in the standard insurance market to create a new type of insurance vehicle called a risk retention group. We assisted in the formation of American Safety RRG in 1988 in order to establish a U.S. insurance company to market and underwrite specialty environmental coverages. The advantage of writing policies through a risk retention group is that it is permitted to write policies in all fifty states without having to qualify to do so in each state.

American Safety RRG is a variable interest entity which is consolidated in our financial statements in accordance with FASB, FIN 46. American Safety RRG is authorized to write liability insurance in all 50 states as a result of the Risk Retention Act and is licensed by the Vermont Department of Banking, Insurance, Securities and HealthCare Administration (the “Vermont Department”) under Title 8 of the Vermont Statute Annotated (the “Vermont Captive Act”) as a stock captive insurance company. Presently, three of our directors are also directors of American Safety RRG: David V. Brueggen, Thomas W. Mueller and Cody W. Birdwell. The directors of American Safety RRG are elected annually by the shareholders of American Safety RRG.

We transferred our book of environmental insurance business previously written in Bermuda to American Safety RRG in 1988 to allow us to write that insurance on a domestic basis. Prior to October 2006, our insurance subsidiaries participated in the ongoing business of American Safety RRG through a pooling agreement (whereby we retained 75% of the premiums and risk). Effective October 1, 2006, the Company commuted this pooling agreement for accident years 2002 to 2006 with its affiliates. This commutation did not result in any gain or loss to the respective parties involved. Also effective October 1, 2006, American Safety RRG entered into a 90/10 quota share agreement with American Safety Re.

Insurance Services

ASI Services, directly and through its subsidiaries, provides business development, underwriting, accounting, program management, brokerage and claims services and ASAS, directly, provides administration, marketing, legal and administrative services to our U.S. insurance operations and our non-subsidiary risk retention group affiliate.

ASI Services has developed many of our primary insurance and reinsurance programs. Since 1990, ASI Services has served as the program manager for American Safety RRG, providing it with program management, underwriting, loss control and through its subsidiary, ASCS, claims services. ASAS provides marketing, accounting, legal and other administrative services. In each case, these services are provided pursuant to guidelines and procedures established by the Board of Directors of American Safety RRG.

ASI Services provides a number of services to our three U.S. insurance subsidiaries and to American Safety RRG. These services include:

- § business development services for developing new producer relations and new business opportunities;
- § program management services for the overall management and administration of a program;
- § underwriting services for evaluating individual risks or classes of risk;
- § reinsurance services for placing reinsurance for a program;
- § loss control services for evaluating the risks posed by a particular class of risk, as well as the ability of insureds to control their losses; and,
- § administrative services, including policy and endorsement issuance.

ASAS provides other services to our three U.S. insurance subsidiaries and to American Safety RRG, including:

- § legal services;
- § accounting and finance services;
- § human resources services;
- § marketing services for designing and placing advertisements and other marketing materials, as well as marketing insurance programs to producers; and
- § other policy administration services.

ASCS provides: claims administration services for the prompt reporting and handling of claims, and the supervision of claims adjusters and TPAs and payment of claims.

Regulatory Environment

Insurance Regulation Generally

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

The nature and extent of state regulation varies from jurisdiction to jurisdiction, but typically involves prior approval of the acquisition of control of an insurance company or of any company controlling an insurance company, regulation of certain transactions entered into by an insurance company with an affiliate, approval of premium rates for lines of insurance, standards of solvency and minimum amounts of capital and surplus which must be maintained, limitations on types and amounts of investments, restrictions on the size of risks which may be insured by a single company, deposits of securities for the benefit of policyholders, licensing to transact business, accreditation of reinsurers, admittance of assets to statutory surplus and reports with respect to financial condition and other matters. In addition, state regulatory examiners perform periodic examinations of insurance companies. American Safety RRG, American Safety Casualty, American Safety Indemnity and American Safety Assurance (Vermont) are all subject to examination by state regulatory examiners every three years. The last state regulatory examination for American Safety RRG, American Safety Casualty and American Safety Indemnity, occurred in 2004, 2005 and 2005, respectively. Oklahoma is currently conducting examinations of American Safety Casualty and American Safety Indemnity for the three years ended December 31, 2007. American Safety Assurance (VT) was formed in 2008 and therefore will be subject to examinations in the future.

Although the federal government does not directly regulate the business of insurance in the U.S., federal initiatives often affect the insurance business in a variety of ways. The insurance regulatory structure has also been subject to scrutiny in recent years by the NAIC, federal and state legislative bodies and state regulatory authorities. Various new regulatory standards have been adopted and proposed in recent years. The development of standards to ensure the maintenance of appropriate levels of statutory surplus by insurers has been a matter of particular concern to insurance regulatory authorities. The “statutory surplus” is the amount remaining after all liabilities, including loss reserves, are subtracted from all admitted assets and is determined in accordance with SAP. The difference between statutory financial statements and statements prepared in accordance with GAAP vary by jurisdiction; however, the primary difference is that statutory financial statements do not reflect deferred policy acquisition costs, certain net deferred tax assets, intangible assets, unrealized appreciation on debt securities or certain unauthorized reinsurance recoverables.

Bermuda Regulation

Our Bermuda subsidiaries that conduct reinsurance business, American Safety Re and American Safety Assurance, are subject to regulation under The Insurance Act 1978, as amended, of Bermuda and related regulations (the “Bermuda Act”), which provide that no person shall conduct insurance business (including reinsurance) in or from Bermuda unless registered as an insurer under the Bermuda Act by the Supervisor of Insurance (the “Supervisor”). American Safety Re and American Safety Assurance are registered insurers under the Bermuda Act.

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

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the solvency capital requirements of the Bermuda Act. Furthermore, the Supervisor is granted powers to supervise, investigate and intervene in the affairs of insurance companies.

Neither American Safety Insurance Holdings, Ltd., American Safety Re nor American Safety Assurance are registered or licensed as an insurance company in any state or jurisdiction in the U.S.

U.S. Regulation

As a Bermuda insurance holding company, we do not do business in the U.S. Our three U.S. insurance subsidiaries' operations are subject to state regulation where each is domiciled and where each writes insurance.

We acquired American Safety Casualty, a U.S. property and casualty insurance company domiciled in Delaware, in 1993. During 2007 American Safety Casualty was re-domesticated from Delaware to Oklahoma. American Safety Casualty is licensed as a property and casualty insurer in 48 states and the District of Columbia. American Safety Casualty is subject to regulation and examination by the Oklahoma Insurance Department and the other states in which it is an admitted insurer. The insurance laws of Oklahoma place restrictions on a change of control of American Safety Insurance as result of our ownership of American Safety Casualty. Under Oklahoma law, no person may obtain 10% or more of our voting securities without the prior approval of the Oklahoma Insurance Department.

American Safety Casualty, as a licensed insurer, is subject to state regulation of rates and policy forms in the various states in which its direct premiums are written. Under these regulations, a licensed insurer may be required to file and obtain prior approval of its policy form and the rates that are charged to insureds. American Safety Casualty is also required to participate in state insolvency funds, or shared markets, which are designed to protect insureds or insurers that become unable to pay claims due to an insurer's insolvency. Assessments made against insurers participating in these funds are usually based on direct premiums written in the state by a participating insurer, as a percentage of total direct premiums written in the state by all participating insurers. "Premiums written" are those premiums written, whether or not earned, during a time period.

We acquired American Safety Indemnity, a U.S. excess and surplus lines insurance company domiciled in Oklahoma, in 2000. American Safety Indemnity is currently licensed or approved as an excess and surplus lines insurer in 44 states and the District of Columbia. The insurance laws of Oklahoma place restrictions on a change of control of American Safety Insurance as a result of our ownership of American Safety Indemnity. Under Oklahoma law, no person may obtain 10% or more of our voting securities without the prior approval of the Oklahoma Insurance Department.

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

The Risk Retention Act allows the establishment of risk retention groups to insure certain liability risks of its members. The statute applies only to commercial liability insurance and does not permit coverage for liability for personal injury, damage to property or workers' compensation.

The Risk Retention Act and Title 8 of the "Vermont Captive Act" require that each insured of American Safety RRG be a shareholder. Each insured is required to purchase one share of American Safety RRG's common stock upon acceptance as an insured. There is no trading market for the shares of common stock of American Safety RRG and each share is restricted as to transfer. If and when a holder of American Safety RRG common stock ceases to be an insured, whether voluntarily or involuntarily, that holder's share of common stock is automatically canceled and that person is no longer a shareholder of American Safety RRG. The ownership interests of members in a risk retention group are considered to be exempt securities for purposes of the registration provisions of the Securities Act of 1933, as amended and the Securities Exchange Act of 1934, as amended and are likewise not considered securities for purposes of any state securities law.

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

American Safety Casualty and American Safety Indemnity and American Safety RRG are required to comply with NAIC risk-based capital ("RBC") requirements. RBC is a method of measuring the amount of capital appropriate for an insurance company to support its overall business in light of its size and risk profile. The ratio of a company's actual policyholder surplus to its minimum capital requirements will determine whether any state regulatory action is required. State regulatory authorities use the RBC formula to identify insurance companies which may be undercapitalized and may require further regulatory attention.

American Safety Assurance (Vermont), Inc. (ASA VT) is a licensed Vermont sponsored captive insurance company formed in December, 2008. ASA VT is subject to regulation and to examination by the Vermont Department of Banking, Insurance, Securities & Health Care Administration. Standard Vermont regulatory requirements applicable to traditional insurers generally are not applicable to captive insurers, but applicable Vermont captive laws do limit the type of entity that may act as a sponsor, limit a participant to insuring its risks only through the segregated or protected cell and require that a participant's assets and liabilities be maintained in a segregated or protected cell separate from the experience of other cells and from the assets of the sponsored captive's general account. Vermont regulators evaluate the financial condition of the company and of each segregated cell.

ASA VT, as a sponsored captive insurer, makes insurance available to a broad range of liability, property and casualty risks and allows the ceding of a portion of those risks to another American Safety Insurance affiliate. The use of the protected cell may be more desirable than a traditional captive insurance company due to the ability to limit exposure primarily to segregated cell covering risk for a specific insured or group of related insureds or specialty books of business.

Harbour Village Development

In March 2000, our subsidiary Ponce Lighthouse Properties Inc. and our general contracting subsidiary Rivermar Contracting Company began development of Harbour Village, located in Ponce Inlet, Florida, with 676 condominium units, a marina containing 142 boat slips, a par-3 golf course and beach club. We acquired the Harbour Village property (comprising 173 acres) through foreclosure in April 1999 from an individual to whom the Company had extended a loan in order to satisfy the loan after it was in default. Development of Harbour Village was completed and all of the condominium units and boat slips had been sold and closed by the second quarter of 2005. The beach club, the last phase of the development, was completed in 2006 and turned over to the home owners association. Ponce Lighthouse Properties, Inc. and Rivermar Contracting Company have been liquidated during 2008 and the Company has no ongoing business or employees at Harbour Village.

Employees

At December 31, 2008, we employed 182 persons, none of whom were represented by a labor union.

Item 1A. Risk Factors

Our business is subject to the following risk factors, among others, in addition to the information (including disclosures relative to forward-looking statements) set forth elsewhere in this report.

Risk Factors Relating to American Safety Insurance

A downgrade in our A.M. Best rating or increased capital requirements could impair our ability to sell insurance policies.

On October 29, 2008, A.M. Best, the most widely recognized insurance company rating agency, affirmed its rating of “A” (Excellent) on a group basis of American Safety Insurance, including our U.S. insurance subsidiaries, our Bermuda reinsurance subsidiary and our U.S. non-subsidiary risk retention group affiliate. A. M. Best also affirmed the rating outlook of stable. An “A” (Excellent) rating is the third highest of fifteen ratings assigned by A.M. Best to companies that have, in the opinion of A.M. Best, an excellent ability to meet their ongoing obligations to policyholders.

Some policyholders are required to obtain insurance coverage from insurance companies that have an “A-” (Excellent) rating or higher from A.M. Best. Additionally, many producers are prohibited from placing insurance or reinsurance with companies that are rated below “A-” (Excellent) by A.M. Best. A.M. Best assigns ratings that represent an independent opinion of a company’s ability to meet its obligations to policyholders that is of concern primarily to policyholders, brokers and agents, and its rating and outlook should not be considered an investment recommendation. Because A.M. Best continually monitors companies with regard to their ratings, our ratings could change at any time, and any downgrade of our current rating may impair our ability to sell insurance policies and, ultimately, our financial condition and operating results.

If A.M. Best requires us to increase our capital in order to maintain our rating and we are unable to raise the required amount of capital to be contributed to our subsidiaries, A.M. Best may downgrade our rating.

The exclusions and limitations in our policies may not be enforceable.

We draft the terms and conditions of our excess and surplus lines policies to manage our exposure to expanding theories of legal liability in business lines such as asbestos abatement, construction defect, environmental and professional liability. Many of the policies we issue include exclusions or other conditions that define and limit coverage. In addition, many of our policies limit the period during which a policyholder may bring a claim under the policy, which period in many cases is shorter than the statutory period under which these claims can be brought against our policyholders. While these exclusions and limitations help us assess and control our loss exposure, it is possible that a court or regulatory authority could nullify or void an exclusion or limitation, or legislation could be enacted modifying or barring the use of these exclusions and limitations particularly with respect to evolving business lines such as construction defect. This could result in higher than anticipated losses and loss adjustment expenses by extending coverage beyond our underwriting intent or increasing the number or size of claims, which could have a material adverse effect on our operating results. In some instances, these changes may not become apparent until some time after we have issued the insurance policies that are affected by the changes. As a result, the full extent of liability under our insurance contracts may not be known for many years after a policy is issued.

The risks we underwrite are concentrated in relatively few industries.

We focus much of our underwriting on specialty risks in the construction and environmental remediation industries. As a result of our diversification efforts, for the year ended December 31, 2008, approximately 32% of our gross written premiums were written in these two industries compared to 49% for 2007. However, our operating results could be more exposed than our more diversified competitors to unfavorable changes in business, economic or regulatory conditions, changes in federal, state or local environmental standards and establishment of legal precedents affecting these industries. Similarly, a significant incident impacting one of these industries that has the effect of increasing claims generally (or their settlement value) could negatively impact our financial condition and operating results.

We may respond to market trends by expanding or contracting our underwriting activities in certain business lines, which may cause our financial results to be volatile.

Although we perform due diligence and risk analysis before entering into a new business line or insuring a new type of risk, and carefully assess the impact of exiting a business line, changing business lines inherently has more risk than remaining in the same business lines over a period of time. Because we actively seek to expand or contract our capacity in the markets we serve in response to factors such as loss experience and premium production, our operating results may experience material fluctuations.

Our industry is highly competitive and we may lack the financial resources to compete effectively.

We believe that competition in the specialty insurance markets that we target is fragmented and not dominated by one or more competitors. We face competition from several types of companies, such as insurance companies, reinsurance companies, underwriting agencies, program managers and captive insurance companies. Many of our competitors are significantly larger and possess greater financial, marketing and management resources than we do. We compete on the basis of many factors, including coverage availability, claims management, payment terms, premium rates, policy terms, types of insurance offered, overall financial strength, financial strength ratings and reputation. If any of our competitors offer premium rates, policy terms or types of insurance that are more competitive than ours we could lose business. If we are unable to compete effectively in the markets in which we operate or to establish a competitive position in new markets, our financial condition and operating results would be adversely impacted.

Our actual incurred losses may be greater than reserves for our losses and loss adjustment expenses.

Insurance companies are required to maintain reserves to cover their estimated liability for losses and loss adjustment expenses with respect to both reported and incurred but not reported ("IBNR") claims. Reserves are estimates at a given time involving actuarial and statistical projections of what we expect to be the cost of the ultimate resolution and administration of claims. These estimates are based on facts and circumstances then known, predictions of future events, estimates of future trends, projected claims frequency and severity, potential judicial expansion of liability precedents, legislative activity and other factors, such as inflation. Our in-house actuarial staff reviews the reserves of our major lines on a quarterly basis and a full actuarial analysis annually. In addition, an independent third party actuarial firm performs a full actuarial analysis annually, which includes assessing the adequacy of statutory reserves.

Notwithstanding these efforts, the establishment of adequate reserves for losses and loss adjustment expenses is an inherently uncertain process, particularly in the environmental remediation industry, construction industry and some of the other industries for which we write policies where extensive historical data may not exist or where the risks insured are long-tail in nature, in that claims that have occurred may not be reported to

us for long periods of time. For instance, there is little empirical data for residential construction defect claims and hence, traditional actuarial analysis may be inapplicable or less reliable. Due to these uncertainties, our ultimate losses could materially exceed our reserves for losses and

loss adjustment expenses, especially in business lines where we have increased or intend to increase our risk retention.

To the extent that reserves for losses or loss adjustment expenses are estimated in the future to be inadequate, we would have to increase our reserves and incur charges to earnings in the periods in which the reserves are increased. In addition, increases in reserves may also cause additional reinsurance premiums to be payable to our reinsurers. These increases in reserves and reinsurance premiums would adversely impact our financial condition and operating results. For more information on our losses and loss adjustment expenses, see "Management's Discussion and Analysis of Financial Condition and Results of Operations."

If we are unable to obtain reinsurance on favorable terms, our ability to write new policies could be adversely affected.

Reinsurance is a contractual arrangement under which one insurer (the ceding company) transfers to another insurer (the reinsurer) a portion of the liabilities that the ceding company has assumed under an insurance policy it has issued. Our business involves ceding portions of the risks that we underwrite to reinsurers. The availability and cost of reinsurance are subject to prevailing market conditions that are beyond our control and are factors that could materially impact our financial condition and operating results. There is no certainty that reinsurance will continue to be available in the form or in the amount that we require or, if available, at an affordable cost. The availability of reinsurance is dependent not only on reinsurers' reactions to the specific risks that we underwrite, but also events that impact the overall reinsurance industry. If we are unable to maintain or replace our reinsurance, our total loss exposure would increase and, if we were unwilling or unable to assume that increase in exposure, we would be required to mitigate the increase in exposure by writing fewer policies or writing policies with lower limits or different coverage.

We may be unable to recover amounts due from our reinsurers.

While reinsurance contractually obligates the reinsurer to reimburse us for a portion of our losses, it does not relieve us of our primary financial liability to our insureds. If our reinsurers are either unwilling or unable to pay some or all of the claims made by us on a timely basis, we bear the financial exposure. As a result, we are subject to credit risk with respect to our reinsurers. The total amount of reinsurance recoverables at December 31, 2008 was \$235.6 million, or 108.6% of shareholders' equity. Of this amount, \$95.7 million, or approximately 40.6% of the total recoverable amount, is collateralized by cash, irrevocable letters of credit or other acceptable forms of collateral posted by the reinsurer.

We purchase reinsurance from reinsurers we believe to be financially sound. We have written reinsurance security procedures that establish financial requirements for reinsurance companies that must be met prior to reinsuring any of the business we write. Among these requirements is a stipulation that reinsurance companies must have an A.M. Best rating of at least "A-" (Excellent) and a financial size category of Class VIII or greater at the time of writing any reinsurance unless sufficient collateral has been provided at the time we enter into our reinsurance agreement. A financial size category of Class VIII is assigned by A.M. Best to companies with adjusted policyholder surplus of \$100 million to \$250 million, which, on a statutory basis of accounting, is the amount remaining after all liabilities, including loss reserves, are subtracted from all admitted assets. We have also established an internal reinsurance security committee, consisting of members of senior management, which meets quarterly to discuss and approve reinsurance security and evaluate collectability of reinsurance recoverables. To protect against our reinsurers inability to satisfy their contractual obligations to us, our reinsurance contracts stipulate a collateral requirement for reinsurance companies that do not meet the financial strength and size requirements described above. These collateral requirements can be met through the issuance of unconditional letters of credit, the establishment and funding of escrow accounts for our benefit or cash advances paid into a segregated account. In the event collateral is not sufficient, there is no certainty that these reinsurers will be able to provide additional collateral or fulfill their obligations to us.

We are unable to ensure the credit worthiness of our reinsurers. In prior years, A.M. Best and Standard and Poor's ("S&P"), downgraded the financial strength ratings of the insurance and reinsurance operating subsidiaries of Alea Group Holdings (Bermuda) Ltd., including among others, Alea North American Insurance Company and Alea London Limited ("Alea"), one of our reinsurers. Subsequently, Alea requested that A.M. Best withdraw all ratings of Alea. A.M. Best currently has assigned a NR-4 (Company Request) to Alea. As of December 31, 2008, our unsecured estimated net exposure to Alea was approximately \$9.9 million, primarily in our specialty programs. This estimate is based upon our estimates of losses and will not reflect our exposure if our actual losses differ from those estimates.

The Company recorded a provision to increase its allowance on reinsurance recoverables of \$2.5 million during the year ended December 31, 2008, due to concerns regarding the collectability of its reinsurance recoverables. The Company had allowances of \$3.8 million and \$1.3 million established at December 31, 2008 and 2007, respectively.

We rely on independent insurance agents and brokers to market our products.

We market most of our insurance products through approximately 250 independent insurance agents and brokers, which we refer to as producers. These producers are not obligated to promote our products and may sell competitors' products. Our profitability depends, in part, on the marketing efforts of these producers and on our ability to offer insurance products and services while maintaining financial strength ratings that meet the requirements of our producers and their customers. The failure or inability of producers to market our insurance products successfully would have a material adverse effect on our business and operating results. As of December 31, 2008, the Company has no individual producers that generate greater than 10% of gross premiums written.

We are subject to credit risk in connection with producers that market our products.

In accordance with industry practice, when the insured pays premiums for our policies to producers for payment over to us, these premiums are considered to have been paid and, in most cases, the insured is no longer liable to us for those amounts, whether or not we actually have received the premiums. Consequently, we assume a degree of credit risk associated with the producers with whom we choose to do business. To date, we have not experienced any material losses related to these credit risks.

Our long-term growth strategy is dependent on several factors, the failure to achieve any one of which may impair our ability to expand our operations or may prevent us from operating profitably.

Our long-term growth strategy includes expanding in our existing markets, entering new geographic markets, creating relationships with new producers and developing new insurance products. In order to generate this growth, we are subject to various risks, including risks associated with our ability to:

- identify insurable risks not adequately served by the standard insurance market;
- maintain adequate levels of capital;
- obtain reinsurance on favorable terms;
- obtain necessary regulatory approvals when writing on an admitted basis;

- attract and retain qualified personnel to manage our expanded operations;
- complete acquisitions of small specialty insurers, general agents or lines of business,
- invest in products and markets that may adversely impact near term results; and

- maintain our financial strength ratings.

Our inability to achieve any of the above objectives could affect our long-term growth strategy and may cause our business and operating results to suffer.

If we lose key personnel or are unable to recruit qualified personnel, our ability to implement our business strategies could be delayed or hindered.

Our future success will depend, in part, upon the efforts of our executive officers and other key personnel. Our ability to recruit and retain key personnel will depend upon a number of factors, such as our results of operations, business prospects and the level of competition then prevailing in the market for qualified personnel. The loss of any of these officers or other key personnel or our inability to recruit key personnel could prevent us from fully implementing our business strategies and could materially adversely affect our business, financial condition and operating results.

We routinely evaluate opportunities to expand our business through acquisitions of other companies or business lines. There are many risks associated with acquisitions that we may be unable to control.

We evaluate potential acquisition opportunities as a means to grow our business. There are a number of risks attendant to any acquisition. These risks include, among others, the difficulty in integrating the operations and personnel of an acquired company; potential disruption of our ongoing business; inability to successfully integrate acquired systems and insurance programs into our operations; maintenance of uniform standards, controls and procedures; possible impairment of relationships with employees and insureds of an acquired business as a result of changes in management; and that the acquired business may not produce the level of expected profitability. As a result, the impact of any acquisition on our future performance may not be consistent with original expectations, and may impair our business, financial condition and operating results.

A prolonged economic downturn may have a negative impact on our financial results.

We are subject to certain risks related to prolonged economic downturn as follows:

- reduced need for insurance;
- lower revenues of our insureds;
- increased claim settlement costs;
- decrease in investment yields;
- impairment of our investment portfolio;
- credit worthiness of our program managers, brokers and reinsurers;
- and
- ability to access capital markets at reasonable rates.

We may require additional capital in the future, which may not be available or may only be available on unfavorable terms.

Our future capital requirements depend on many factors, including our ability to write profitable new business, retain existing customers and establish premium rates and reserves at levels sufficient to cover losses and related expenses. Many factors will affect our capital needs and their amount and timing, including our growth and profitability, our claims experience and the availability of reinsurance, as well as possible acquisition opportunities, market disruptions, changes in regulatory requirements and other unforeseeable developments. If we have to raise additional capital, equity or debt financing may not be available at all or may be available only on terms that are unfavorable to us. In the case of equity

financings, dilution to our shareholders could result. In the case of debt financings, we may be subject to covenants that restrict our ability to freely operate our business. If we cannot obtain adequate capital on favorable terms or at all, we may not have sufficient funds to implement our operating plans and our business, financial condition and operating results could be adversely affected.

Changes in the value of our investment portfolio may have a material impact on our operating results.

We derive a significant portion of our net earnings from our invested assets. As a result, our operating results depend in part on the performance of our investment portfolio. As of the year ended December 31, 2008, the fair value of our investment portfolio was \$673.7 million and net investment income derived from these assets was \$29.6 million. We also incurred net realized losses of \$14.3 million in 2008. Our investment portfolio is subject to various risks, including:

- credit risk, which is the risk that our invested assets will decrease in value due to unfavorable changes in the financial prospects or a downgrade in the credit rating of an entity in which we have invested;
- interest rate risk, which is the risk that our invested assets or investment income may decrease due to changes in interest rates;
- equity price risk, which is the risk that we will incur economic loss due to a decline in equity prices;
- duration risk, which is the risk that our invested assets may not adequately match the duration of our insurance liabilities
- industry sector concentration risk, which is the risk that our invested assets are concentrated in a small number of investment sectors;
- mortgage-backed securities, which may have exposure to sub-prime mortgages although all mortgage-backed securities in the Company's portfolio are issued by Fannie Mae, Freddie Mac or Ginnie Mae; and
- general economic conditions that may negatively impact the volume or income stream from our invested amounts or require that we recognize losses on certain investments.

Our investment portfolio is comprised mostly of fixed-income securities. We do not hedge our investments against interest rate risk and, accordingly, changes in interest rates may result in fluctuations in the value of these investments.

Our investment portfolio is managed by an independent, nationally recognized investment management firm, in accordance with detailed investment policies and guidelines established by the Board of Directors, that stress preservation of principal with due consideration for

operating income targets and the Company's overall asset/liability strategy. If our investment portfolios are not appropriately matched with the respective insurance and reinsurance liabilities, we may be forced to liquidate investments prior to their maturity at a significant loss in order to cover these liabilities. This might occur, for instance, in the event of a large or unexpected claim or series of claims. Large investment losses could significantly decrease our asset base, thereby affecting our ability to underwrite new business. For more information about our investment portfolio, see "Business-Investments."

We rely upon the successful and uninterrupted functioning of our information technology, information processing and telecommunication systems.

Our business is highly dependent upon the successful and uninterrupted functioning of our information technology, information processing and telecommunications systems. We rely on these systems to support our marketing operations, process new and renewal business, provide customer service, make claims payments, and facilitate premium collections and policy cancellations. These systems also enable us to perform actuarial and other modeling functions necessary for underwriting and rate development. We have a highly trained staff that is committed to the continual development and maintenance of these systems. However, the failure of these systems could interrupt our operations or materially impact our ability to evaluate and write new business. Because our information technology, information processing and telecommunications systems interface with and depend on third party systems, we could experience service denials if demand for this service exceeds capacity or if the third party systems fail or experience interruptions. If sustained or repeated, a system failure or service denial could result in a deterioration of our ability to write and process new and renewal business and provide customer service or compromise our ability to pay claims in a timely manner. There can be no guarantee that these systems can effectively support our continued growth. Additionally, some of our systems are not fully redundant, and our disaster recovery planning does not account for all eventualities, which could adversely affect our business.

We are subject to risks related to litigation.

From time to time, we are subject to lawsuits and other claims arising out of our insurance, reinsurance and former real estate operations. We have responded to the lawsuits we face and, although the outcome of these lawsuits cannot be predicted, we believe that there are meritorious defenses and intend to vigorously contest these claims. Adverse judgments in one or more of these lawsuits could require us to change aspects of our operations in addition to paying significant damage amounts. In addition, the expenses related to these lawsuits may be significant. Lawsuits can have a material adverse effect on our business and operating results, particularly where we have not established an accrual or a sufficient accrual for damages, settlements or expenses. For information on the material litigation in which we are involved, see “Item 3 - Legal Proceedings”.

Risk Factors Related to Taxation

Our Bermuda operations may be subject to U.S. tax.

American Safety Insurance Holdings, Ltd., its reinsurance subsidiary, American Safety Re and its segregated account captive, American Safety Assurance, are organized in Bermuda. American Safety Insurance Holdings, Ltd., American Safety Re and American Safety Assurance are operated in a manner such that they should not be subject to U.S. tax (other than U.S. excise tax on insurance and reinsurance premium income attributable to insuring or reinsuring U.S. risks and U.S. withholding tax on some types of U.S. source investment income) because none of these companies should be treated as engaged in a trade or business within the U.S. (and, in the case of American Safety Re and American Safety Assurance, to be doing business through a permanent establishment within the U.S.). However, because there is considerable uncertainty as to the activities that constitute being engaged in a trade or business within the U.S. (and what constitutes a permanent establishment under the income tax treaty between the U.S. and Bermuda (the “Bermuda Treaty”) as well as the entitlement of American Safety Re and American Safety Assurance to treaty benefits), there can be no assurances that the U.S. Internal Revenue Service (the “IRS”) will not contend successfully that American Safety Insurance Holdings, Ltd., American Safety Re and/or American Safety Assurance is engaged in a trade or business in the U.S. (or that American Safety Re or American Safety Assurance is carrying on business through a permanent establishment in the U.S.). If any of American Safety Insurance Holdings, Ltd., American Safety Re or American Safety Assurance were considered to be engaged in a trade or business in the U.S., it could be subject to U.S. corporate income and additional branch profits taxes on the portion of its earnings effectively connected to such U.S. business, in which case its operating results could be materially adversely affected.

Changes in U.S. federal income tax law could materially adversely affect us.

Legislation has been introduced in the U.S. Congress intended to eliminate some perceived tax advantages of companies (including insurance companies) that have legal domiciles outside the United States but have certain U.S. connections. changes in federal income tax law could be enacted by the current Congress or future Congresses that could have an adverse impact on our results of operations.

If you acquire 10% or more of the Common Shares, you may be subject to taxation under the “controlled foreign corporation” (“CFC”) rules.

Under certain circumstances, a “U.S. 10% shareholder” of a foreign corporation that is a CFC for an uninterrupted period of 30 days or more during a taxable year must include in gross income for U.S. federal income tax purposes that U.S. 10% shareholder’s “subpart F income,” even if the “subpart F income” is not distributed to that U.S. 10% shareholder. “Subpart F income” of a foreign insurance corporation typically includes foreign personal holding company income (such as interest, dividends and other types of passive income), as well as insurance and reinsurance income (including underwriting and investment income) attributable to the insurance of risks situated outside the CFC’s country of incorporation.

We believe that because of the dispersion of our Common Share ownership, provisions in our organizational documents that limit voting power and other factors, no U.S. person who acquires Common Shares directly or indirectly through one or more foreign entities should be required to include our “subpart F income” in income under the CFC rules of the Code. It is possible that the IRS could challenge the effectiveness of these provisions and that a court could sustain that challenge, in which case, one’s investment could be materially adversely affected.

U.S. persons who hold Common Shares may be subject to U.S. federal income taxation at ordinary income rates on their proportionate share of our “related party insurance income” (“RPII”).

If the RPII of American Safety Re or American Safety Assurance were to equal or exceed 20% of its gross insurance income in any taxable year and direct or indirect insureds (and persons related to those insureds) own directly or indirectly through entities 20% or more of the voting power or value of American Safety Re or American Safety Assurance, then a U.S. person who owns any Common Shares (directly or indirectly through foreign entities) on the last day of the taxable year would be required to include in income for U.S. federal income tax purposes that person’s pro rata share of that company’s RPII for the entire taxable year, determined as if that RPII were distributed proportionately only to U.S. persons at that date regardless of whether that income is distributed. In addition, any RPII that is includible in the income of a U.S. tax-exempt organization may be treated as unrelated business taxable income. Neither American Safety Re nor American Safety Assurance expects gross RPII to equal or exceed 20% of its gross income for 2008 or subsequent years, and neither expects its direct or indirect insureds (including related persons) to directly or indirectly hold 20% or more of its voting power or value, but we cannot be certain that this will be the case because some of the factors which determine the extent of RPII may be beyond our control. If these thresholds are met or exceeded, and if you are an affected U.S. person, your investment could be materially adversely affected. The RPII provisions, however, have never been interpreted by the courts or the U.S. Treasury Department (the “Treasury Department”) in final regulations, and regulations interpreting the RPII provisions of the Code exist only in proposed form. It is not certain whether these regulations will be adopted in their proposed form or what changes or clarifications might ultimately be made thereto or whether any of those changes, as well as any interpretation or application of RPII by the IRS, the courts or otherwise, might have retroactive effect. The Treasury Department has authority to impose, among other things, additional reporting requirements with respect to RPII. Accordingly, the meaning of the RPII provisions and the application thereof to us is uncertain.

U.S. persons who dispose of Common Shares may be subject to U.S. federal income taxation at the rates applicable to dividends on a portion of their gain, if any.

Section 1248 of the Internal Revenue Code of 1986, as amended (the “Code”) provides that if a U.S. person sells or exchanges stock of a foreign corporation and that person owned, directly, indirectly through certain foreign entities or constructively, 10% or more of the voting power of the corporation at any time during the five-year period ending on the date of disposition when the corporation was a CFC, any gain from the sale or exchange of the shares will be treated as a dividend to the extent of that person’s share of the CFC’s earnings and profits (determined under U.S. federal income tax principles) during the period that person held the shares and while the corporation was a CFC (with certain adjustments). We believe that because of the dispersion of our Common Share ownership, provisions in our organizational documents that limit voting power and other factors, no U.S. shareholder, other than Fredrick C. Treadway or Treadway Associates, L.P., of American Safety Insurance should be treated as owning (directly, indirectly through foreign entities or constructively) 10% or more of the total voting power of American Safety Insurance. As a result, American Safety Insurance should not be a CFC and Section 1248 of the Code, as applicable under the general CFC rules, should not apply to dispositions of our shares. It is possible, however, that the IRS could challenge these provisions in our organizational documents and that a court could sustain that challenge. To the extent American Safety Insurance is a CFC, a 10% U.S. Shareholder may in certain circumstances be required to report a disposition of Common Shares by attaching IRS Form 5471 to the U.S. federal income tax or information return that it would normally file for the taxable year in which the disposition occurs.

For purposes of Section 1248 of the Code and the requirement to file Form 5471, special rules apply with respect to a U.S. person’s disposition of shares of a foreign insurance company that has RPII during the five-year period ending on the date of the disposition. In general, if a U.S. person disposes of shares in a foreign insurance corporation in which U.S. persons own 25% or more of the shares (even if the amount of gross RPII is less than 20% of the corporation’s gross insurance income and the ownership of its shares by direct or indirect insureds and related persons is less than the 20% threshold), any gain from the disposition may be treated as a dividend to the extent of that person’s share of the corporation’s undistributed earnings and profits that were accumulated during the period that person owned the shares (whether or not those earnings and profits are attributable to RPII). As a result of these special rules and proposed Treasury Department regulations, the IRS may assert that Section 1248 of the Code and the requirement to file Form 5471 apply to dispositions of Common Shares because American Safety Insurance is engaged in the insurance business indirectly through subsidiaries.

U.S. persons who hold Common Shares will be subject to adverse tax consequences if American Safety Insurance is considered to be a Passive Foreign Investment Company (a “PFIC”) for U.S. federal income tax purposes.

If American Safety Insurance is considered a PFIC for U.S. federal income tax purposes, a U.S. person who owns Common Shares will be subject to adverse tax consequences, including subjecting the investor to a greater tax liability than might otherwise apply and subjecting the investor to tax on amounts in advance of when tax would otherwise be imposed, in which case your investment could be materially adversely affected. In addition, if American Safety Insurance were considered a PFIC, upon the death of any U.S. individual owning Common Shares, that individual’s heirs or estate would not be entitled to a “step-up” in the basis of the shares which might otherwise be available under U.S. federal income tax laws. American Safety Insurance does not believe that it is, and does not expect to become, a PFIC for U.S. federal income tax purposes. No assurance can be given, however, that American Safety Insurance will not be deemed a PFIC by the IRS. If American Safety Insurance were considered a PFIC, it could have material adverse tax consequences for an investor that is subject to U.S. federal income taxation. There are currently no regulations regarding the application of the PFIC provisions to an insurance company. New regulations or pronouncements interpreting or clarifying these rules may be forthcoming. We cannot predict what impact, if any, that guidance would have on an investor that is subject to U.S. federal income taxation.

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American Safety Insurance Holdings, Ltd., American Safety Re, American Safety Assurance and Ordinance Holdings, Limited may become subject to Bermuda taxes in the future.

Bermuda currently imposes no income taxes on corporations. American Safety Insurance, American Safety Re and American Safety Assurance have received an assurance from the Bermuda Minister of Finance, under the Exempted Undertakings Tax Protection Act 1966 of Bermuda, as amended (the “Tax Protection Act”), that if any legislation is enacted in Bermuda that would impose tax computed on profits or income, or computed on any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, then the imposition of the tax will not be applicable to American Safety Insurance, American Safety Re or American Safety Assurance until March 28, 2016. No assurance can be given that American Safety Insurance, American Safety Re or American Safety Assurance will not be subject to any Bermuda tax after that date.

The impact of Bermuda’s letter of commitment to the Organization for Economic Cooperation and Development to eliminate harmful tax practices is uncertain and could adversely affect the Bermuda tax status of American Safety Insurance, American Safety Re, and American Safety Assurance.

The Organization for Economic Cooperation and Development (the “OECD”) has published reports and launched a global dialogue among member and non-member countries on measures to limit harmful tax competition. These measures are largely directed at counteracting the effects of tax havens and preferential tax regimes in countries around the world. In the OECD’s report dated April 18, 2002 and updated as of June 2004, Bermuda was not listed as an uncooperative tax haven jurisdiction because it had previously committed to eliminate harmful tax practices and to embrace international tax standards for transparency, exchange of information and the elimination of any aspects of the regimes for financial and other services that attract business with no substantial domestic activity. We are not able to predict what changes will arise from the commitment or whether these changes will subject us to additional taxes.

Risk Factors Relating to the Property and Casualty Insurance Industry

Policy pricing in our industry is cyclical, and our financial results are impacted by that cyclicity.

The property and casualty insurance industry has historically been a cyclical industry consisting of both “hard market” periods and “soft market” periods. The excess and surplus lines market historically has tended to move in response to the underwriting cycles in the standard insurance market. Hard market periods are characterized by shortages of underwriting capacity, limited availability of capital, less competition and higher premium rates. Typically, during hard markets, as rates increase and coverage terms become more restrictive, business shifts from the standard insurance market to the excess and surplus lines market as standard insurance market carriers rely on traditional underwriting techniques and focus on their core business lines. In soft markets, business shifts from the excess and surplus lines market to the standard insurance market as standard insurance market carriers tend to loosen underwriting standards and seek to expand market share by moving into business lines traditionally characterized as “surplus lines.”

Our industry is subject to significant and increasing regulatory scrutiny.

In recent years, the insurance industry has been subject to a significant and increasing level of scrutiny by various regulatory bodies, including state attorneys general and insurance departments, concerning certain practices within the insurance industry. These practices include the receipt of contingent commissions by insurance brokers and agents from insurance companies and the extent to which this compensation has been disclosed, bid rigging and related matters. As a result of these and related matters, there have been a number of recent revisions to existing, or

proposals to modify or enact new, laws and regulations regarding the relationship between insurance companies and producers. Any changes or further requirements that are adopted by federal, state or local governments could adversely affect our business and operating results.

We operate in a heavily regulated industry, and existing and future regulations may constrain how we conduct our business and could impose liabilities and other obligations upon us.

Insurance Regulation. Our primary insurance and reinsurance subsidiaries, as well as our non-subsidiary risk retention group affiliate, are subject to regulation under applicable insurance statutes of the jurisdictions in which they are domiciled or licensed and write insurance. This regulation may limit our ability to, or speed with which we can, effectively respond to market opportunities and may require us to incur significant annual regulatory compliance expenditures. Insurance regulation is intended to provide safeguards for policyholders rather than to protect shareholders of insurance companies. Insurance regulation relates to authorized business lines, capital and surplus requirements, types and amounts of investments, underwriting limitations, trade practices, policy forms, claims practices, mandated participation in shared markets, loss reserve adequacy, insurer solvency, transactions with related parties, changes in control, payment of dividends and a variety of other financial and non-financial components of an insurance company's business. For instance, our insurance subsidiaries are subject to risk-based capital, or RBC, restrictions. RBC is a method of measuring the amount of capital appropriate for an insurance company to support its overall business in light of its size and risk profile. The ratio of a company's actual policyholder surplus to its minimum capital requirements will determine whether any state regulatory action is required. State regulatory authorities use the RBC formula to identify insurance companies which may be undercapitalized and may require further regulatory attention. Each of our domestic insurance subsidiaries satisfies its minimum capital requirements and none of them is identified by any regulatory authority as being undercapitalized or requiring further regulatory attention. A number of legislative initiatives currently are under consideration by Congress. Any changes in insurance laws and regulations could materially adversely affect our operating results. We are unable to predict what additional laws and regulations, if any, affecting our business may be promulgated in the future or how they might be interpreted.

Dividend Regulation. Like other insurance holding companies, American Safety Insurance relies on dividends from its insurance subsidiaries to be able to pay dividends and fulfill its other financial obligations. The payment of dividends by these subsidiaries and other intercompany transactions are subject to regulatory restrictions and will depend on the surplus and earnings of these subsidiaries. As a result, insurance holding companies may not be able to receive dividends from their subsidiaries at times and in amounts sufficient to pay dividends and fulfill their other financial obligations. Additionally, as a Bermuda holding company, American Safety Insurance is subject to Bermuda regulatory constraints that will affect its ability to pay dividends on the Common Shares and to make other payments. Under the Companies Act 1981, of Bermuda ("the Companies Act") insurance holding companies may declare or pay a dividend out of distributable reserves only if it has reasonable grounds to believe that it is, and would after the payment be, able to pay liabilities as they become due and if the realizable value of its assets would thereby not be less than the aggregate of its liabilities and issued share capital and share premium accounts. We do not anticipate paying cash dividends on the Common Shares in the near future.

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

The risk factors presented above are all of the ones that we consider to be material as of the date of this annual report on Form 10-K. However, they are not the only risks facing the company. Additional risks not presently known to us, or which we consider immaterial based on our current knowledge or understanding, may also adversely affect us. There may be risks that a particular investor views differently than we do, and our analysis may be incorrect. If any of the risks that we face actually occurs, our business, financial

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condition and operating results could be materially adversely affected and could differ materially from any possible results suggested by any forward-looking statements that we have made or may make. We expressly disclaim any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required by law.

Item 1B. Unresolved Staff Comments

None

Item 2. Properties

Our offices are located at 31 Queen Street, 2nd Floor, Hamilton, Bermuda, and the telephone number is (441) 296-8560. The principal corporate offices of our U.S. subsidiaries are located at 100 Galleria Parkway, Suite 700, Atlanta, Georgia 30339, and the telephone number is (770) 916-1908.

Item 3. Legal Proceedings

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

Griggs et al. v. American Safety Reinsurance, Ltd. et al., Case No. 2003-31509, Circuit Court, Seventh Judicial District, Volusia County, Florida. Seven plaintiffs filed suit against us and three of our subsidiaries seeking to recover a \$2.1 million loan made by the plaintiffs in 1986 to Ponce Marina, Inc., the former owner of the Harbour Village property. The plaintiffs claimed that we were responsible for the repayment of the loan, with interest. The plaintiffs propounded four theories of liability and the court granted summary judgment for us on three of the theories. However, the court entered judgment on August 10, 2005 against us for approximately \$3.4 million, which includes interest, on the remaining theory. The court held that we, as a condition of our loan, required Ponce Marina, Inc. to demand that the plaintiffs enter into an agreement with Ponce Marina, Inc., to the detriment of their loans and to our benefit, and thus, we had entered into a quasi-contract with the plaintiffs to repay their loan with interest.

On May 18, 2007, the District Court of Appeals of the State of Florida, Fifth District, reversed the judgment against the Company. The Plaintiffs' filed a motion for rehearing with the Appeals Court, which was denied by the Court on July 6, 2007. The Plaintiffs' filed a motion for leave to amend their complaint with the trial court. On September 14, 2007, the trial court issued an order vacating its judgment against the Company, dismissing the Plaintiffs' claims with prejudice and denying Plaintiffs' motion for leave to amend. On October 9, 2007, the Plaintiffs' appealed the denial of their motion for leave to amend. On February 7, 2008, the Plaintiffs filed their initial brief in support of their appeal and an oral argument was held in front of the Fifth District Court of Appeals on October 7, 2008. In November 2008, the Court of Appeals upheld the trial court's denial of Plaintiff's motion for leave to amend. This case is now concluded with no liability on the part of the Company.

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

No matter was submitted to a vote of the Company's security holders during the fourth quarter of the fiscal year ended December 31, 2008.

Executive Officers of the Company

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

<u>Name</u>	<u>Age</u>	<u>Position</u>
Stephen R. Crim	45	President, Chief Executive Officer and Director
Joseph D. Scollo, Jr.	45	Executive Vice President and Chief Operating Officer
William C. Tepe	51	Chief Financial Officer
Randolph L. Hutto	60	General Counsel

Stephen R. Crim became President and Chief Executive Officer of the Company in January 2003. He served as President of the Company's U.S. insurance operations from January 2002 until April 2008. Previously, Mr. Crim had been responsible for various underwriting functions since joining the Company in 1990. Previously, Mr. Crim was employed in the underwriting department of Aetna Casualty and Surety and The Hartford Insurance Company between 1986 and 1990.

Joseph D. Scollo, Jr. became Executive Vice President and Chief Operating Officer of the Company in January 2006. He was Executive Vice President of the Company from January 2003 through January 2006 and assumed the role of President of the U.S. insurance operations in April 2008. He was Executive Vice President of the company from January 2003 through January 2006 and was Senior Vice President-Operations since November 1998. Previously, Mr. Scollo served as Senior Vice President-Operations of United Coastal Insurance Company, New Britain, Connecticut between 1989 and 1998.

William C. Tepe became Chief Financial Officer of American Safety Insurance in November 2005. Prior to joining American Safety Insurance, Mr. Tepe was the Chief Financial Officer for GAB Robins Inc., an international insurance claims management and adjusting company. Mr. Tepe has also been employed in senior financial reporting and accounting positions within major property and casualty insurance companies such as W. R. Berkley Corp. and USF&G Corporation. Mr. Tepe is a certified public accountant.

Randolph L. Hutto became General Counsel and Secretary of the Company in September 2006. Prior to joining the Company, Mr. Hutto served as Executive Vice President, General Counsel and Secretary of NDC Health Corporation, a New York Stock Exchange-listed healthcare claims processing and information management company, from April 2004 to January 2006 and as Executive Vice President and Chief Financial Officer from November 2000 to April 2004.

PART II**Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

The Company's common shares trade on the New York Stock Exchange, Inc. under the symbol "ASI". As of March 11, 2009, there were approximately 653 holders of the Company's common shares. The closing price on March 11, 2009 was \$9.10.

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

<u>Fiscal Year Ended December 31, 2008</u>	<u>High</u>	<u>Low</u>	<u>Close</u>
First Quarter	\$21.06	\$16.00	\$17.10
Second Quarter	18.54	14.38	14.38
Third Quarter	16.97	12.58	15.11
Fourth Quarter	15.17	6.10	13.21
<u>Fiscal Year Ended December 31, 2007</u>	<u>High</u>	<u>Low</u>	<u>Close</u>
First Quarter	\$19.44	\$17.82	\$19.06
Second Quarter	23.96	18.95	23.83
Third Quarter	24.21	18.21	19.82
Fourth Quarter	20.85	17.45	19.65

The Company did not pay any cash dividends during fiscal year 2008 and 2007 and does not intend to pay cash dividends in the foreseeable future. Payment of cash dividends in the future will be periodically reviewed by the Board of Directors. As an insurance holding company, the Company's ability to pay cash dividends to its shareholders will depend, to a significant degree, on the ability of the Company's subsidiaries to generate earnings from which to pay cash dividends to American Safety Insurance Holdings, Ltd. The Company's current plans are for its insurance and reinsurance subsidiaries to principally retain their capital for growth.

The jurisdictions in which American Safety Insurance Holdings, Ltd. and its insurance and reinsurance subsidiaries are domiciled place limitations on the amount of dividends or other distributions payable by insurance companies in order to protect the solvency of insurers. See "Regulatory Environment" in Item 1 of this report.

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid Per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
10/1 – 10/31/2007	-	-	-	500,000
11/1 – 11/30/2007	-	-	-	500,000
12/1 – 12/31/2007	27,300	\$18.75	27,300	472,700
1/1 – 1/31/2008	-	-	27,300	472,700
2/1 – 2/29/2008	-	-	27,300	472,700
3/1 – 3/31/2008	116,500	\$16.95	143,800	356,200
4/1 – 4/30/2008	10,900	\$17.67	154,700	345,300
5/1 – 5/31/2008	93,850	\$16.05	248,550	251,450
6/1 – 6/30/2008	10,000	\$15.90	258,550	241,450
7/1 – 7/31/2008	141,765	\$13.50	400,315	99,685
8/1 – 8/31/2008	<u>99,685</u>	\$15.44	500,000	-
Total	500,000	\$15.59		

The Company completed a stock repurchase program for 500,000 shares of the Company's outstanding common stock on August 12, 2008.

Equity Compensation Plan Information

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for issuance under equity compensation plans
Equity compensation plans approved by security holders ⁽¹⁾	795,553	\$11.25	1,808,847
Equity compensation plans approved by security holders ⁽²⁾	<u>22,672</u>	n/a	<u>4,021</u>
Total	818,225		1,812,868

⁽¹⁾ Includes securities available for future issuance under the 2007 Incentive Stock Option Plan.

⁽²⁾ The 22,672 represents shares actually issued to directors under the 1998 Directors Stock Award Plan. The 4,021 represents the shares available for future awards under the 1998 Directors Stock Award Plan.

Item 6. Selected Financial Data

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

Years Ended December 31

	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
	<u>(dollars in thousands except per share data and ratios)</u>				
Statement of Operations					
Data:					
Gross premiums written	\$ 260,384	\$ 218,370	\$ 239,607	\$ 237,880	\$ 221,576
Net premiums written	179,865	150,001	157,268	138,515	131,664
Net premiums earned	174,471	148,793	146,756	137,580	136,300
Fee income earned	2,632	2,145	1,685	1,197	210
Net investment income	29,591	30,268	21,766	14,316	9,773
Net realized (losses) gains	(14,348)	(311)	1,190	(54)	208
Real estate sales	-	-	-	3,000	67,967
Total revenue	192,322	180,961	171,439	155,874	214,656
Losses and loss adjustment expenses incurred	110,146	91,184	92,329	84,406	93,503
Acquisition expenses	43,484	28,872	27,378	28,752	26,649
Payroll and other underwriting expenses	33,882	26,952	25,043	21,190	19,966
Real estate expenses	(2,747)	326	381	2,439	55,480
Earnings before income taxes	341	28,929	22,846	16,048	18,453
Net earnings	310	28,192	20,532	14,656	14,757
Net earnings per share:					
Basic	\$0.03	\$ 2.65	\$2.35	\$2.18	\$ 2.15
Diluted	\$0.03	\$ 2.56	\$2.26	\$2.05	\$ 2.01
Common shares and common share equivalents used in computing net basic earnings per share	10,459	10,648	8,730	6,737	6,864
Common shares and common share equivalents used in computing net diluted earnings per share	10,686	10,997	9,095	7,164	7,343
Balance Sheet Data (at end of period):					
Total investments, excluding real estate	\$ 673,739	\$617,211	\$551,158	\$415,497	\$327,037
Total assets	1,026,364	934,009	847,131	694,999	583,204
Unpaid losses and loss adjustment expenses	586,647	504,779	439,673	393,493	321,038
Unearned premiums	122,259	111,459	115,198	97,983	93,082
Loans payable	38,932	38,646	38,139	37,810	13,019
Total liabilities	809,334	703,609	650,981	576,564	474,424
Total shareholders' equity	217,030	230,400	196,150	118,435	108,780
GAAP Underwriting Ratios:					
Loss and loss adjustment expense ratio ⁽¹⁾	63.1%	61.3%	62.9%	61.4%	68.6%
Expense ratio ⁽²⁾	42.9%	36.1%	34.6%	36.3%	34.2%
Combined ratio ⁽³⁾	106.0%	97.4%	97.5%	97.7%	102.8%
Other Data:					
Return on average shareholders' equity ⁽⁴⁾	6.6%	13.5%	12.4%	13.0%	14.6%
Debt to total capitalization ratio ⁽⁵⁾	15.2%	14.4%	16.3%	24.2%	10.7%
Net premiums written to equity ⁽⁶⁾	0.8X	0.7X	0.8X	1.2X	1.2X

- (1) *Loss and loss adjustment expenses ratio*: The loss and loss adjustment expenses ratio, expressed as a percentage of loss and loss adjustment expenses to net premiums earned.

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- (2) *Expense ratio*: The expense ratio is the ratio, expressed as a percentage, of acquisition and other operating expenses less fee income to net premiums earned. Our reported expense ratio excludes certain holding company expenses such as interest expense as well as real estate and rescission expenses.

- (3) *Combined ratio:* The combined ratio is the sum of the losses and loss adjustment expenses ratio and the expense ratio.

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- (4) *Return on average shareholders' equity*: Return on average shareholders' equity is the ratio, expressed as a percentage, of net earnings, excluding realized gains and losses, to the average of the beginning of period and end of period total shareholders' equity, excluding accumulated other comprehensive income.

- (5) *Debt to total capitalization ratio*: The debt to total capitalization ratio, is the ratio, expressed as a percentage, of total debt to the sum of total debt and shareholders' equity. The Company's total debt consists solely of loans payable.

- (6) *Net premiums written to equity:* The net premiums written to equity is the ratio of net premiums written to the total shareholders' equity.

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

We are a Bermuda-based specialty insurance and reinsurance company that provides customized products and solutions to small and medium-sized businesses in industries that we believe are underserved by the standard market. For over twenty years, we have developed specialized coverages and alternative risk transfer products not generally available to our customers in the standard market because of the unique characteristics of the risks involved and the associated needs of the insureds. We specialize in underwriting these products for insureds with certain environmental, products liability, construction, healthcare and property risks, as well as developing programs for other specialty classes of risks and providing third party reinsurance.

We segregate our business into insurance operations and other, with the insurance operations being further classified into four segments: excess and surplus lines (E&S), alternative risk transfer (ART), assumed reinsurance (Assumed Re) and runoff. E&S is further classified into seven business lines: environmental, construction, products liability, excess, property, surety and healthcare. ART is further classified into two business lines: specialty programs and fully funded. In our Assumed Re segment, the Company assumes specialty property and casualty business from affiliated and unaffiliated insurers and reinsurers. Run-off includes lines of business that we no longer write.

Within the E&S sub segment, our environmental insurance coverages protect against general liability and environmental exposures for contractors and consultants in the environmental remediation industry and property owners. Construction provides commercial general liability insurance, generally for residential and commercial contractors. Products liability offers general liability and product liability coverages for smaller manufacturers and distributors, non-habitational real estate and certain real property owner, landlord and tenant risks. Excess provides excess and umbrella liability coverages over our own and other carriers' primary casualty policies, with a focus on construction risks. Our property coverage encompasses non-standard, surplus lines commercial property business and commercial multi-peril (CMP) policies. The casualty focus of our CMP products is premises liability. Surety provides payment and performance bonds primarily to the environmental remediation and construction industries. Our healthcare line provides customized liability insurance solutions for long-term care facilities.

In our ART segment, Specialty Programs facilitate the offering of insurance to homogeneous niche groups of risks and we receive a fee for arranging this type of transaction. Our specialty programs consist primarily of casualty insurance coverages for construction contractors, pest control operators, small auto dealers, real estate brokers, restaurant and tavern owners, bail bondsmen and parent/teacher associations. Fully funded policies give our insureds the ability to fund their liability exposure via a self-insurance vehicle. We write fully funded general and professional liability for businesses operating primarily in the healthcare and construction industries.

Our assumed reinsurance segment offers primarily casualty reinsurance products in the form of treaty and facultative contracts. We provide this coverage on an excess of loss and quota share basis. Casualty business includes general casualty, commercial auto, professional liability and workers' compensation. The Company's primary focus is traditional and structured reinsurance for small specialty insurers, risk retention groups and captives.

Our runoff segment includes lines of business that we have placed in run-off, such as workers' compensation, excess liability insurance for municipalities and commercial lines.

The other segment consists of amounts associated with realized gains and losses on investments, certain corporate expenses and real estate operations that were completed in 2005.

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The following information is presented on the basis of accounting principles generally accepted in the United States of America (“GAAP”) and should be read in conjunction with “Business” and “Risk

Factors,” and our consolidated financial statements and the related notes included elsewhere in this report. All amounts and percentages are rounded.

The following table sets forth the Company’s consolidated premium and total revenue information:

Years Ended December 31,

2008

2007

2006

2008 to 2007

2007 to 2006

(dollars in thousands)

Net premiums written:

Excess and Surplus:

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Environmental	\$34,372	\$31,444	\$ 37,746	9.3%	(16.7)%
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Construction	26,649	50,502	92,530	(47.2)	(45.4)
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Products Liability	5,549	3,746	1,524	48.3	145.8
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Excess	1,088	578	670	88.2	(13.7)
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Property	5,900	2,145	-	175.1	-
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Surety	8,333	6,084	3,042	37.0	100.0
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Healthcare

7.955

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-

89,846

94,499

135,512

(4.9)

(30.3)

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Alternative Risk Transfer:						
Specialty Programs	43,849	34,260	21,756	26.9		57.5
					-	
Assumed Re	45,913	21,242	-	116.14	-	
Runoff	<u>257</u>	<u>-</u>	<u>-</u>		-	-

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Total Net Premiums Written	\$ 179,865	\$150,001	\$157,268		
				19.9%	(4.6)%

Net premiums earned:

Excess and Surplus:

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Environmental	\$34,026	\$36,356	\$ 35,138	(6.4)%	3.5%
Construction	37,358	66,450	88,612	(43.8)	(25.0)
Products Liability	4,954	2,382	653	108.0	264.8
Excess	789	527	532	49.7	(.9)
Property	4,905	520	-	830.7	-
Surety	7,355	5,469	2,566	34.5	113.1
Healthcare	<u>3,588</u>	<u>-</u>	<u>-</u>	-	-
	92,975	111,704	127,501	(16.8)	(12.4)
Alternative Risk Transfer:					
Specialty Programs	38,695	27,737	19,255	39.5	44.1
Assumed Re	42,544	9,352	-	354.9	-
Runoff	<u>257</u>	<u>-</u>	<u>-</u>	-	-
Total Net Premiums	\$174,471	\$148,793	\$146,756	17.3%	1.4%

Earned

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Fee Income Earned	2,632	2,145	1,685	22.7	27.3
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Net investment income	29,591	30,268	21,766	(2.2)	39.1
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Net (losses) realized gains	(14,348)	(311) 1,190	(4,513.5)	(126.1)
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Other income	<u>(24)</u>	<u>66</u>	<u>42</u>	(136.4)	54.8
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Total Revenues	\$192,322	\$180,961	\$171,439	6.2%	5.6%
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The following table sets forth the Company's consolidated expenses:

Years Ended December 31,

2008

2007

2006

2008

2007

to to

2007

2006

(dollars in thousands)

Total Expenses:

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Loss and loss adjustment	\$110,146	\$ 91,184	\$ 92,329	19.9%	(1.2)%
expenses incurred					

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Acquisition expenses	43,484	28,872	27,37850.6	5.5
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Payroll expenses	20,667	17,268	14,89619.7	15.9
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Interest expense	3,163	3,283	3,376(3.7)	(2.8)
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Other expenses	13,215	9,684	10,14733.4	1.9
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Minority interest	1,153	(1,245)	(1,873)1,337.0	33.5
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Corporate and other expenses	153	2,986	2,340(94.9)	27.6
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Income taxes	<u>31</u>	<u>737</u>	<u>2,314</u>	(92.7)	(68.1)
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Total expenses	\$192,012	\$152,769	\$150,90725.0%	1.2%
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The following table sets forth the components of the Company's insurance operations GAAP combined ratio for the periods indicated:

	Years Ended December 31,		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Insurance operations:			
Loss & loss adjustment expense ratio	63.1%	61.3%	62.9%

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Expense ratio	<u>42.9</u>	<u>36.1</u>	<u>34.6</u>
Combined ratio	<u>106.0%</u>	<u>97.4%</u>	<u>97.5%</u>

Year Ended December 31, 2008 compared to Year Ended December 31, 2007

Net earnings for the year ended December 31, 2008 were \$0.3 million, or \$0.03 per diluted share, compared to net earnings of \$28.2 million, or \$2.56 per diluted share, for 2007. Net earnings for 2008 were negatively impacted by \$14.3 million of net realized losses on investments, \$5.4 million of prior year adverse reserve development, \$1.6 million reinsurance reinstatement premium and a \$2.5 million provision to increase the valuation allowance on reinsurance recoverables. The 2007 results were negatively impacted by \$2.2 million of prior year reserve development and \$2.3 million of additional ceded reinsurance.

Revenues for the year were \$192.3 million, an increase of 6.3% over 2007. Excluding net realized losses on investments, revenues for the year were \$206.7 million, an increase of \$25.4 million, or 14.0%, over 2007, due to increased net premiums earned. Net premiums earned from our lines of business entered since 2006 from our diversification efforts totaled \$56.8 million, an increase of \$44.0 million over 2007. The increase from the newer lines was partially offset by a decrease in other lines, including a \$29.1 million decrease in our construction line

The 2008 combined ratio was 106.0%, composed of a loss ratio of 63.1% and an expense ratio of 42.9% compared to the 2007 combined ratio of 97.4% comprised of a 61.3% loss ratio and 36.1% expense ratio. The adjustments for the reinsurance reinstatement premiums, the adverse prior year reserve development and the increase in the allowance for reinsurance recoverables increased the combined ratio by

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4.7 percentage points. The 2007 combined ratio was impacted by unfavorable reserve development of \$2.2 million and additional ceded reinsurance premiums of \$2.3 million. During 2008, 33.4% of gross premiums written, compared to 16.7% for 2007, were generated by new products as part of our product diversification strategy, primarily assumed reinsurance and healthcare. As a result, the expense component of the combined ratio has increased due to our investment in these products and will remain higher than historical levels until we achieve critical mass for these products.

The property and casualty insurance market has softened significantly and the number of insurers competing for premium in the excess and surplus lines market has increased. These competitors include several start-up companies as well as larger excess and surplus lines and standard market insurers looking to capture market share by moving from the admitted market to the excess and surplus lines market. This increased competition has caused rates to decline in our targeted markets, in some cases, significantly. Despite this softening trend, we believe there are profitable business opportunities from which we can benefit resulting from our diversification into new geographic locations and lines of business.

Net Premiums Earned

Net premiums earned totaled \$174.5 million in 2008, compared to \$148.8 million in 2007, an increase of 17.3%. Net premiums earned by line of business are described below:

Excess and Surplus Lines

Environmental. Net premiums earned decreased 6.4% to \$34.0 million for the year ended December 31, 2008 compared to \$36.4 million for 2007. As part of the detailed actuarial and underwriting review of the markets and lines of business in the environmental segment, the Company ceased writing contractor business in New York, reduced its focus on the more competitive middle market segment and has increased its efforts in the ProStar market. Net premiums earned for 2008 and 2007 were negatively affected by \$1.6 million and \$2.3 million, respectively, of additional premiums ceded to reinsurers as a result of large losses, primarily related to New York contractor business.

Construction. Net premiums earned decreased 43.8% to \$37.4 million for the year ended December 31, 2008 compared to \$66.5 million for 2007, primarily due to our exercise of underwriting discipline in a soft insurance market, coupled with the softening in the housing market and lower revenue of insureds. The housing market has been negatively impacted by the credit crisis and economy resulting in very little new construction activity throughout the country.

Products Liability. The Company's products liability line began production in July 2006 producing \$5.0 million of net premiums earned in 2008 compared to \$2.4 million in 2007. The products liability business is offered to small and middle market accounts. The Company does not intend to write certain high severity classes of risks such as invasive medical products, pharmaceuticals and nutraceuticals.

Excess. Net premiums earned increased to \$0.8 million for the year ended December 31, 2008 from \$0.5 million for the same period in 2007. The Company's excess product offering is focused primarily in the construction and products liability area. During 2006, we expanded our product to write over other carriers' primary policies and to offer umbrella liability coverage. In 2007, the Company increased the available policy limits to \$10 million.

Property. In 2007, the Company hired an experienced underwriting team to write property and CMP liability coverage with a focus on fire exposed premises liability risks with limited catastrophe exposure, primarily in the eastern United States. For the year ended December 31, 2008, net premiums earned from the property business line was \$4.9 million compared to \$0.5 million in 2007.

Surety. Net premiums earned increased 34.5% to \$7.4 million for the year ended December 31, 2008 compared to \$5.5 million for 2007. The increase in surety premiums is due to the Company continuing to

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focus its growth efforts in the environmental contractor surety market due to the lack of capacity serving this segment of the market. During 2007 we entered into an agreement with a small specialty carrier to provide contract surety to small non-environmental contractors that do not fit the standard surety market.

Healthcare. The Company continued its diversification strategy in 2008 through the acquisition of 100% of the membership interests of LTC Risk Management, LLC and LTC Insurance Services, LLC ("LTC Group"). The LTC Group, now known as ASI Healthcare, provides insurance and risk management solutions for the long-term care industry. Net premiums earned for the period ended December 31, 2008 were \$3.6 million.

Alternative Risk Transfer

Specialty Programs. Net premiums earned increased 39.5% to \$38.7 million for the year ended December 31, 2008 compared to \$27.7 million for 2007. Net premiums earned increased primarily due to the full year impact of the July 1, 2007 casualty reinsurance treaty that increased retention levels on selected programs increasing its earnings potential from underwriting profits. During 2008, the Company added four (4) new programs and had fifteen (15) active programs as of December 31, 2008 compared to twelve (12) active programs at December 31, 2007. The Company's focus on its specialty programs business line is on insurance programs that allow the Company to participate in underwriting profits, while also earning fee income as the policy issuer.

Assumed Reinsurance

The Company began writing third party assumed reinsurance in 2007. Net premiums earned for the year ended December 31, 2008 totaled \$42.5 million compared to \$9.4 million in 2007 due to increased assumed reinsurance premiums written as the Company builds this line of business. The Company's primary focus is on traditional and structured casualty reinsurance for small specialty insurers, risk retention groups and captives. For the year ended December 31, 2008, gross premiums written as a percentage of total assumed reinsurance gross premiums written were 1.6%, 20.6% and 77.8% for facultative, excess of loss and quota share, respectively.

Fee Income Earned

Fee income earned increased 22.7% to \$2.6 million for the year ended December 31, 2008 compared to \$2.1 million for 2007. The increase is primarily attributable to consulting fees earned through our Ordinance subsidiary, which was acquired during the third quarter of 2007, as well as brokerage fees earned from the ASI Healthcare acquisition. Partially offsetting the increase, the Company has experienced an adverse impact on fees received from its fully funded products due to the overall market softening as declining traditional insurance pricing provides a cost effective alternative to self-insurance.

Net Investment Income

Net investment income decreased 2.2% to \$29.6 million for the year ended December 31, 2008, from \$30.3 million for 2007 due to lower investment yields, despite increases in the Company's invested assets. Average invested assets increased to \$645.5 million as of December 31, 2008 from \$584.2 million as of December 31, 2007. The increase in invested assets was due primarily to \$101.0 million of cash flow from

operations. The average pre-tax investment yield decreased from 5.2% for 2007 to 4.6% for 2008.

Net Realized Losses

The \$14.3 million net realized losses in 2008 includes other-than-temporary-impairment charges of \$13.7 million and realized losses of \$1.4 million from the sale of investments due to credit concerns about the financial services sector partially offset by net realized gains of \$0.8 million. All but \$0.4 million of the impairment relates to securities issued by companies in the financial services sector. Net realized losses in 2007 totaled \$0.3 million.

The Company, from time to time, may sell securities in response to market conditions, interest rate fluctuations or credit concerns in accordance with its investment guidelines (described under "Business-Investments") and/or to fund its cash needs or the cash needs of individual operating subsidiaries.

Losses and Loss Adjustment Expenses

Losses and loss adjustment expenses totaled \$110.1 million or 63.1% of net premiums earned for the year ended December 31, 2008 compared to \$91.2 million and 61.3% in 2007. The \$18.9 million increase in losses and LAE is due to higher net earned premiums and \$5.4 million of prior year adverse reserve development.

The table below sets forth the prior year reserve development by the Company for the years ended December 31, 2008 and 2007 (dollars in thousands):

	Years Ended December 31,	
	<u>2008</u>	<u>2007</u>
Excess & Surplus lines		
Environmental	\$ 5,202	\$ 4,066
Construction	-	(728)
Surety	<u>-</u>	<u>(267)</u>
	5,202	3,071
Alternative Risk Transfer		
Programs	(1,913)	(115)
Runoff	<u>2,105</u>	<u>(744)</u>
Total	\$ 5,394	\$ 2,212

The 2008 prior year adverse reserve development primarily relates to increased paid and case reserves related to accident years 2002 through 2006 for environmental contractor business written in New York. In 2008, the Company decided to exit the New York contractor business by non-renewing policies. The adverse development in the runoff line relates to increased estimates of workers' compensation claims related to site cleanup activities following the terrorist attack in New York on 9/11. The adverse development is partially offset by decreases in special programs primarily related to the pest control program.

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The 2007 prior year adverse reserve development for the environmental line primarily relates to increased case reserves on 2004 claims for environmental contractors in New York. This development was partially offset by decreases in construction, surety and runoff business lines reserves.

See “Business-Losses and Loss Adjustment Expenses Reserves” and Note 13 to the Company’s consolidated financial statements for additional information regarding the Company’s reserves for unpaid losses and loss adjustment expenses.

Acquisition Expenses

Policy acquisition expenses are the cost of acquiring policies including commissions, premium taxes paid to states in which we are admitted to conduct business and excise taxes, offset by ceding

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commissions we receive from our reinsurers. Policy acquisition expenses increased to \$43.5 million for the year ended December 31, 2008 from \$28.9 million for 2007. Policy acquisition expenses as a function of net premiums earned increased to 24.9% for the year ended December 31, 2008 from 19.4% for 2007. The increase is due to the change in the mix of business and increased acquisition expense in the specialty program line. The proportion of premiums generated by our assumed reinsurance segment, which is currently comprised primarily of quota share reinsurance treaties that carry higher acquisition expenses, resulted in an increase in acquisition expenses of \$9.4 million. The increase related to the specialty program line was due to a change in our reinsurance structure for specialty programs from quota share, where we received a ceding commission to excess of loss, where no ceding commission is received. Specialty programs acquisition expenses increased by \$7.8 million. Partially offsetting this increase was a decrease in acquisition expense for our construction line of business of \$5.5 million due to a 43.8% reduction in net premiums earned.

Payroll and Other Underwriting Expenses

Payroll and other underwriting expenses increased 25.6% to \$33.9 million for 2008, compared to \$27.0 million for 2007. The increase is due to normal salary increases, increased headcount primarily from the addition of new product lines and acquisitions added with the Company's product diversification strategy, the increase in the allowance established for reinsurance recoverables and higher depreciation, amortization and software maintenance expenses.

Interest Expense

Interest expenses decreased to \$3.2 million for the year ended December 31, 2008 from \$3.3 million for 2007. The decrease was primarily related to lower interest rates experienced in 2008.

Corporate and Other Expenses

Corporate and other expenses were \$0.2 million and \$3.0 million for the periods ended December 31, 2008 and 2007, respectively. The decrease was due to the \$2.8 million reversal of an accrued warranty liability established in 2004 in connection with our former real estate project in Florida, which was essentially completed in 2005.

Minority Interest

Minority interest expense was \$1.2 million for the year ended December 31, 2008 compared to a negative expense of \$1.2 million at December 31, 2007. Our minority interest expense relates to the net earnings of our non subsidiary affiliate, American Safety RRG. In 2008, American Safety RRG had net earnings of \$1.2 million compared to a net loss of \$1.2 million in 2007, due to adverse prior year reserve development.

Income taxes

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Income tax expense totaled \$0.03 million or 9.1% and \$0.7 million, or 2.5% of pre-tax earnings for the years ended December 31, 2008 and 2007, respectively. The reduction in income tax expense is primarily the result of the prior year reserve development and the allowance for reinsurance recoverables, which reduced taxable income in our U.S. subsidiaries. During the year ended December 31, 2008, the Company established a deferred tax asset of \$2.6 million related to realized losses on securities held and established a valuation allowance for the same amount as it determined that it is not more likely than not that all of the deferred tax asset related to realized losses on securities held will be realized.

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Operations by Geographic Segment

The Company operates through its subsidiaries in the U.S. and Bermuda. Significant differences exist in the regulatory environment in each country. The table below describes the Company's operations by geographic segment for the years ended December 31, 2008 and 2007 (dollars in thousands):

<u>December 31, 2008</u>	<u>U.S.</u>	<u>Bermuda</u>	<u>Total</u>
Income Tax	\$ 31	\$ -	\$ 31
Net earnings	\$ (6,920)	\$ 7,230	\$ 310
Assets	\$ 597,725	\$ 428,639	\$1,026,364
Equity	\$ 80,422	\$ 136,608	\$ 217,030

<u>December 31, 2007</u>	<u>U.S.</u>	<u>Bermuda</u>	<u>Total</u>
Income Tax	\$ 737	\$ -	\$ 737
Net earnings	\$ 2,009	\$ 26,183	\$ 28,192
Assets	\$550,485	\$383,524	\$934,009
Equity	\$ 72,900	\$157,500	\$230,400

Net Earnings. Net earnings from Bermuda operations decreased to \$7.2 million for the year ended December 31, 2008, compared to \$26.2 million for 2007, due to an increase of \$6.8 million related to net realized losses on investments, as well as lower gross underwriting profit of \$17.6 million due to higher loss and loss adjustment expenses along with higher acquisition expense. The U.S. operations incurred a net loss of \$6.9 million for the year ended December 31, 2008, compared to net earnings of \$2.0 million for 2007, primarily due to an increase of \$7.3 million related to net realized losses on investments and an increase of \$2.2 million from prior year adverse reserve development.

Assets. Assets from Bermuda operations increased to \$428.6 million at the end of 2008 compared to \$383.5 million at the end of 2007. This increase is primarily due to the 2008 net earnings, along with the increased cash flow from operations due to the increase in net premiums written. Assets from U.S. operations at the end of 2008 increased to \$597.7 million as compared to \$550.5 million at the end of 2007 due to higher cash flow from operations due primarily to the increase in net premiums written.

Equity. Equity of the Bermuda operations decreased to \$136.6 million at the end of 2008 compared to \$157.5 million at the end of 2007 due to higher net unrealized losses on the investment portfolio together with capital of \$14.6 million transferred to the U.S. operations as discussed below. Equity of U.S. operations increased to \$80.4 million at the end of 2008 from \$72.9 million at December 31, 2007 due to capital contributions of \$14.6 million from the parent, \$8.6 million of which was used to acquire the LTC Group, partially offset by current year losses.

Year Ended December 31, 2007 compared to Year Ended December 31, 2006

Net earnings increased 37.3% to \$28.2 million for the year ended December 31, 2007, compared to \$20.5 million for 2006. Total revenues increased 5.6% to \$181 million, as net premiums earned increased 1.4% to \$148.8 million and net investment income increased 39.1% to \$30.3

million. The increase in net investment income related to a 20.9% increase in average invested assets and a 13.3% increase in the

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average yield to 5.1%. Net realized losses on the investment portfolio before taxes were \$311,000 compared to a gain of \$1.2 million in 2006.

The 2007 combined ratio was 97.4% composed of a loss ratio of 61.3% and an expense ratio of 36.1%. Unfavorable reserve development for the year totaled \$2.2 million, increasing the loss ratio by 1.5 percentage points. The 2006 combined ratio was 97.5% composed of a loss ratio of 62.9% and an expense ratio of 34.6%. The 2006 combined ratio was impacted by unfavorable reserve development of \$2.6 million and reinsurance reinstatement premiums of \$3.7 million.

The property and casualty insurance market has softened significantly and the number of insurers competing for premium in the excess and surplus lines market has increased. These competitors include several start-up companies as well as larger excess and surplus lines and standard market insurers looking to capture market share by moving from the admitted market to the excess and surplus lines market. This increased competition has caused rates to decline in our targeted markets, in some cases, significantly. Despite this softening trend, we believe there are profitable growth opportunities from which we can benefit, resulting from our diversification into new geographic locations and lines of business.

Net Premiums Earned

Net premiums earned totaled \$148.8 million in 2007, an increase of 1.4% over 2006. Net premiums earned by line of business are described below:

Excess and Surplus Lines

Environmental. Net premiums earned increased 3.5% to \$36.4 million for the year ended December 31, 2007 compared to \$35.1 million for 2006. In 2007, \$2.3 million of premium was ceded to reinsurers due to adverse loss development. The reserve development and ceded reinsurance adjustments predominantly relate to losses from policies covering New York contractors from accident years 2003 – 2004. The 2006 premium was decreased \$3.7 million resulting from the accrual for reinsurance reinstatement premium resulting from one large New York loss. The Company instituted more restrictive policy forms and underwriting guidelines for such business during 2006 and 2007.

Construction. Net premiums earned decreased 25% or \$22.1 million to \$66.5 million primarily due to our exercise of underwriting discipline in a soft insurance market, coupled with a slowing housing market and rate decreases on business written. The decrease was primarily driven by a decrease in western states (California, Arizona, Colorado, Nevada and Washington), partially offset by an increase in other states as part of our geographic diversification effort implemented in 2006.

Products Liability. The Company's general and products liability product began production in July 2006 with the acquisition of an underwriting team in Middletown, New Jersey producing \$2.4 million of net premiums earned in 2007 compared to \$0.7 million in 2006. The general and products liability business is offered to small and middle market accounts. The Company does not intend to write certain high severity classes of risks such as invasive medical products, pharmaceuticals and nutraceuticals.

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Excess. Net premiums earned remained relatively level at \$0.5 million for the year ended December 31, 2007. The Company's excess product offering is focused primarily in the construction and products liability area. During 2006, we expanded our product to write over other carriers' primary policies and to offer umbrella liability coverage. In 2007 the Company increased the available policy limits to \$10 million.

Property. In 2007, the Company hired an experienced underwriting team to write property and CMP liability coverage with a focus on fire exposed premises liability risks with limited catastrophe exposure, primarily in the eastern United States. For the year ended December 31, 2007, net premiums earned from the property business line was \$0.5 million.

Surety. Net premiums earned increased 113.1% to \$5.5 million for the year ended December 31, 2007 compared to \$2.6 million for 2006. Effective June 1, 2006 the Company did not renew the quota share reinsurance treaty in its surety line contributing to the increase in net premiums earned. The increase in surety net premiums earned is also due to the Company continuing to focus its growth efforts in the environmental contractor surety market due to the lack of capacity serving this segment of the market. The Company also recently expanded its offerings to include non-environmental contractor bonds during 2006. During 2007 we entered into an agreement with a small specialty carrier to provide contract surety to small non-environmental contractors that do not fit the standard surety market.

Alternative Risk Transfer

Specialty Programs. Net premiums earned increased 44.1% to \$27.7 million for the year ended December 31, 2007 compared to \$19.3 million for 2006. Net premiums earned increased primarily due to increased retention levels on selected programs thereby allowing the Company the opportunity to increase its earnings potential from underwriting profits. During 2007 the Company added 3 new programs and had 11 active programs as of December 31, 2007. The Company's focus on its specialty programs business line is on insurance programs that allow the Company to participate in underwriting profits, while also earning fee income as the policy issuer.

Assumed Reinsurance

The Company began writing third party assumed reinsurance in 2007. Treaties written in 2007 include professional liability for accountants and lawyers, general liability for small grocery stores, auto liability, international and domestic D&O and small participation in an international property/catastrophe treaty. Net earned premium for the year ended December 31, 2007 totaled \$9.4 million.

Fee Income Earned

Fee income earned on fully funded policies increased 27.3% to \$2.1 million for the year ended December 31, 2007 compared to \$1.7 million for 2006. The Company has seen some adverse impact from the overall market softening on its production efforts in this line as traditional insurance provides a cost effective alternative to self-insurance.

We introduced a partially funded product to complement our fully funded product. This product is used for entities that want to self insure a portion of their risk and combines a level of underwriting risk with a self insured component.

Net Investment Income

Net investment income increased 39.1% to \$30.3 million for the year ended December 31, 2007 from \$21.8 million for 2006 due to an increase in the Company's invested assets and higher investment yields. Average invested assets increased to \$584.2 million as of December 31, 2007 from \$483.6 million as of December 31, 2006. The increase in invested assets was due to \$67.0 million of cash flow from operations and the \$53.3 million secondary equity offering completed in June 2006. The average pre-tax investment yield increased from 4.5% to 5.1% from 2006

to 2007.

Net Realized Gains

Net realized gains and losses from the sale of investments decreased to a net loss of \$0.3 million for the year ended December 31, 2007 from a gain of \$1.2 million for 2006. The Company from time to time may sell securities in response to market conditions or interest rate fluctuations in accordance with its investment guidelines (described under “Business-Investments”) and or to fund the cash needs of individual operating subsidiaries.

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Losses and Loss Adjustment Expenses

Losses and loss adjustment expenses totaled \$91.2 million or 61.3% of net premiums earned for the year ended December 31, 2007 compared to \$92.3 million and 62.9% in 2006. Due to the impact of rate decreases in the soft insurance market, the Company increased its accrued losses in its environmental line for the 2007 accident year from 53% in 2006 to 63% in 2007.

The table below sets forth the prior year reserve development by the Company for the years ended December 31, 2007 and 2006 (dollars in thousands):

	Years Ended December 31,	
	<u>2007</u>	<u>2006</u>
Excess & Surplus lines		
Environmental	\$ 4,066	\$ 56
Construction	(728)	2,425
Surety	<u>(267)</u>	<u>(224)</u>
	3,071	2,257
Alternative Risk Transfer		
Programs	(115)	641
Runoff	<u>(744)</u>	<u>(300)</u>
Total	\$ 2,212	\$ 2,598

The 2007 prior year adverse reserve development for the environmental line primarily relates to increased case reserves on 2004 claims for environmental contractors in New York. This development was partially offset by decreases in construction, surety and runoff business lines reserves.

The 2006 prior year development in the construction line primarily relates to development in layers that were previously reinsured, but the reinsurance treaty was commuted in 2005. The development in the programs primarily relates to an increase in certain case reserves on policies written in 2004 and 2005. This development is partially offset by reserve reductions in our surety and runoff lines.

See "Business-Losses and Loss Adjustment Expenses Reserves" and Note 13 to the Company's consolidated financial statements for additional information regarding the Company's reserves for unpaid losses and loss adjustment expenses.

Acquisition Expenses

Policy acquisition expenses are amounts that are paid to producers of premium offset by the ceding commissions we receive from our reinsurers. For our program business, fees typically are earned through ceding commissions and have the effect of lowering our acquisition expenses. Policy

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acquisition expenses also include amounts paid for premium taxes to the states where we do business on an admitted basis. Policy acquisition expenses increased to \$28.9 million for the year ended December 31, 2007 from \$27.4 million for 2006. Policy acquisition expenses as a function of net premiums earned increased to 19.4% for the year ended December 31, 2007 from 18.7% for 2006, primarily due to the mix of business the Company writes and a new excess of loss reinsurance treaty that went into effect July 1, 2007 where we do not receive a ceding commission.

Payroll and Other Underwriting Expenses

Payroll and other underwriting expenses increased to \$27.0 million for the year ended December 31, 2007 from \$25.0 million for 2006. The change is primarily due to an increased number of employees which was 178 at December 31, 2007 compared to 145 at the same date 2006.

Interest Expenses

Interest expense decreased to \$3.3 million for the year ended December 31, 2007 from \$3.4 million for 2006.

Corporate and Other Expenses

Corporate and other expenses were \$3.0 million and \$2.3 million for the periods ended December 31, 2007 and 2006 respectively.

Minority Interest

Minority interest expense was a loss of \$1.2 million for the year ended December 31, 2007 compared to a loss of \$1.9 million at December 31, 2006. Our minority interest expense relates to our non subsidiary affiliate, American Safety RRG. In 2007 and 2006, American Safety RRG had a net loss due to reserve development on its environmental line of business.

Income Taxes

Income tax expense totaled \$0.7 million or 2.6% of pre-tax earnings for the year ended December 31, 2007, compared to \$2.3 million or 10.1% of pre-tax earnings for 2006. The reduction in expense is primarily the result of the prior year reserve development which reduced taxable income in our U.S. subsidiaries. Included in tax expense for 2006, is the establishment of a valuation allowance for American Safety RRG of \$1.1 million and 2005 provision to return adjustments for permanent differences in the 2005 federal and state income tax returns of \$483,000. The establishment of the valuation allowance is reflected in minority interest on the consolidated financial statements. Absent these adjustments, the effective tax rate for 2006 would have been 5.1%. The reduction in the effective rate is due to lower earnings from U.S. operations from the impact of reinstatement premiums and prior-year loss development.

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Operations by Geographic Segment

The Company operates through its subsidiaries in the U.S. and Bermuda. Significant differences exist in the regulatory environment in each country. The table below describes the Company's operations by geographic segment for the years ended December 31, 2007 and 2006 (dollars in thousands):

<u>December 31, 2007</u>	<u>U.S.</u>	<u>Bermuda</u>	<u>Total</u>
Income Tax	\$ 737	\$ -	\$ 737
Net earnings	\$ 2,009	\$ 26,183	\$ 28,192
Assets	\$550,485	\$ 383,524	\$ 934,009
Equity	\$ 72,900	\$ 157,500	\$ 230,400

<u>December 31, 2006</u>	<u>U.S.</u>	<u>Bermuda</u>	<u>Total</u>
Income Tax	\$ 2,314	\$ -	\$ 2,314
Net earnings	\$ 3,491	\$ 17,041	\$ 20,532
Assets	\$509,552	\$337,579	\$ 847,131
Equity	\$ 66,896	\$129,254	\$ 196,150

Net Income. Net income from Bermuda operations increased to \$26.2 million for the year ended December 31, 2007, compared to \$17.0 million for 2006, due to higher investment income as a result of increased invested assets from our \$53.0 million secondary offering in 2006 and the addition of the third party assumed reinsurance business in 2007. Net income from U.S. operations decreased to \$2.0 million for the year ended December 31, 2007, compared to \$3.5 million for 2006, primarily due to prior year loss development and accrued ceded reinsurance reinstatement premium.

Assets. Assets from Bermuda operations increased to \$383.5 million at the end of 2007 compared to \$337.6 million at the end of 2006. This increase is primarily due to the 2007 net earnings, along with the increased unrealized gains on the investment portfolio. Assets from U.S. operations at the end of 2007 increased to \$550.5 million as compared to \$509.5 million at the end of 2006.

Equity. Equity of the Bermuda operations increased to \$157.5 million at the end of 2007 compared to \$129.3 million at the end of 2006 due to higher net income and an improvement in net unrealized gains on the investment portfolio. Equity of U.S. operations increased to \$72.9 million at the end of 2007 from \$66.9 million at December 31, 2006 due to an increase in net unrealized gains on the U.S. insurance operations invested assets.

Fair Value Measurements

Effective January 1, 2008, on a prospective basis, we determined the fair values of certain financial instruments based on the fair value hierarchy established in Statement of Financial Accounting Standard 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value.

Level 1: quoted price (unadjusted) in active markets for identical assets

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Level 2: inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the instrument

Level 3: inputs to the valuation methodology are unobservable for the asset or liability

SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

Our Level 1 instruments are primarily U.S. Treasuries, money market funds and equity securities listed on stock exchanges. We use quoted prices for identical instruments to measure fair value.

Our Level 2 instruments include most of our fixed income securities, which consist of U.S. government agency securities, municipal bonds, certain corporate debt securities, and certain mortgage and asset-backed securities. We measure fair value of our Level 2 instruments using quoted prices of securities with similar characteristics.

Our Level 3 instruments include certain fixed maturity securities and an investment in an unrelated third party insurance entity. Fair value is based on internally developed criteria that use assumptions or other data that are not readily observable from objective sources.

As management is ultimately responsible for determining the fair value measurements for all securities, we validate prices received by comparing the fair value estimates to our knowledge of the current market and investigate any prices deemed not to be representative of fair value.

Assets measured at fair value on a recurring basis are summarized below:

As of December 31, 2008

Fair Value Measurements Using

(dollars in thousands)

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Fixed maturities	\$ 38,621	\$523,882	\$7,407	\$569,910
Equities securities	18,742	-	5,082	23,824
Short term investments	<u>80,005</u>	<u>-</u>	<u>-</u>	<u>80,005</u>
Total	\$137,368	\$523,882	\$12,489	\$673,739

Fair Value Measurements
Using Significant
Unobservable Inputs (Level 3)

(dollars in thousands)

Fixed

Maturities

Equities

Level 3 Financial Instruments:

Balance at January 1, 2008	\$ -	\$ 2,611
Total gains (losses) (realized/unrealized):		
Included in earnings	-	-
Included in other comprehensive income	211	-
Net purchases	6,986	2,471
Net transfers in (out of) Level 3	<u>210</u>	<u>-</u>
Balance at December 31, 2008	\$ 7,407	\$ 5,082

Change in net unrealized gains relating to assets still held at reporting date

\$ 211 \$ -

On a quarterly basis, we evaluate whether the fair values of the Company's individual securities are other-than-temporarily impaired when the fair value is below amortized cost. To make this assessment we consider several factors including (i) our intent and ability to hold the security, (ii) the potential for the security to recover in value, (iii) an analysis of the financial condition of the issuer, (iv) an analysis of the collateral structure and credit support of the security, if applicable, (v) the time during which there has been a decline below cost, and (vi) the extent of the decline below cost. If we conclude a security is other-than-temporarily impaired, we write down the amortized cost of the security to fair value, with a charge to net realized investment losses in the Consolidated Statements of Operations.

After a review of the individual securities in the investment portfolio, the Company recorded \$13.7 million of net realized losses due to other-than-temporary-impairment of its investments. All but \$0.4 of the impairment relates to securities issued by companies in the financial services sector. Other-than-temporary-impairment totaled \$9.5 million of fixed maturities, \$3.2 million of preferred stock and \$1.0 million of common stock. The analysis to determine other-than-temporary-impairment was completed on all securities with additional focus on securities with unrealized losses greater than 30% of book value and securities whose unrealized loss was greater than 20% of book value for more than three months.

Liquidity and Capital Resources

The Company meets its cash requirements and finances its growth principally through cash flows generated from operations. Due to the soft market, the Company has experienced a reduction in premium rates due to the entrance of new insurance competitors and overall market conditions. The Company's primary sources of short-term cash flow are premium writings and investment income. Short-term cash requirements relate to claims payments, ceded reinsurance premiums, commissions, salaries, employee benefits and other operating expenses. Due to the uncertainty regarding the timing and amount of settlements of unpaid claims, the Company's future liquidity requirements may vary; therefore, the Company has structured its investment portfolio maturities to help mitigate the variations in those factors. The Company believes its current cash flows are sufficient for the short-term needs of its business and its invested assets are sufficient for the long-term needs of its insurance business.

Net cash provided by operations was \$101.0 million for the year ended December 31, 2008 and \$67.0 million for the year ended December 31, 2007. The cash flow from operations increased in 2008 compared to 2007 primarily due to an increase in premium and reinsurance recoverable receipts partially offset by higher paid claims, acquisition expenses and other operating expenses.

Net cash used in investing activities was \$93.8 million for the year ended December 31, 2008, compared to net cash used in investing activities of \$66.4 million for the same period of 2007. The increase in net cash used in investing activities was primarily due to a net purchase of investments of \$79.4 million for 2008 compared to a net purchase of investments during the 2007 period of \$61.6 million. In addition, during 2008, consideration paid for acquired subsidiaries totaled \$8.9 million including direct transaction costs.

Net cash used in financing activities was \$7.1 million for the year ended December 31, 2008. The use of cash was due to the repurchase of 472,700 shares of the Company's common stock for \$7.3 million, or a weighted average price of \$15.41 partially offset by funds received from stock option exercises of \$0.5 million. During the corresponding 2007 period, there were stock option exercises of \$1.5 million and 27,300 share repurchases of the Company's stock for \$0.5 million, or a weighted average price of \$18.75.

Our ability to pay future dividends to shareholders will depend, to a significant degree, on the ability of our subsidiaries to generate earnings from which to pay dividends. The jurisdiction in which we and our insurance and reinsurance subsidiaries are domiciled places limitations on the amount of dividends or other distributions payable by insurance companies in order to protect the solvency of insurers. Given our growth and the capital requirements associated with that growth, we do not anticipate paying dividends on the common shares in the near future.

In June 2006 the Company completed a secondary equity offering of 3,680,000 common shares, raising approximately \$53.3 million net of underwriting expenses. The proceeds of the offering were used to support the growth in insurance operations. Additionally, in November 2005, in conjunction with American Safety Capital Trust III, the Company issued a 30-year trust preferred obligation in the amount of \$25.0 million. This obligation bears a fixed interest rate of 8.31% for the first five years, and a floating rate of three-month LIBOR plus 3.4% thereafter. Interest is payable on a quarterly basis and the securities may be called solely at the Company's option after five years.

Contractual Obligations

Our contractual obligations (in thousands of dollars) as of December 31, 2008 were:

		<u>Less than 1 year</u>	<u>1-3</u>	<u>3-5</u>	<u>More than 5</u>
	<u>Total</u>		<u>Years</u>	<u>Years</u>	<u>Years</u>
Long term debt	\$ 38,932	\$ -	\$ -	\$ -	\$ 38,932
Interest (1)	64,667	2,894	4,993	4,424	52,356
Operating leases	7,100	1,507	2,780	2,538	275
Gross loss reserves (2)	<u>586,647</u>	<u>124,721</u>	<u>245,922</u>	<u>36,431</u>	<u>179,573</u>
Total contractual obligations	\$697,346	\$ 129,122	\$253,695	\$ 43,393	\$271,136

(1) The above table includes all interest payments through the expiration of interest rate swaps as discussed in Note 8 to the Company's consolidated financial statements. At that time the Company may redeem the debt or continue with variable interest payments. All amounts are reflected based on final maturity dates. Variable rate interest obligations are estimated based on current interest rates. As a result of applying interest rates based on the current LIBOR rate plus the contractual spread for each capital trust, the interest rates were 6.38%, 6.13% and 8.31% for American Safety Capital Trust, American Safety Capital Trust II and American Safety Capital Trust III, respectively as of December 31, 2008. These rates are used to calculate the variable interest rate obligations through maturity. Fixed rates include, where applicable, the effects of interest rate derivatives employed to manage such interest rate risk.

(2) The above table includes the expected settlement of our gross loss reserves. The Company relies on reinsurance to reduce current risk exposures. The expected payoff of gross loss reserves net of reinsurance recoverables is as follows (dollars in thousands): total \$393,309; \$100,923 less than a year, \$215,140, 1-3 years, \$35,123, 3-5 years and \$42,123, more than 5 years. More information about our unpaid loss and loss adjustment expenses appears in Note 13 to our consolidated financial statements.

For these purposes, routine purchases of services, including insurance, that are expected to be used in the ordinary course of the Company's business have been excluded. More information about our contractual obligations appears in Notes 9 and 12 to our consolidated financial statements.

Recent Accounting Pronouncements

See Note 1(n), "Summary of Significant Accounting Policies," to the Company's consolidated financial statements included herein for a discussion on recent accounting pronouncements.

Critical Accounting Policies

The accounting policies described below are those we consider critical in preparing our financial statements. These policies include significant estimates made by management using information available at the time the estimates are made. However, as described below, these estimates could change materially if different information or assumptions were used and there is no assurance that actual results will not differ materially from the estimates.

Investments. We routinely review our investments that have experienced declines in fair value to determine if the decline is other than temporary. These reviews are performed with consideration of the facts and circumstances of an issuer in accordance with the Securities and Exchange Commission (“SEC”) Staff Accounting Bulletin No. 59, Accounting for Non-Current Marketable Equity Securities; Statement of Financial Accounting Standards (“SFAS”) No. 115, Accounting for Certain Investments in Debt and Equity Securities; and Issue No. 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments; FASB Staff Position No. FAS 115-1 and related guidance. The identification of

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distressed investments and the assessment of whether a decline is other than temporary, involve significant management judgment and require evaluation of factors including but not limited to:

- percentage decline in value and the length of time during which the decline has occurred;
- recoverability of principal and interest;
- market conditions;
- ability and intent to hold the investment to recovery;
- a pattern of continuing operating losses of the issuer;
- rating agency actions that affect the issuer's credit status;
- adverse changes in the issuer's availability of production resources, revenue sources, technological conditions; and
- adverse changes in the issuer's economic, regulatory or political environment.

The Company had impairment charges of \$7.7 million and \$1.4 million realized loss due to the sale of investments in the third quarter and \$6.0 million in the fourth quarter of 2008. The Company in conjunction with its investment advisor, monitors its investments for potential impairments. See "Business-Investments" for information as to the credit quality of its investment portfolio. At December 31, 2008, 94.5% of the investment portfolio was rated A or better by S&P and Moody's, with 54.1% being rated AAA.

Effective January 1, 2008, on a prospective basis, we determined the fair values of certain financial instruments based on the fair value hierarchy established in Statement of Financial Accounting Standard 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value.

Level 1: quoted price (unadjusted) in active markets for identical assets

Level 2: inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the instrument

Level 3: inputs to the valuation methodology are unobservable for the asset or liability

SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

Our Level 1 instruments are primarily U.S. Treasuries, money market funds and equity securities listed on stock exchanges. We use quoted prices for identical instruments to measure fair value.

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Our Level 2 instruments include most of our fixed income securities, which consist of U.S. government agency securities, municipal bonds, certain corporate debt securities, and certain mortgage and asset-backed securities. We measure fair value of our Level 2 instruments using quoted prices of securities with similar characteristics.

Our Level 3 instruments include certain fixed maturity securities and an investment in an unrelated third party insurance entity. Fair value is based on internally developed criteria that use assumptions or other data that are not readily observable from objective sources.

If all securities carrying an unrealized loss were determined to be other than temporarily impaired, our future earnings would be reduced by the \$20.8 million carried unrealized loss on investments at December 31, 2008. The Company's portfolio managers routinely monitor and evaluate the difference between the cost and fair value of our investments. Additionally, credit analysis and/or credit rating issues related to

specific investments may trigger more intensive monitoring to determine if a decline in market value is other than temporary. For investments with a market value below cost, the process includes evaluating the length of time and the extent to which cost exceeds market value, the prospects and financial condition of the issuer, and evaluation for a potential recovery in market value, among other factors. As a result, management concluded that the recoverability of the principal and interest on these investments is reasonably assured and no additional impairments needed to be recognized.

At December 31, 2008, mortgage backed securities comprised 27.6% of the entire portfolio. All mortgage backed securities are issued by agencies of the U.S. Government. The single largest security in this class is a Ginnie Mae investment with a \$7.4 million par value. In the corporate sector, the Company has concentrations in the industrial sector with par value of \$155.8 million or 24.5% of the total portfolio, with the largest single security being McDonalds Corporation having a par value of \$4.0 million. The Company also has concentrations in the financial services sector with \$69.4 million or 10.9% of the total portfolio, with the largest single security being Goldman Sachs Group, Inc. with a par value of \$4.8 million. U.S. Government securities were 5.3% of the total portfolio with the largest security being a U.S. Treasury note, having a par value of \$5.6 million.

Reserves. Claims made policies provide coverage for claims that are incurred and reported during the policy period. Occurrence form policies provide coverage for claims that occur during the policy period regardless of when they are reported. Certain of our insurance policies and reinsurance assumed are occurrence policies and therefore may be subject to claims brought years after an incident has occurred or the policy period has ended. We are required to maintain reserves to cover the unpaid portion of our ultimate liability for losses and loss adjustment expenses with respect to (i) reported claims and (ii) incurred but not reported (IBNR) claims. A full actuarial analysis is performed annually to estimate all of our unpaid losses and loss adjustment expenses under the terms of our contracts and agreements. In evaluating whether the reserves are adequate for unpaid losses and loss adjustment expenses, it is necessary to project future losses and loss adjustment expenses payments. It is certain that the actual future losses and loss adjustment expenses will not develop exactly as projected and may, in fact, vary materially from the projections.

With respect to reported claims, reserves are established on a case-by-case basis. The reserve amounts on each reported claim are determined by taking into account the circumstances surrounding each claim and policy provisions relating to the type of loss. Loss reserves are reviewed on a regular basis, and as new information becomes available, appropriate adjustments are made to reserves. See "Business-Losses and Loss Adjustment Expense Reserves" for a description of reserve methodology.

The Company does not write a material amount of short-tail business. Short-tail business is defined as business for which claims are received and settled within one year. Total net reserves for short tail business are not material and as of December 31, 2008 were approximately 1.4% of total net reserves. In the aggregate, our primary long-tail lines are construction, where we offer general liability insurance to construction contractors and environmental where we offer general liability and professional liability insurance to environmental contractors and consultants.

Because the Company primarily writes long-tail business, the current year ultimate loss reserve is developed using the expected loss ratio method. The method is appropriate because there are very few claims reported from the most recent accident year for long-tail lines of business. The expected loss ratio is determined based on the review of the projected ultimate loss ratios for the prior accident years. At December 31, 2008 the carried loss and loss adjustment reserves for accident years prior to 2008 were determined largely based on the indications produced by the Bornhuetter-Ferguson method because of the additional claims experience gained as the business line matures.

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On a quarterly basis, the Company's in-house internal actuary performs a review of our major lines of business with significant net exposure. The evaluation entails the examination of our current actuarial assumptions compared to actual claim activity. If there is a material deviation from actual emerged losses and the actuarially determined expected losses, further research is completed to determine the cause. Discussions with the claims staff and the underwriting staff about these deviations, in some cases, reveal trends that warrant modifications of the current assumptions about loss development patterns and or expected loss ratios. Based on these latest loss reserve projections, management establishes revised estimates of loss reserves primarily due to increased paid case reserves related to accident years 2002 through 2006 for environmental contractor business written in New York, as well as increases in the runoff line related to increased estimates of workers' compensation claims related to site cleanup activities following the terrorist attack in New York on 9/11. In 2008, the Company decided to exit the New York contractor business. The adverse development is partially offset by decreases in specialty programs primarily related to the pest control program.

As part of our year-end process, the Company has an external actuarial firm review the analysis prepared by our internal actuary and it issues an actuarial opinion on the insurance operating companies' reserve adequacy.

The carried gross loss reserves for each line of business are as follows (in thousands of dollars):

December 31, 2008					
	<u>Loss</u>	<u>Loss Adjustment</u>			<u>Total</u>
	<u>Case</u>	<u>IBNR</u>	<u>Case</u>	<u>IBNR</u>	<u>Case and IBNR</u>
Environmental	\$22,794	\$ 40,295	6,037	26,863	\$ 95,989
Construction	16,428	134,717	6,956	89,811	247,912
Products liability	1,420	6,576	73	4,384	12,453
Excess	-	3,222	-	2,148	5,370
Property	916	1,463	89	976	3,444
Surety	(2,311)	2,308	85	1,538	1,620
Healthcare ⁽¹⁾	<u>546</u>	<u>1,337</u>	<u>92</u>	<u>891</u>	<u>2,866</u>
Subtotal	39,793	189,918	13,332	126,611	369,654
Programs ⁽²⁾	26,264	69,977	8,350	46,651	151,242
Assumed Re	6,512	31,693	1,628	7,923	47,756
Runoff	<u>7,409</u>	<u>6,083</u>	<u>448</u>	<u>4,055</u>	<u>17,995</u>
Total	<u>\$79,978</u>	<u>\$297,671</u>	<u>\$23,758</u>	<u>\$185,240</u>	<u>\$586,647</u>

⁽¹⁾ Line of business acquired in 2008

⁽²⁾ Represents 33 different programs with diverse risks. Some programs are in runoff.

December 31, 2007

	<u>Loss</u>		<u>Loss Adjustment</u>		<u>Total</u>
	<u>Case</u>	<u>IBNR</u>	<u>Case</u>	<u>IBNR</u>	<u>Case and IBNR</u>
Environmental	\$ 30,889	\$ 31,863	\$ 5,213	\$ 21,242	\$ 89,207
Construction	24,001	127,676	5,161	85,118	241,956
Products liability	1,182	1,721	70	1,157	4,130
Excess	-	4,121	-	2,747	6,868
Property ⁽¹⁾	13	246	20	164	443
Surety	<u>(2,993)</u>	<u>1,156</u>	<u>214</u>	<u>770</u>	<u>(853)</u>
	53,092	166,783	10,678	111,198	341,75
Programs ⁽²⁾	22,791	61,056	7,854	40,704	132,405
Assumed Re ⁽¹⁾	294	6,159	-	-	6,453
Runoff	<u>13,039</u>	<u>6,254</u>	<u>708</u>	<u>4,169</u>	<u>24,170</u>
Total	\$ 89,216	\$240,252	\$19,240	\$156,071	\$504,779

⁽¹⁾ New products launched in 2007.

⁽²⁾ Represents 30 different programs with diverse risks. Some programs are in runoff.

Construction: In addition to evaluating the loss reserves on all exposures on a combined basis the actuarial staff evaluated reserves for each of the following exclusive categories: (1) construction defect claims in California; (2) construction defect in all other states; (3) commercial and residential contractors claims other than construction defects; (4) claims in New York state; (5) claims from product liability exposures; (6) claims from habitational risks; and (7) claims from miscellaneous risks.

Construction defect claims in general had a higher frequency, a lower severity and a longer reporting period then other types of claims. The construction defect exposures in California were analyzed separately from other states because of the state's relatively longer statute which makes the claim reporting period longer, and the litigious environment, which makes the claims more expensive. Other commercial and residential contractors' claims tended to be high in severity. The Company wrote New York commercial contractor risks in 1999, 2000 and 2001. Due to the short amount of time we wrote this business and the higher severity in New York claims, the reserves for these exposures are calculated separately. Products liability claims tended to be severe and took a longer time to report. The habitational exposures were mostly slips and falls on the insured premises with low severity and frequency.

Environmental: Most exposures involved common types of bodily injury and property damage claims. These claims tend to be reported sooner but take longer to settle because often times multiple parties are involved in a claim. The loss development patterns and the expected loss ratios are estimated based on our actual emerged losses.

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Variability of Loss Reserves Based on Reasonably Likely Assumptions

A number of assumptions were made in the determination of the best reserve estimates for each line of business at December 31, 2008. The key assumptions among them were the expected loss ratios and loss development patterns. If the actual future losses and loss adjustment expenses develop materially differently from those key assumptions, there could be a potential for significant variation in the development of loss reserves. The effect of any specific assumptions can vary by accident year and line of business. We performed sensitivity analyses that tested the effects on the loss reserve position of using alternative loss ratios and loss development patterns rather than those actually used in determining the net carried reserve at December 31, 2008. The tests addressed each major line of business for which a material deviation to the overall reserve position is believed reasonably possible and used what we believed was reasonably likely range of potential deviation for each line of business. If our net carried reserves were to decrease from our best estimate, this would increase our net earnings, while an increase in our net carried reserves would decrease our earnings.

The following table displays the resulting range of potential deviation of the net carried reserves for each line of business at December 31, 2008 (in thousands of dollars):

	Possible Amount Change			Possible Percentage Change	
	<u>From The Carried Reserves</u>			<u>From The Carried Reserves</u>	
	<u>Net Carried</u>				
	<u>Reserves</u>	<u>(Decrease)</u>	<u>Increase</u>	<u>(Decrease)</u>	<u>Increase</u>
Excess & Surplus Lines:					
Environmental	\$ 72,983	\$ (9,433)	\$ 6,364	(13)%	9%
Construction	200,156	(38,471)	24,793	(19)	12
Products liability	5,015	(1,617)	1,906	(32)	38
Excess	1,642	(460)	-	(28)	-
Property	2,228	(750)	907	(34)	41

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Healthcare		<u>1,863</u>	<u>(241)</u>	<u>162</u>	(13)	9
Total	287,207	(51,066)	34,204	(18)	12	
Alternative Risk Transfer: Specialty programs ⁽¹⁾	51,163	-	-	-	-	-
Assumed reinsurance	40,913	(10,838)	13,914	(26)	34	
Runoff	<u>14,026</u>	<u>(287)</u>	<u>236</u>	(2)	2	
Total Net Reserves	\$393,309	\$(62,191)	\$48,354	(16)%	12%	

⁽¹⁾ Represents 33 different programs with diverse risks. Some programs are in runoff. Each individual program is not material to our total net carried reserves therefore no variability has been shown.

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Ceded Reinsurance. Ceded unearned premiums and reinsurance balances recoverable on paid and unpaid losses and settlement expenses are reported separately as assets, instead of being netted with the related liabilities, since reinsurance does not relieve us of our legal liability to our policyholders. We continuously monitor the financial condition of our reinsurers. Our policy is to periodically charge to earnings, in the form of an allowance, an estimate of unrecoverable amounts from troubled or insolvent reinsurers. We believe that current reserve levels for uncollectible reinsurance are sufficient to cover our exposures.

The following table depicts the effects on our financial position and results of operations of our ceded reinsurance activities (in thousands of dollars):

	Years Ended December 31,		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Shareholders' equity as reported	\$ 217,030	\$230,400	\$ 196,150
Net effects of reinsurance	<u>(1,665)</u>	<u>(861)</u>	<u>(7,536)</u>
Shareholders' equity without reinsurance	\$ 215,365	\$229,539	\$ 188,614
Net earnings as reported	\$ 310	\$ 28,192	\$ 20,532
Effects of reinsurance	<u>(1,665)</u>	<u>(861)</u>	<u>(7,536)</u>
Net earnings without reinsurance	\$ (1,355)	\$ 27,331	\$ 12,996
Net cash flow from operations	\$ 7,295	\$ 8,851	\$ 1,044

Effective September 1, 2008 the Company renewed its excess of loss reinsurance treaty on our casualty lines of business. The cost of the reinsurance provided by the renewal varies based on premium and the area of coverage. The renewal provides four areas of coverage on essentially an as expiring basis, summarized as follows:

Casualty Lines – \$4.5 million excess of \$500,000, covering all casualty lines other than surety, commercial umbrella and excess. The treaty also provides excess coverages of \$6.0 million excess of \$5.0 million atop the environmental lines layer with 100% of the risk ceded to the reinsurers.

Umbrella and Excess - \$5 million quota share placed on a cessions basis for umbrella and excess business on policies written over primary general liability policies both written by the Company as well as other insurers.

Effective September 1, 2008, the Company renewed the treaty providing protection from claims associated with bad faith allegations, improper claims handling and multiple insured being involved in the same occurrence. This reinsurance provides limits of \$5.0 million per occurrence, subject to an aggregate limit of \$15 million.

Effective May 1, 2008, the Company entered a consolidated surety reinsurance treaty providing \$7.5 million of limits with \$1,000,000 per principal retention by the Company. Coverage extends to all of the Company's surety operations.

Effective September 1, 2007 the Company entered a consolidated property reinsurance treaty providing \$10 million of limits with a \$500,000 per occurrence retention by the Company. The treaty also provides protection for multiple losses arising out of one occurrence, with limits totaling \$20.5 million across all layers. Loss adjustment expense is provided on a prorated basis in addition to the treaty limits shown above. The renewal date of this has been extended to April 1, 2009.

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For the period of July 1, 2007 through September 1, 2008, the Company was covered under an excess of loss reinsurance treaty on our casualty lines of business. Under this treaty, the Company retains the first \$500,000 of a loss and has a 10% participation in the \$4.5 million excess of \$500,000 layer for its environmental, construction and products liability lines of business, as well as the general liability portion of its property line. The Company retains the first \$250,000 of a loss on certain of its program lines of business, participates 50% of the next \$250,000 and 10% of the \$4.5 million in excess of \$500,000. The treaty provides that the Company retains a 10% quota share on the first \$5 million of loss on the excess line of business and provides coverage on policies up to a \$10 million limit.

Policy Acquisition Costs. We defer commissions, premium taxes and other expenses that are related to the acquisition of insurance contracts. These costs are capitalized and charged to expense in proportion to premium revenue recognized. The method followed in computing deferred policy acquisition costs limits the amount of such deferred costs to their estimated realizable value. This would also give effect to the premiums to be earned and anticipated losses and settlement expenses as well as certain other costs expected to be incurred as the premiums are earned. Judgments as to the ultimate recoverability of such deferred costs are highly dependent upon estimated future loss costs associated with the premiums written as well as investment income.

Deferred Income Taxes. We are required to establish a valuation allowance for the portion of any deferred tax asset that we believe will not be realized. The majority of our deferred taxes associated with our premium writings will be realized over the policy period and payout of related claims. We believe it is more likely than not that we will realize the full benefit of our deferred tax assets, except for deferred tax assets associated with American Safety RRG. See Note 6 to the Company's consolidated financial statements for additional information on deferred tax assets.

Recognition of Premium Income. Our premiums are primarily estimated based upon the annual revenues of the underlying insureds. Additional or return premiums are recognized for differences between provisional premiums billed and ultimate premiums due when a final audit is complete after the policy has expired. Our premiums are recorded ratably over the policy period with unearned premium calculated on a pro rata basis over the lives of the underlying coverages. The Company reviews the collectability of its premium receivables on a quarterly basis.

Income Taxes

We are incorporated under the laws of Bermuda and, under current Bermuda law, are not obligated to pay any taxes in Bermuda based upon income or capital gains. We have received an undertaking from the Minister of Finance in Bermuda pursuant to the provisions of the Tax Protection Act, which exempts us and our shareholders, other than shareholders ordinarily resident in Bermuda, from any Bermuda taxes computed on profits, income or any capital asset, gain or appreciation, or any tax in the nature of estate, duty or inheritance until March 28, 2016. Exclusive of our U.S. subsidiaries, we do not consider ourselves to be engaged in a trade or business in the U.S. and accordingly do not expect to be subject to direct U.S. income taxation. Our U.S. subsidiaries are subject to taxation in the U.S.

In July 2006, the FASB issued a Staff Position Number FIN 48 ("FIN 48"), Accounting for Uncertainty in Income Taxes. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement Number 109, Accounting for Income Taxes. This interpretation prescribes a recognition threshold and measurement attributable for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

Impact of Inflation

Property and casualty insurance premiums are established before the amount of losses and loss adjustment expenses, or the extent to which inflation may affect such amounts, is known. The Company attempts to anticipate the potential impact of inflation in establishing its premiums and reserves. Substantial future increases in inflation could result in future increases in interest rates, which, in turn, are likely to result in a decline in the market value of the Company's investment portfolio and resulting unrealized losses and/or reductions in shareholders' equity.

Off-Balance Sheet Arrangements

The Company has guaranteed a \$2 million letter of credit to the State of Vermont on behalf of American Safety RRG, its non-subsidiary affiliate. This letter of credit served as initial capitalization of American Safety RRG and may be drawn upon in the event of the insolvency of American Safety RRG.

Forward Looking Statements

This report contains forward-looking statements. These forward-looking statements reflect the Company's current views with respect to future events and financial performance, including insurance market conditions, premium growth, acquisitions and new products and the impact of new accounting standards. Forward-looking statements involve risks and uncertainties which may cause actual results to differ materially, including competitive conditions in the insurance industry, levels of new and renewal insurance business, developments in loss trends, adequacy and changes in loss reserves and actuarial assumptions, timing or collectability of reinsurance recoverables, market acceptance of new coverages and enhancements, changes in reinsurance costs and availability, potential adverse decisions in court and arbitration proceedings, the integration and other challenges attendant to acquisitions, and changes in levels of general business activity and economic conditions.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the risk of economic losses due to adverse changes in the estimated fair value of a financial instrument as the result of changes in equity prices, interest rates, foreign exchange rates and commodity prices. Our consolidated balance sheets include assets whose estimated fair values are subject to market risk. The primary market risks to us are interest rate and credit risk associated with our investments. We have no direct commodity or foreign exchange risk as of December 31, 2008. The estimated fair value of our investment portfolio at December 31, 2008 was \$673.7 million, of which 96.5% was invested in fixed maturities and short-term investments and 3.5% was invested in equities.

Interest Rate Risk. Our fixed rate holdings are invested predominantly in high quality government, corporate and municipal bonds with relatively short durations. The fixed rate portfolio is exposed to interest rate fluctuations; assuming all other factors remain constant as interest rates rise, their fair values decline and as interest rates fall, their fair values rise. The changes in the fair market value of the fixed rate portfolio are presented as a component of shareholders' equity in accumulated other comprehensive income, net of taxes.

We work to manage the impact of interest rate fluctuations on our fixed rate portfolio. The effective duration of the fixed rate portfolio is managed with consideration given to the estimated payout timing of our liabilities. We have investment policies which limit the maximum duration of individual securities within the portfolio and set target levels for average duration of the entire portfolio. For additional information on our investments and investment policies, see "Business—Investments."

The table below summarizes our interest rate risk and shows the effect of hypothetical changes in interest rates as of December 31, 2008. The selected hypothetical changes do not indicate what would be the potential best or worst case scenarios (dollars in thousands):

	Estimated Fair Value at December 31, 2008	Hypothetical Change in Interest Rate (bp=basis points)	Estimated Fair Value after Hypothetical Change in Interest Rate	Hypothetical Percentage Increase (Decrease) in Shareholders' Equity
Total Fixed Maturity Investments (including short-term investments, cash and cash equivalents)	\$ 662,813	200bp decrease	706,450	20.1%

100bp decrease

686,647

11.0

100bp increase

636,729

(12.0)

200bp increase

610,142

(24.3)

Credit Risk. We invest primarily in the debt securities markets, which exposes us to credit risk. Credit risk is a consequence of extending credit and/or carrying investment positions. We require that all securities be rated investment grade at the time of purchase. We use specific criteria to judge the credit quality and liquidity of our investments and use a variety of credit rating services to monitor these criteria. For additional information on our investments and our investment criteria, see “Business - Investments.”

Item 8. Financial Statements and Supplementary Data

The Company's consolidated financial statements required under this Item 8 are included as part of Item 15 of this Report.

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

None.

Item 9A. Controls and Procedures

Management's Responsibility for Financial Statements

The financial statements presented in this Annual Report have been prepared with integrity and objectivity and are the responsibility of the management of American Safety Insurance Holdings, Ltd. These financial statements have been prepared in conformity with U.S. generally accepted accounting principles and properly reflect certain estimates and judgments based upon the best available information.

The financial statements of the Company have been audited by BDO Seidman, LLP, an independent registered public accounting firm. Their accompanying report is based upon an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States).

The Audit Committee of the Board of Directors, consisting solely of outside directors, meets a minimum of three times a year with the independent registered public accounting firm, the internal auditor and representatives of management to discuss auditing and financial reporting matters. In addition, a meeting is held prior to each quarterly earnings release. The Audit Committee recommends to the Board of Directors the appointment of the independent registered public accounting firm and reviews management's supervision of the effectiveness of the internal accounting controls, the activities of the independent registered public accounting firm and internal auditor and the financial condition of the Company. Both the Company's independent registered public accounting firm and the internal auditor have access to the Audit Committee at any time.

Evaluation of Disclosure Controls and Procedures

As of December 31, 2008, an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a – 15(e) under the Securities Exchange Act of 1934) was carried out on behalf of American Safety Insurance Holdings, Ltd., and its subsidiaries by our management with the participation of our Chief Executive Officer and Chief Financial Officer. Based upon the evaluation, management concluded that these disclosure controls and procedures were effective as of December 31, 2008.

Changes in Internal Controls

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During the fourth quarter of the year ended December 31, 2008, no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) occurred that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

None.

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Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) promulgated under the Securities Exchange Act of 1934, as amended. Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2008.

/s/ Stephen R. Crim

Stephen R. Crim

President and Chief Executive Officer

/s/ William C. Tepe

William C. Tepe

Chief Financial Officer

PART III

Item 10. Directors, Executive Officers and Corporate Governance of the Registrant

The information required by this Item 10 regarding directors and executive officers of the Company will be set forth in the Company's 2009 Proxy Statement which will be filed with the Securities and Exchange Commission pursuant to applicable regulations, and is hereby incorporated by this reference. Additional information required by this Item 10 with respect to executive officers is set forth in Item 4 of this Report.

The information set forth in the second paragraph of Item 1 of this Report is incorporated herein by reference. The code of business conduct and ethics referenced therein applies to our principal executive officers, principal financial officer, principal and senior accounting officers or controller, or persons performing similar functions.

Item 11. Executive Compensation

The information required by this Item 11 regarding executive compensation will be set forth in the Company's 2009 Proxy Statement which will be filed with the Securities and Exchange Commission pursuant to applicable regulations, and is hereby incorporated by this reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this Item 12 regarding security ownership of certain beneficial owners and management of the Company will be set forth in the Company's 2009 Proxy Statement which will be filed with the Securities and Exchange Commission pursuant to applicable regulations, and is hereby incorporated by this reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this Item 13 regarding certain relationships and related transactions of the Company will be set forth in the Company's 2009 Proxy Statement which will be filed with the Securities and Exchange Commission pursuant to applicable regulations, and is hereby incorporated by this reference.

Item 14. Principal Accountant Fees and Services

The information required by this Item 14 regarding principal accountant fees and services will be set forth in the Company's 2009 Proxy Statement which will be filed with the Securities and Exchange Commission pursuant to applicable regulations, and is hereby incorporated by reference.

PART IV

Item 15. Exhibits and Financial Statements, Schedules.

(a) Financial Statements, Schedules and Exhibits

1. Financial Statements

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

- Reports of BDO Seidman, LLP, Independent Registered Public Accounting Firm
- Consolidated Balance Sheets at December 31, 2008 and 2007
- Consolidated Statements of Operations for the Years Ended December 31, 2008, 2007 and 2006
- Consolidated Statements of Shareholders' Equity for the Years Ended December 31, 2008, 2007 and 2006
- Consolidated Statements of Cash Flow for the Years Ended December 31, 2008, 2007 and 2006
- Consolidated Statements of Comprehensive Earnings for the Years Ended December 31, 2008, 2007 and 2006
- Notes to Consolidated Financial Statements
- Selected Quarterly Financial Data

2. Financial Statement Schedules and Exhibits

The following is a list of financial statement schedules and exhibits filed as part of this report:

Schedule/Exhibit Number	Page
- Schedule II - Condensed Financial Statements (Parent only)	117
- Schedule III – Supplemental Information	121
- Schedule IV – Reinsurance	122

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

3. Exhibits

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

Exhibit Number	Title
3.1	Memorandum of Association of American Safety Insurance Holdings, Ltd. [incorporated by reference to Exhibit 3.1 to Registrant's Amendment No. 1 to the Registration Statement on Form S-1 filed January 27, 1998 (Registration No. 333-42749)] and the Certificate of Incorporation of Change of Name
3.2	Bye-Laws of American Safety Insurance Holdings, Ltd. [incorporated by reference to Exhibit 3.2 to Registrant's Amendment No. 1 to Registration Statement on Form S-1 filed January 27, 1998 (Registration No. 333-42749)]
4.2	Amended and Restated Declaration of Trust of American Safety Capital Trust dated as of May 22, 2003 among Wilmington Trust Company, as institutional trustee, American Safety Holdings Corp., as sponsor, American Safety Insurance Holdings, Ltd. (formerly known as American Safety Insurance Group, Ltd.), as guarantor, Steven B. Mathis, Stephen R. Crim and Fred J. Pinckney, as administrators. [incorporated by reference to the Exhibits to the Current Report on Form 8-K dated May 22, 2003 (File No. 001-14795)]
4.3	Indenture dated as of May 22, 2003 between American Safety Holdings Corp., American Safety Insurance Holdings, Ltd. (formerly known as American Safety Insurance Group, Ltd.), as guarantor, and Wilmington Trust Company, as trustee [incorporated by reference to the Exhibits to the Current Report on Form 8-K dated May 22, 2003 (File No. 001-14795)]
4.4	Guarantee Agreement dated as of May 22, 2003, between American Safety Insurance Holdings, Ltd. (formerly known as American Safety Insurance Group, Ltd.), as guarantor, and Wilmington Trust Company, as trustee [incorporated by reference to the Exhibits to the Current Report on Form 8-K dated May 22, 2003 (File No. 001-14795)]

- 4.5 Amended and Restated Trust Agreement of American Safety Capital Trust II dated as of September 30, 2003 among American Safety Holdings Corp., as depositor, JPMorgan Chase Bank, as property trustee, Chase Manhattan Bank USA, National Association, as Delaware trustee, and Steven B. Mathis, Stephen R. Crim and Fred J. Pinckney, as administrative trustees [incorporated by reference to the Exhibits to the Current Report on Form 8-K dated September 30, 2003 (File No. 001-14795)]
- 4.6 Junior Subordinated Indenture dated as of September 30, 2003 between American Safety Holdings Corp. and JPMorgan Chase Bank, as trustee. [incorporated by reference to the Exhibits to the Current Report on Form 8-K dated September 30, 2003 (File No. 001-14795)]
- 4.7 Guarantee Agreement dated as of September 30, 2003 among American Safety Holdings Corp., as guarantor, American Safety Insurance Holdings, Ltd., as parent guarantor and JPMorgan Chase Bank, as guarantee trustee [incorporated by reference to the Exhibits to the Current Report on Form 8-K dated October 15, 2003 (File No. 001-14795)]
- 4.8 Common Securities Subscription Agreement dated as of September 30, 2002 between American Safety Holdings Corp. and American Safety Capital Trust II, together as offerors [incorporated by reference to the Exhibits to the Current Report on Form 8-K filed October 15, 2003 (File No. 1-14795)]
- 4.9 Amended and Restated Declaration of Trust of American Safety Capital Trust III dated as of November 17, 2005 among American Safety Holdings Corp., Wilmington Trust Company, as institutional trustee and Delaware trustee, and Steven B. Mathis and Stephen R. Crim, as administrators [incorporated by reference to the Exhibits to the Current Report on Form 8-K dated November 16, 2006 (File No. 001-14795)]
- 4.10 Indenture dated as of November 17, 2006 between American Safety Holdings Corp. and Wilmington Trust Company as trustee [incorporated by reference to the Exhibits to the Current Report on Form 8-K dated November 16, 2005 (File No. 001-14795)]
- 4.11 Guarantee Agreement dated as of November 17, 2006 between American Safety Holdings Corp., as guarantors and Wilmington Trust Company, as guarantee trustee, [incorporated by reference to the Exhibits to the Current Report on Form 8-K dated November 16, 2005 (File No. 001-14795)]
- 4.12 Parent Guarantee Agreement dated as of November 17, 2005 between American Safety Insurance Holdings, Ltd. and Wilmington Trust Company [incorporated by reference to the Exhibits to the Current Report on Form 8-K dated November 16, 2006 (File No. 001-14795)]

- 4.13 Subscription Agreement dated as of November 17, 2005 among American Safety Capital Trust III, American Safety Holdings Corp. and Keefe, Bruyette & Woods, Inc. [incorporated by reference to the Exhibits to the Current Report on Form 8-K dated November 16, 2006 (File No. 001-14795)]
- 10.1+ 2007 Incentive Stock Plan
- 10.2+ 1998 Director Stock Award Plan [incorporated by reference to Exhibit 10.3 to the Form 10-K of American Safety Insurance Holdings, Ltd. For the year ended December 31, 2005 (File No. 001-14795)]
- 10.3 Amended and Restated Program Management Agreement between American Safety Insurance Services, Inc. and American Safety Risk Retention Group, Inc., dated January 1, 2009.
- 10.4 Amended and Restated Program Management Agreement between American Safety Insurance Services, Inc. and American Safety Casualty Insurance Company, dated January 1, 2009.
- 10.5 Amended and Restated Program Management Agreement between American Safety Insurance Services, Inc. and American Safety Indemnity Company, dated January 1, 2009.
- 10.6 Professional and Administrative Services Agreement between American Safety Administrative Services, Inc. and American Safety Risk Retention Group, Inc., dated January 1, 2009.
- 10.7 Professional and Administrative Services Agreement between American Safety Administrative Services, Inc. and American Safety Casualty Insurance Company, dated January 1, 2009
- 10.8 Professional and Administrative Services Agreement between American Safety Administrative Services, Inc. and American Safety Indemnity Company, dated January 1, 2009.
- 10.9+ Employment Agreement between American Safety Insurance Services, Inc. and Stephen R. Crim [incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K dated August 31, 2007 (File No. 1-14795)]
- 10.10+ Employment Agreement between American Safety Insurance Services, Inc. and Joseph D. Scollo [incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K dated August 31, 2007 (File No.1-14795)]

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10.11+	Employment Agreement between American Safety Insurance Services, Inc. and William C. Tepe [incorporated by reference to Exhibit 10.3 to the Current Report on Form 8-K dated August 31, 2007 (File No.1-14795)]
10.12+	Employment Agreement between American Safety Insurance Services, Inc. and Randolph L. Hutto [incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K dated August 31, 2007 (File No.1-14795)]
10.13	Office Lease Agreement between ORT, an Ohio general partnership, and American Safety Insurance Services, Inc. for office space in Atlanta, Georgia [incorporated by reference to Exhibit 10.8 to the Form 10-K of American Safety Insurance Holdings, Ltd., for the year ended December 31, 2006 [(File No. 001-14795)]
11	Computation of Earnings Per Share
12	Ratio of Earnings to Fixed Charges
14	Code of Business Conduct and Ethics [incorporated by reference to Exhibit 14 to Form 10K of American Safety Insurance Holdings, Ltd. For the year ended December 31, 2003 (File No. 001 14795)]
21	Subsidiaries of the Company
23.1	Consent of BDO Seidman, LLP
31.1	Certification of Chief Executive Officer
31.2	Certification of Chief Financial Officer
32.1	Certifications of Chief Executive Officer and Chief Financial Officer

+Management contract or compensatory plan or arrangement.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized on March 13, 2009.

AMERICAN SAFETY INSURANCE HOLDINGS, LTD.

By: /s/ Stephen R. Crim

Stephen R. Crim

President

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed by the following persons in the capacities indicated on March 13, 2009.

Signature

Title

/s/ Stephen R. Crim

Stephen R. Crim

President and Chief Executive Officer

(Principal Executive Officer)

/s/ William C. Tepe

William C. Tepe

Chief Financial Officer

(Principal Financial Officer and Principal Accounting Officer)

/s/ David V. Brueggen

David V. Brueggen

Chairman of the Board of Directors

/s/ Cody W. Birdwell

Cody W. Birdwell

Director

/s/ Lawrence I. Geneen

Lawrence I. Geneen

Director

/s/ Frank D. Lackner

Frank D. Lackner

Director

/s/ Steven L. Groot

Steven L. Groot

Director

/s/ Thomas W. Mueller

Thomas W. Mueller

Director

/s/ Jerome D. Weaver

Jerome D. Weaver

Director

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors

American Safety Insurance Holdings, Ltd.

We have audited American Safety Insurance Holdings, Ltd. and subsidiaries' (the "Company") internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO" criteria). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Item 9A, Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of American Safety Insurance Holdings, Ltd. and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of operations, shareholders' equity, cash flows, and comprehensive income for each of the three years in the period ended December 31, 2008 and our report dated March 13, 2009 expressed an unqualified opinion thereon.

/s/ BDO Seidman, LLP

Atlanta, Georgia

March 13, 2009

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors

American Safety Insurance Holdings, Ltd.

We have audited the accompanying consolidated balance sheets of American Safety Insurance Holdings, Ltd. and subsidiaries as of December 31, 2008 and 2007 and the related consolidated statements of operations, shareholders' equity, cash flows and comprehensive income for each of the three years in the period ended December 31, 2008. We have also audited Schedules II, III, and IV as of and for each of the three years in the period ended December 31, 2008. These consolidated financial statements and schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and schedules based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of American Safety Insurance Holdings, Ltd. and subsidiaries at December 31, 2008 and 2007, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related schedules present fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of American Safety Insurance Holdings, Ltd.'s internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 13, 2009 expressed an unqualified opinion thereon.

/s/ BDO Seidman, LLP

Atlanta, Georgia

March 13, 2009

AMERICAN SAFETY INSURANCE HOLDINGS, LTD. AND SUBSIDIARIES

Consolidated Balance Sheets

(dollars in thousands except per share data)

	December 31,	
	<u>2008</u>	<u>2007</u>
<u>Assets</u>		
Investments:		
Fixed maturity securities available-for-sale, at fair value		
	\$ 569,910	\$ 529,569
Common stock, at fair value	20,537	25,394
Preferred stock, at fair value	3,287	5,793
Short-term investments	<u>80,005</u>	<u>56,455</u>
Total investments	673,739	617,211
Cash and cash equivalents	12,898	12,860
Accrued investment income	6,214	5,772
Premiums receivable	19,917	22,851
Ceded unearned premium	36,118	30,951
Reinsurance recoverable	199,455	190,299
Deferred income taxes	11,784	9,768
Deferred policy acquisition costs	18,171	16,831
Property, plant and equipment, net	10,976	9,216
Goodwill	9,696	2,317
Other assets	<u>27,396</u>	<u>15,933</u>
Total assets	\$ 1,026,364	\$ 934,009
<u>Liabilities and Shareholders' Equity</u>		
Liabilities:		
Unpaid losses and loss adjustment expenses	\$ 586,647	\$ 504,779
Unearned premiums	122,259	111,459
Ceded premiums payable	20,732	15,369
Deferred revenues	1,770	1,074
Accounts payable and accrued expenses	8,586	10,005
Deferred rent	1,626	1,780
Funds held	25,684	18,510
Loans payable	38,932	38,646
Minority Interest	<u>3,098</u>	<u>1,987</u>
Total liabilities	<u>809,334</u>	<u>703,609</u>

continued on next page

Consolidated Balance Sheets (continued)

(dollars in thousands except per share data)

	December 31,	
	<u>2008</u>	<u>2007</u>
Shareholders' equity:		
Preferred stock, \$0.01 par value; authorized 5,000,000 shares; no shares issued and outstanding		
Common stock, \$0.01 par value; authorized 30,000,000 shares; issued and outstanding at December 31, 2008, 10,274,368 shares and at December 31, 2007, 10,703,457 shares	\$ 103	\$ 107
Additional paid-in capital	100,645	106,238
Retained earnings	119,491	119,181
Accumulated other comprehensive (loss) income, net	<u>(3,209)</u>	<u>4,874</u>
Total shareholders' equity	<u>217,030</u>	<u>230,400</u>
 Total liabilities and shareholders' equity	 \$ 1,026,364	 \$ 934,009
 Book value per share	 \$ 21.12	 \$ 21.53
 Diluted book value per share	 \$ 20.55	 \$ 20.81

See accompanying notes to consolidated financial statements.

AMERICAN SAFETY INSURANCE HOLDINGS, LTD. AND SUBSIDIARIES

Consolidated Statements of Operations

(dollars in thousands except per share data)

	Years Ended December 31,		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Revenues:			
Direct premiums earned	\$201,735	\$ 212,757	\$ 222,257
Assumed premiums earned	48,089	9,352	135
Ceded premiums earned	<u>(75,353)</u>	<u>(73,316)</u>	<u>(75,636)</u>
Net premiums earned	174,471	148,793	146,756
Net investment income	29,591	30,268	21,766
Net realized (losses) gains	(14,348)	(311)	1,190
Fee income	2,632	2,145	1,685
Other (loss) income	<u>(24)</u>	<u>66</u>	<u>42</u>
Total revenues	<u>192,322</u>	<u>180,961</u>	<u>171,439</u>
Expenses:			
Losses and loss adjustment expenses	110,146	91,184	92,329
Acquisition expenses	43,484	28,872	27,378
Payroll and related expenses	20,667	17,268	14,896
Other underwriting expenses	13,215	9,684	10,147
Interest expense	3,163	3,283	3,376
Minority interest	1,153	(1,245)	(1,873)
Corporate and other expenses	<u>153</u>	<u>2,986</u>	<u>2,340</u>
Total expenses	<u>191,981</u>	<u>152,032</u>	<u>148,593</u>
Earnings before income taxes	341	28,929	22,846
Income taxes	<u>31</u>	<u>737</u>	<u>2,314</u>
Net earnings	\$ 310	\$ 28,192	\$ 20,532
Net earnings per share:			
Basic	\$ 0.03	\$ 2.65	\$ 2.35
Diluted	\$ 0.03	\$ 2.56	\$ 2.26
Weighted average number of shares outstanding			
Basic	<u>10,459,161</u>	<u>10,648,408</u>	<u>8,729,734</u>
Diluted	<u>10,685,933</u>	<u>10,997,206</u>	<u>9,095,422</u>

See accompanying notes to consolidated financial statements.

AMERICAN SAFETY INSURANCE HOLDINGS, LTD. AND SUBSIDIARIES

Consolidated Statements of Shareholders' Equity

(dollars in thousands)

	Years ended December 31,		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Common stock - number of shares:			
Balance at beginning of period	10,703,457	10,554,200	6,753,731
Issuance of common shares	57,956	176,557	3,800,469
Repurchase of common shares	<u>(487,045)</u>	<u>(27,300)</u>	<u>-</u>
Balance at end of period	10,274,368	10,703,457	10,554,200
Common stock:			
Balance at beginning of period	\$ 107	\$ 106	\$ 68
Issuance of common shares	1	2	38
Repurchase of common shares	<u>(5)</u>	<u>(1)</u>	<u>-</u>
Balance at end of period	\$ 103	\$ 107	\$ 106
Additional paid-in capital:			
Balance at beginning of period	\$106,238	\$104,514	\$ 49,460
Issuance of common shares	704	1,718	54,439
Repurchase of common shares	(7,560)	(512)	-
Share based compensation	<u>1,263</u>	<u>518</u>	<u>615</u>
Balance at end of period	\$100,645	\$106,238	\$104,514
Retained earnings:			
Balance at beginning of period	\$ 119,181	\$ 90,989	\$ 70,457
Net earnings	<u>310</u>	<u>28,192</u>	<u>20,532</u>
Balance at end of period	\$ 119,491	\$119,181	\$ 90,989
Accumulated other comprehensive income (loss):			
Balance at beginning of period	\$ 4,874	\$ 541	\$ (1,550)
Unrealized (loss) gain during the period (net of deferred tax expense of \$96, \$499, and \$207, respectively)	<u>(8,083)</u>	<u>4,333</u>	<u>2,091</u>
Balance at end of period	<u>\$ (3,209)</u>	<u>\$ 4,874</u>	<u>\$ 541</u>
Total shareholders' equity	\$217,030	\$230,400	\$196,150

See accompanying notes to consolidated financial statements.

AMERICAN SAFETY INSURANCE HOLDINGS, LTD. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(dollars in thousands)

	Years ended December 31,		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Cash flow from operating activities:			
Net earnings	\$ 310	\$ 28,192	\$ 20,532
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Realized losses (gains) on investments	14,348	311	(1,190)
Depreciation and amortization expense	4,196	3,058	2,114
Stock based compensation expense	1,263	518	615
Amortization of deferred acquisition costs, net	(1,340)	(4,429)	(1,520)
Amortization of investment premium	533	406	1,535
Deferred income taxes	(2,154)	(540)	478
Change in operating assets and liabilities:			
Accrued investment income	(442)	(1,472)	(262)
Premiums receivable	2,934	(1,104)	(4,432)
Reinsurance recoverable	(9,156)	(5,289)	(12,900)
Ceded unearned premiums	(5,167)	4,947	(7,027)
Funds held	7,174	2,181	5,138
Unpaid losses and loss adjustment expenses	81,868	65,106	46,180
Unearned premiums	10,800	(3,739)	17,215
Ceded premiums payable	5,363	(10,094)	8,957
Accounts payable and accrued expenses	(1,174)	(1,566)	(1,016)
Deferred rent	(154)	371	-
Deferred revenue	696	(118)	(309)
Other, net	<u>(8,935)</u>	<u>(9,729)</u>	<u>(3,438)</u>
Net cash provided by operating activities	100,963	67,010	70,670
Cash flow from investing activities:			
Purchase of fixed maturities	(208,771)	(210,355)	(388,134)
Purchase of common stock	(3,643)	(13,320)	(4,044)
Purchase of preferred stocks	-	-	(4,406)
Proceeds from sales of fixed maturities	118,568	170,088	230,496
Proceeds from matured securities	37,650	6,461	34,000
Proceeds from sales of equity securities	382	1,387	13,773
Increase in short-term investments	(23,550)	(15,849)	(15,279)
Consideration paid for acquired companies	(8,927)	-	-
Purchases of fixed assets	<u>(5,529)</u>	<u>(4,793)</u>	<u>(3,268)</u>
Net cash used in investing activities	(93,820)	(66,381)	(136,862)
Cash flow from financing activities:			
Proceeds from secondary offering of common stock	-	-	53,277
Proceeds from exercised stock options	460	1,450	918
Stock repurchase payments	<u>(7,565)</u>	<u>(512)</u>	<u>-</u>

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Net cash (used in) provided by financing activities	<u>\$ (7,105)</u>	<u>\$ 938</u>	<u>\$ 54,195</u>
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continued on next page

Consolidated Statements of Cash Flows (continued)

(dollars in thousands)

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Net increase (decrease) in cash	\$ 38	\$ 1,567	\$ (11,997)
Cash and cash equivalents at beginning of period	<u>12,860</u>	<u>11,293</u>	<u>23,290</u>
Cash and cash equivalents at end of period	\$ 12,898	\$ 12,860	\$ 11,293
Supplemental disclosure of cash flow:			
Income taxes (refunded) paid	\$ (1,244)	\$ 1,211	\$ 2,698
Interest paid	\$ 3,226	\$ 3,148	\$ 3,212
Non-cash activity: (1)			
Fixed asset additions	\$ -	\$ 1,409	\$ -
Deferred rent	\$ -	\$ 1,409	\$ -

(1) Represents tenant build-out allowance and future reduction in rent over term of the lease.

See accompanying notes to consolidated financial statements.

AMERICAN SAFETY INSURANCE HOLDINGS, LTD. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

(dollars in thousands)

	Years ended December 31,		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Net earnings	\$ 310	\$28,192	\$20,532
Other comprehensive (loss) income:			
Unrealized (losses) gains on securities available-for sale, net of minority interest of \$(41), \$57, and \$12 for 2008, 2007 and 2006 respectively	(21,967)	4,817	3,617
Unrealized (losses) gains on hedging transactions	(94)	(292)	(103)
Reclassification adjustment for realized losses (gains) included in net earnings, net of minority interest of \$275, \$5 and \$26 for 2008, 2007 and 2006, respectively	<u>14,074</u>	<u>307</u>	<u>(1,216)</u>
Total other comprehensive (loss) income before income taxes	(7,987)	4,832	2,298
Income tax expense related to items of other comprehensive income, net of minority interest of \$0, \$28 and \$9 for 2008, 2007 and 2006, respectively	<u>96</u>	<u>499</u>	<u>207</u>
Other comprehensive (loss) income	<u>(8,083)</u>	<u>4,333</u>	<u>2,091</u>
Total comprehensive (loss) income	\$(7,773)	\$32,525	\$22,623

See accompanying notes to consolidated financial statements.

AMERICAN SAFETY INSURANCE HOLDINGS, LTD. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(1) (1) Summary of Significant Accounting Policies

(a) Basis of Presentation

The accompanying consolidated financial statements of American Safety Insurance Holdings, Ltd. ("American Safety") and its subsidiaries and American Safety Risk Retention Group Inc. ("American Safety RRG"), a non-subsidiary risk retention group affiliate (collectively, the "Company") are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates, based on the best information available, in recording transactions resulting from business operations. The balance sheet amounts that involve a greater extent of accounting estimates and/or actuarial determinations subject to future changes are the Company's invested assets, deferred income taxes, and the liabilities for unpaid losses and loss adjustment expenses. As additional information becomes available (or actual amounts are determinable), the recorded estimates may be revised and reflected in operating results. While management believes that these estimates are adequate, such estimates may change in the future.

Dollar amounts are in thousands unless otherwise noted.

(b) Description of Common Stock - Voting and Ownership Rights

The authorized share capital of the Company is 35 million shares, consisting of 30 million common shares, par value \$.01 per share ("Common Shares"), and 5 million preferred shares, par value \$.01 per share ("Preferred Shares"). The Common Shares are validly issued, fully paid, and non-assessable. There are no provisions of Bermuda law or the Company's Bye-Laws which impose any limitations on the rights of shareholders to hold or vote Common Shares by reason of such shareholders not being residents of Bermuda. Holders of Common Shares are entitled to receive dividends ratably when and as declared by the Board of Directors out of funds legally available therefore.

Each holder of Common Shares is entitled to one vote per share on all matters submitted to a vote of the Company's shareholders, subject to the 9.5% voting limitation described below. All matters, including the election of directors, voted upon at any duly held shareholders meeting shall be authorized by a majority of the votes cast at the meeting by shareholders represented in person or by proxy, except (i) approval of a merger, consolidation or amalgamation; (ii) the sale, lease, or exchange of all or substantially all of the assets of the Company; and (iii) amendment of certain provisions of the Bye-Laws, which each require the approval of at least 66-2/3% of the outstanding voting shares (in addition to any regulatory or court approvals). The Common Shares have non-cumulative voting rights, which means that the holders of a majority of the Common Shares may elect all of the directors of the Company and, in such event, the holders of the remaining shares will not be able to elect any directors.

The Bye-Laws contain certain provisions that limit the voting rights that may be exercised by certain holders of Common Shares. The Bye-Laws provide that each holder of Common Shares is entitled to one vote per share on all matters submitted to a vote of the Company's shareholders, except that if, and so long as, the Controlled Shares (as defined below) of any person constitute 9.5% or more of the issued and outstanding Common Shares, the voting rights with respect to the Controlled Shares owned by such person shall be limited, in the aggregate, to a voting power of 9.5%, other than the voting rights of Frederick C. Treadway or Treadway Associates, L.P., affiliates of a founding shareholder of the

Company.

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“Controlled Shares” mean (i) all shares of the Company directly, indirectly, or constructively owned by any person and (ii) all shares of the Company directly, indirectly, or beneficially owned by such person within the meaning of Section 13(d) of the Exchange Act (including any shares owned by a group of persons, as so defined and including any shares that would otherwise be excluded by the provisions of Section 13(d)(6) of the Exchange Act). Under these provisions, if, and so long as, any person directly, indirectly, or constructively owns Controlled Shares having more than 9.5% of the total number of votes exercisable in respect of all shares of voting stock of the Company, the voting rights attributable to such shares will be limited, in the aggregate, to 9.5% of the total number of votes.

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

(c) Principles of Consolidation

The consolidated financial statements include the accounts of American Safety Insurance Holdings, Ltd., a Bermuda company, American Safety Reinsurance, Ltd. (“American Safety Re”) and American Safety Assurance Ltd., (“ASA”), two 100%-owned licensed Bermuda insurance companies, Ordinance Holdings Limited, a 100% owned actuarial, consulting and licensed Bermuda-based brokerage company, American Safety Holdings Corp. (“American Safety Holdings”), a 100%-owned insurance holding company, and American Safety Risk Retention Group, Inc. (“American Safety RRG”), a non-subsidiary risk retention group affiliate. American Safety Holdings in turn wholly owns American Safety Casualty Insurance Company (“American Safety Casualty”), a property and casualty insurance company, American Safety Assurance (VT), a 100%, wholly owned Vermont sponsored captive, American Safety Insurance Services, Inc. (“ASI Services”), an underwriting and administrative subsidiary, LTC Risk Management, LLC and LTC Insurance Services, LLC, providing risk management solutions for the long-term care industry, Ponce Lighthouse Properties, Inc. (“Ponce”), the development company of the Harbour Village project, and Rivermar Contracting Company (“Rivermar”), the general contractor of the Harbour Village project. As of December 31, 2008, American Safety Casualty owns 78% of American Safety Indemnity Company, a property and casualty excess and surplus lines insurance company. The remaining 22% is owed by American Safety Holdings. ASI Services wholly owns the following subsidiaries: Sureco Bond Services, Inc. (“Sureco”), a bonding agency; American Safety Claims Services, Inc. (“ASCS”), a claims service firm; American Safety Financial Corp., a financial services subsidiary; and American Safety Purchasing Group, Inc., which acts as a purchasing group for the placement of certain business with American Safety Casualty.

In accordance with FASB Interpretation No. 46 (FIN 46), *Consolidation of Variable Interest Entities* (VIEs) and FASB Interpretation No. 46 Revised (FIN 46R), the accompanying financial statements consolidate American Safety RRG, based on its status as a VIE and the Company’s status as the primary beneficiary of the VIE. A minority interest has been established for the equity holders of American Safety RRG. The accompanying financial statements also de-consolidate American Safety Capital Trust, American Safety Capital Trust II and American Safety Capital Trust III (“American Safety Capital”, “American Safety Capital II” and “American Safety Capital III”, respectively) based on their status as variable interest special purpose entities of the Company’s status as not being the primary beneficiary. American Safety Capital, American Safety Capital II and American Safety Capital III are accounted for under the equity method.

All significant intercompany balances have been eliminated, as appropriate, in consolidation.

(d) Business Environment

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

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

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

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

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

Interest Rate Risk is the risk that interest rates will change and cause a decrease in the value of an insurer's investments or impact the amount of interest on the Company's loans payable. The Company attempts to mitigate this risk by attempting to match the maturities of its assets with the expected payouts of its liabilities and entering into fixed or floating interest rate swap arrangements on its interest due on its outstanding debt obligations.

(e) Investments

Investment income is recorded as earned on the accrual basis and includes amortization of premiums and accretion of discounts using the interest method. Realized gains or losses on disposal of investments are determined on a specific identification basis and are included in revenues. Premiums and discounts arising from the purchase of mortgage-backed securities are treated as yield adjustments over their estimated lives.

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

The Company notes that it has the ability and intent to hold securities with unrealized losses until they mature or recover in value. However, the Company may, from time to time, sell securities in response to market conditions or interest rate fluctuations in accordance with its investment guidelines or to fund the cash needs of individual operating subsidiaries. When a decision is made to sell a security that has an unrealized loss, the loss is recognized at the time of the decision. At December 31, 2008 and 2007, the Company considered all of its fixed maturity securities as “available for sale”.

The Company routinely monitors and evaluates the difference between the cost and fair value of our investments. Additionally, credit analysis and/or credit rating issues related to specific investments may trigger more intensive monitoring to determine if a decline in market value is other than temporary. For investments with a market value below cost, the process includes evaluating the length of time and the extent to which cost exceeds market value, the prospects and financial condition of the issuer, and evaluation for a potential recovery in market value, among other factors. This process is not exact and further requires consideration of risks such as credit risk, which to a certain extent can be controlled, and interest rate risk, which cannot be controlled. Therefore, if an investment’s cost exceeds its market value solely due to changes in interest rates, impairment may not be appropriate. If, after monitoring and analysis, the Company believes that a decline in fair value is other than temporary, the Company adjusts the amortized cost of the security and reports a realized loss in the consolidated statements of earnings.

As a result of our evaluations, the Company recorded \$13,712 of net realized losses due to other-than-temporary-impairment of its investments. All but \$400 of the impairment relates to securities issued by companies in the financial services sector. Other-than-temporary-impairment totaled \$9,431 of fixed maturities, \$3,236 of preferred stock and \$1,045 of common stock. No other-than-temporary-impairment charges were recorded during 2007 and 2006.

(f) Recognition of Premium Income

General liability premiums written are primarily estimated based upon the annual revenues of the underlying insureds. Additional or return premiums are recognized for differences between provisional premiums billed and estimated ultimate general liability premiums due when the final audit is complete after the policy has expired. Premiums are generally recorded ratably over the policy period with unearned premium calculated on a pro rata basis over the lives of the underlying coverages.

(g) Deferred Policy Acquisition Costs

The costs of acquiring business, primarily commissions and premium tax expenses offset by reinsurance ceding commission received, are deferred (to the extent they are recoverable from future premium income) and amortized to earnings in relation to the amount of premiums earned. Investment income is also considered in the determination of the recoverability of deferred policy acquisition costs.

An analysis of deferred policy acquisition costs follows:

	Years ended December 31,		
	2008	2007	2006
Balance, beginning of period	\$ 16,831	\$ 12,403	\$ 10,882
Acquisition costs deferred, net	44,824	33,300	28,899
Costs amortized during the period	<u>(43,484)</u>	<u>(28,872)</u>	<u>(27,378)</u>
Balance, end of period	\$ 18,171	\$ 16,831	\$ 12,403

(h) Unpaid Losses and Loss Adjustment Expenses

The Company provides a liability for unpaid losses and loss adjustment expenses based upon aggregate case estimates for reported claims and estimates for incurred but not reported losses. Because of the length of time required for the ultimate liability for losses and loss adjustment expenses to be determined for certain lines of business underwritten, the Company has limited experience upon which to base an estimate of the ultimate liability. For these lines, management has established loss and loss adjustment expense reserves based on actuarial methods that determine ultimate losses and loss adjustment expenses utilizing a combination of both industry and the Company's reporting and settlement patterns, as appropriate. One primary set of actuarial methods utilized, Bornhuetter-Ferguson, entails developing an initial expected loss ratio based upon gross ultimate losses from prior accident years, estimating the portion of ultimate losses expected to be reported and unreported, and adding the actual reported losses to the expected unreported losses to derive the indicated ultimate losses. However, the net amounts that will ultimately be paid to settle the liability may be more or less than the estimated amounts provided.

(i) Income Taxes

For subsidiaries subject to taxation, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. When the Company does not believe that, on the basis of available information, it is more likely than not deferred tax assets will be recovered it recognizes a valuation allowance against its deferred tax assets.

In July 2006, the FASB issued a Staff Position Number FIN 48 ("FIN 48"), Accounting for Uncertainty in Income Taxes. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB statement number 109, Accounting for Income Taxes. This interpretation prescribes a recognition threshold and measurement attributable for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company adopted the pronouncement on January 1, 2007. FIN 48 did not have a material impact on its operating results. Interest and penalties recognized in accordance with the tax code are reported as a component of income tax expense.

(j) Reinsurance

Reinsurance contracts do not relieve the Company from its obligation to policyholders. Failure of reinsurers to honor their obligations could result in losses to the Company. The Company evaluates the financial condition of its reinsurers and monitors concentration of credit risk to minimize its

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exposure to significant losses from reinsurer insolvencies. In addition, we review reinsurance recoverables for collectability on a quarterly basis. As of December 31, 2008 and 2007, we had a recoverable allowance of \$3,800 and \$1,318 respectively. Reinsurance recoverables on unpaid losses and prepaid reinsurance represent amounts recoverable from reinsurers for unpaid losses and unearned ceded reinsurance premiums, respectively.

(k) Acquisitions and Goodwill

On February 11, 2008, the Company acquired 100% of the membership interests of LTC Group for \$8,771. The LTC Group provides insurance and risk management solutions for the long-term care industry and will allow the Company to further diversify its business interests. The purchase excluded liabilities for any policies produced by the LTC Group prior to the effective date of the transaction. The results of the LTC Group's operations have been included with the Company's results since the acquisition date. The purchase price was allocated to the assets acquired and the liabilities assumed based on their fair value at the acquisition date. As a result, approximately \$1,602 was assigned to intangible assets which are being amortized over their estimated useful lives of ten years. The remaining purchase price of approximately \$7,181 was allocated to goodwill. Proforma financial statements are not presented as the acquisition does not meet materiality thresholds.

The Company adopted SFAS 142 on January 1, 2002. Under SFAS 142, goodwill is reviewed annually (or more frequently if impairment indicators arise) for impairment. Prior to adoption, the Company amortized goodwill over a 20 year period.

In determining possible impairments of goodwill, the Company compares the estimated net present value of future cash flows against net assets of the business acquired. At December 31, 2008 and 2007, the Company determined that goodwill was not impaired. At December 31, 2008 and 2007, goodwill was \$9,696 and \$2,317, respectively.

(l) Net Earnings Per Share

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

Earnings per share for the years ended December 31, are as follows:

	2008	2007	2006
Weighted average shares outstanding	10,459,161	10,648,408	8,729,734
Shares attributable to stock options and restricted stock	<u>226,772</u>	<u>348,798</u>	<u>365,689</u>
Weighted average common and common equivalents	10,685,933	10,997,206	9,095,423
Net earnings per share:			
Basic	\$0.03	\$2.65	\$ 2.35
Diluted	\$0.03	\$2.56	\$ 2.26

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(m) Employee Stock Compensation

The Company's stock option plan grants stock options to employees. The majority of the options outstanding under the plan generally vest evenly over a period of three to five years and have a term of 10 years.

The Company applied the recognition and measurement principles of SFAS No. 123R, Share Based Payments under modified prospective application method, commencing in the first quarter of 2006 and recognizes the expense over the vesting period. The Company uses the Black-Scholes option pricing model to value stock options. This plan is described further in Note 14. Compensation expense relating to stock options of \$779, \$518 and \$615 reflected in earnings for the years ended December 31, 2008, 2007 and 2006, respectively.

In addition to stock options discussed above, the Company may grant restricted shares to employees under the incentive stock plan. During 2008, the Company granted 47,850 shares of restricted stock at a weighted average grant price of \$17.78. The restricted shares vest on the grant date anniversary ratably over three years at 25%, 25% and 50%, respectively. Stock based compensation expense related to the restricted shares was \$324 for the year ended December 31, 2008, and is reflected in net earnings under payroll and related expenses. There was no expense incurred during 2007 or 2006.

(n) Accounting Pronouncements

During the last two years, the Financial Accounting Standard Board (FASB) has issued a number of accounting pronouncements with various future effective dates.

In December 2007, the FASB issued SFAS No. 160, "Non-controlling Interests in Consolidated Financial Statements – an amendment of ARB No. 51" ("SFAS 160"). SFAS 160 establishes new accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement requires the recognition of a non-controlling interest as equity in the consolidated financial statements and separate from the parent's equity. The amount of net income attributable to the non-controlling interest will be included in consolidated net income on the face of the income statement. SFAS 160 clarifies that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the non-controlling equity investment on the deconsolidation date. SFAS 160 also includes expanded disclosure requirements regarding the interests of the parent and its non-controlling interests. SFAS 160 is effective for the Company beginning January 1, 2009. The Company is currently evaluating the impact of the adoption of SFAS 160.

In December 2007, the FASB issued SFAS 141(R), "Business Combinations" ("SFAS 141(R)"). SFAS 141(R) expands on the guidance of SFAS 141, extending its applicability to all transactions and other events in which an entity obtains control over one or more other businesses. It broadens the fair value measurement and recognition of assets acquired, liabilities assumed and interests transferred as a result of business combinations. SFAS 141(R) expands on required disclosures to improve the statement users' abilities to evaluate the nature and financial effects of business combinations. SFAS 141(R) establishes principles and requirements for determining how an enterprise recognizes and measures the fair value of certain assets and liabilities acquired in a business combination, including non-controlling interest, contingent consideration and certain acquired contingencies. SFAS 141(R) also requires acquisition-related transaction expenses and restructuring cost be expensed as incurred rather than capitalized as a component of the business combination. SFAS 141(R) is effective for any acquisitions made on or after January 1, 2009. The pronouncement will only have an affect to the extent the Company completes business acquisitions after the effective date.

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In February 2008, the FASB issued FASB Staff Position No. FAS 157-2, "Effective Date of FASB Statement No. 157" ("FSP No. 157-2"), which delays the effective date of SFAS 157 for non-financial assets and non-financial liabilities to fiscal years beginning after November 15, 2008.

The Company is currently evaluating the impact of the adoption of FSP No. 157-2. As allowed under FSP No. 157-2, as of January 1, 2008, we have elected not to fully adopt SFAS 157 and are deferring adoption for certain non-financial assets and liabilities until January 1, 2009.

In March 2008, the FASB issued SFAS No. 161, "Disclosures About Derivative Instruments and Hedging Activities — an amendment of FASB Statement No. 133" ("SFAS 161"). SFAS No. 161 enhances the disclosure requirements of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", regarding an entity's derivative instruments and hedging activities. SFAS No. 161 is effective for the Company's fiscal year beginning January 1, 2009. The Company is currently evaluating the impact of the adoption of SFAS 161.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" ("SFAS 162"). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of non-governmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States (the GAAP hierarchy). SFAS 162 is effective sixty days following the SEC's approval of the Public Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in conformity with Generally Accepted Accounting Principles. The Company does not believe that the adoption of SFAS 162 will have a material impact on its financial statements.

(o) Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and overnight investments.. Included in cash and cash equivalents are deposits with certain states, required in order to be licensed in these states. These deposits were \$206, and \$4,566 at December 31, 2008 and 2007, respectively.

(p) Derivatives

The Company has limited activity with derivative financial instruments. Interest rate swaps have been used to hedge interest rate volatility on the trust preferred and are not used for trading purposes, nor does the Company engage in leveraged derivative transactions. At December 31, 2008, there were no interest rate swaps outstanding.

(q) Reclassifications

Certain line items in the statements of operations have been reclassified for the years ended December 31, 2007 and 2006. The presentation is consistent with the presentation for the year ended December 31, 2008 and did not result in any impact to net earnings or shareholders' equity.

(2) Investments

Net investment income is summarized as follows:

	Years ended December 31,		
	2008	2007	2006
Fixed maturity securities	\$ 28,513	\$ 27,711	\$ 19,019
Common stock	385	290	416
Preferred stock	384	502	332
Short-term investments and cash and cash equivalents	<u>1,293</u>	<u>2,435</u>	<u>2,595</u>
	30,575	30,938	22,362
Less investment expenses	<u>984</u>	<u>670</u>	<u>596</u>
Net investment income	\$ 29,591	\$ 30,268	\$ 21,766

Realized and unrealized gains and losses were as follows:

	Years ended December 31,		
	2008	2007	2006
Realized gains:			
Fixed maturity	\$ 993	\$ 95	\$ 1,176
Common stock	<u>44</u>	<u>131</u>	<u>2,790</u>
Total gains	<u>1,037</u>	<u>226</u>	<u>3,966</u>
Realized losses:			
Fixed maturity	(11,047)	(488)	(2,224)
Common stock	(1,102)	(12)	(552)
Preferred stock	<u>(3,236)</u>	<u>(37)</u>	<u>-</u>
Total losses	<u>(15,385)</u>	<u>(537)</u>	<u>(2,776)</u>
Net realized (losses) gains	\$ (14,348)	\$ (311)	\$ 1,190
Changes in unrealized (losses) gains:			
Fixed maturity	\$ (1,430)	\$ 6,418	\$ 1,886
Common stock	(7,093)	61	421
Preferred stock	<u>648</u>	<u>(1,358)</u>	<u>105</u>
Net change in unrealized (losses) gains	\$ (7,875)	\$ 5,121	\$ 2,412

As a result of our quarterly evaluations, the Company recorded \$13,712 of net realized losses in 2008 due to other-than-temporary-impairment of its investments. All but \$400 of the impairment relates to securities issued by companies in the financial services sector.

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Other-than-temporary-impairment totaled \$9,431 of fixed maturities, \$3,236 of preferred stock and \$1,045 of common stock. There were no other-than-temporary-impairment charges for 2007 and 2006.

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At December 31, 2008 and 2007, the Company did not hold fixed maturity securities, which individually exceeded 10% of shareholders' equity, except U.S. government and government agency securities.

The amortized cost and estimated fair values of investments at December 31, 2008 and 2007 (dollars in thousands) are as follows:

	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
<u>December 31, 2008</u>				
Fixed maturities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 57,335	\$ 4,874	\$ -	\$ 62,209
States of the U.S. and political subdivisions of the states	41,804	479	(692)	41,591
Corporate securities	256,141	6,467	(10,669)	251,939
Mortgage-backed securities	181,032	5,126	-	186,158
Commercial mortgage-backed securities	14,097	-	(2,179)	11,918
Asset-backed securities	<u>17,006</u>	<u>3</u>	<u>(914)</u>	<u>16,095</u>
Total fixed maturities	\$567,415	\$16,949	\$ (14,454)	\$569,910
 Common stock	 \$ 25,425	 \$ 975	 \$ (5,863)	 \$ 20,537
 Preferred stock	 \$ 3,785	 \$ 11	 \$ (509)	 \$ 3,287

At December 31, 2008 the Company's investment in corporate fixed maturities totaled \$251,939, composed of \$155,205 of securities issued by companies in the industrial sector, \$55,193 in the financial sector, \$33,597 in utilities and \$7,943 in foreign agencies and other securities.

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Fixed income securities with fair values of \$30,419 and \$26,981 were on deposit with insurance regulatory authorities at December 31, 2008 and 2007 in accordance with statutory requirements.

December 31, 2007

Fixed maturities:

U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 84,567	\$ 1,581	\$ (13)	\$ 86,135
States of the U.S. and political subdivisions of the states	7,549	50	(119)	7,480
Corporate securities	212,127	3,075	(1,740)	213,462
Mortgage-backed securities	181,129	1,534	(575)	182,088
Commercial mortgage-backed securities	15,457	94	(75)	15,476
Asset-backed securities	<u>24,815</u>	<u>213</u>	<u>(100)</u>	<u>24,928</u>
Total fixed maturities	\$525,644	\$ 6,547	\$(2,622)	\$529,569
Common stock	\$ 23,189	\$ 3,313	\$(1,108)	\$ 25,394
Preferred stock	\$ 6,939	\$ -	\$(1,146)	\$ 5,793

The amortized cost and estimated fair values of fixed maturities at December 31, 2008 by contractual maturity are shown below. Expected maturities may differ from contractual maturities as certain borrowers may have the right to call or prepay obligations with or without call or prepayment penalty.

	Amortized cost	Estimated fair value
Due in one year or less	\$ 18,548	\$ 18,609
Due after one year through five years	125,814	126,765
Due after five years through ten years	173,702	169,975
Due after ten years	54,222	56,485
Mortgage and asset-backed securities	<u>195,129</u>	<u>198,076</u>
Total	\$567,415	\$569,910

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The tables below show the securities the Company is holding which have been held at a loss for less than 12 months and 12 months or greater at December 31, 2008 and December 31, 2007 respectively.

December 31, 2008

	<u>Less than 12 months</u>		<u>12 months or longer</u>		<u>Total</u>	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
US Treasury Securities & other government corporations and agencies	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
States of the US and political subdivisions of the states	15,098	(387)	4,072	(305)	19,170	(692)
Corporate securities	107,018	(8,402)	12,145	(2,267)	119,163	(10,669)
Commercial mortgage-backed securities	2,532	(351)	9,386	(1,828)	11,918	(2,179)
Asset-backed securities	<u>13,884</u>	<u>(606)</u>	<u>1,667</u>	<u>(308)</u>	<u>15,551</u>	<u>(914)</u>
Subtotal fixed maturities	138,532	(9,746)	27,270	(4,708)	165,802	(14,454)
Common stock	6,103	(2,201)	5,098	(3,662)	11,201	(5,863)
Preferred stock	<u>-</u>	<u>-</u>	<u>2,469</u>	<u>(509)</u>	<u>2,469</u>	<u>(509)</u>
Total temporarily impaired securities	\$144,635	\$ (11,947)	\$ 34,837	\$ (8,879)	\$179,472	\$ (20,826)

December 31, 2007

	<u>Less than 12 months</u>		<u>12 months or longer</u>		<u>Total</u>	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
US Treasury Securities & other government corporations and agencies	\$ -	\$ -	\$ 9,190	\$ (13)	\$ 9,190	\$ (13)
States of the US and political subdivisions of the states	-	-	6,490	(118)	6,490	(118)
Corporate securities	44,932	(1,106)	22,517	(634)	67,449	(1,740)
Mortgage-backed securities	6,880	(21)	42,458	(544)	49,338	(565)
Commercial mortgage-backed securities	-	-	8,735	(86)	8,735	(86)
Asset-backed securities	<u>1,426</u>	<u>(9)</u>	<u>5,965</u>	<u>(91)</u>	<u>7,391</u>	<u>(100)</u>
Subtotal, fixed maturities	53,238	(1,136)	95,355	(1,486)	148,593	(2,622)
Common stock	8,390	(723)	854	(386)	9,244	(1,109)
Preferred stock	<u>5,793</u>	<u>(1,147)</u>	<u>-</u>	<u>-</u>	<u>5,793</u>	<u>(1,146)</u>
Total temporarily impaired securities	\$67,421	\$ (3,006)	\$ 96,209	\$ (1,872)	\$163,630	\$ (4,877)

(3) Investment in Real Estate

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The Company's investment in real estate known as Harbour Village Golf and Yacht Club ("Harbour Village") comprised of 173 acres of property in Ponce Inlet, Florida was acquired in foreclosure during April 1999. The Harbour Village project is complete as all units are sold and closed. The Company does

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not expect to engage in any further real estate activities. As of December 31, 2008, no additional revenue or expenses from Harbour Village are expected.

(4) Financial Instruments

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

Estimated fair values for fixed maturities were determined using market quotations, prices provided by market makers' estimates of fair values obtained from yield data relating to investment securities with similar characteristics or internally developed criteria that use assumptions or other data that are not readily observable from objective sources.

(5) Ceded Reinsurance

Reinsurance is a contractual arrangement under which one insurer (the ceding company) transfers to another insurer (the reinsurer) a portion of the liabilities that the ceding company has assumed under an insurance policy it has issued. A ceding company may purchase reinsurance for any number of reasons, including obtaining, through the transfer of a portion of its liabilities, greater underwriting capacity than its own capital resources would otherwise support, protection against catastrophic loss or to enter into or withdraw from a business line. Reinsurance can be written on either a quota share basis (where premiums and losses are shared proportionally) or excess of loss basis (where losses are covered if they exceed a certain amount), under a treaty (involving more than one policy) or facultative (involving only one policy) reinsurance agreement.

We evaluate each of our ceded reinsurance contracts at inception to determine if there is sufficient risk transfer to allow the contract to be accounted for as reinsurance under current accounting guidance. At December 31, 2008 all ceded contracts are accounted for as risk transferring contracts

Our philosophy is to utilize reinsurance for asset protection against business and capital risks where economically appropriate and to maximize our use of capital

For the year ended December 31, 2008, we ceded \$80.5 million of premium (30.9% of gross premiums written) to unaffiliated third party reinsurers, as compared to \$68.4 million of premium (31.3% of gross premiums written) in 2007. Ceded reinsurance premiums from the specialty programs business line were 44.0% of the 2008 amount and 49.5% of the 2007 amount. We monitor the reinsurance market and will increase or decrease our reliance on reinsurance depending on Company needs, available coverage and rates.

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The approximate effects of reinsurance on the financial statement accounts listed below are as follows:

	Years ended December 31,		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
	(dollars in thousands)		
Net premiums written:			
Direct	\$ 207,316	\$ 197,129	\$ 239,472
Assumed	53,032	21,242	135
Ceded	<u>(80,483)</u>	<u>(68,370)</u>	<u>(82,339)</u>
Net	\$ 179,865	\$ 150,001	\$ 157,268
Net premiums earned:			
Direct	\$ 201,735	\$ 212,757	\$ 222,257
Assumed	48,089	9,352	135
Ceded	<u>(75,353)</u>	<u>(73,316)</u>	<u>(75,636)</u>
Net	\$ 174,471	\$ 148,793	\$ 146,756
Losses and loss adjustment expenses incurred:			
Direct	\$ 142,396	\$ 151,336	\$ 159,920
Assumed	33,847	3,692	-
Ceded	<u>(66,097)</u>	<u>(63,844)</u>	<u>(67,591)</u>
Net	\$ 110,146	\$ 91,184	\$ 92,329
Unpaid loss and loss adjustment expenses:			
Direct	\$ 538,891	\$ 488,288	\$ 425,342
Assumed	47,756	16,491	14,331
Ceded	<u>(193,338)</u>	<u>(175,481)</u>	<u>(161,146)</u>
Net	\$ 393,309	\$ 329,298	\$ 278,527

(6) Income Taxes

Total income tax (benefit) expense for the years ended December 31, 2008, 2007 and 2006 was allocated as follows:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Tax expense attributable to income from operations	\$ 31	\$ 737	\$ 2,314

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Unrealized losses on hedging transactions	(50)	(81)	(35)
Unrealized gains on securities available-for-sale	<u>188</u>	<u>552</u>	<u>233</u>
Total	\$ 169	\$1,208	\$ 2,512

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The Company's subsidiaries that are based in the United States are subject to the tax laws of the United States and the jurisdictions in which they operate. The tax years open to examination by the U.S. Internal Revenue Service for the U.S. subsidiaries are the years 2005 to the present.

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

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Current	\$ 45	\$ 860	\$ 694
Deferred	(2,154)	(540)	478
Establishment of valuation allowance	<u>2,140</u>	<u>417</u>	<u>1,142</u>
Total	\$ 31	\$ 737	\$2,314

The state income tax components aggregated \$145, \$(8) and \$(18) for the years ended December 31, 2008, 2007 and 2006, respectively.

Income tax expense for the years ended December 31, 2008, 2007 and 2006 differed from the amount computed by applying the U.S. Federal income tax rate of 34% to earnings before Federal income taxes as a result of the following:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Expected income tax	\$ 116	\$9,836	\$ 7,768
Foreign earned income not subject to direct taxation	(2,458)	(8,902)	(5,794)
Establishment of valuation allowance	2,140	417	1,142
Tax exempt interest	(276)	-	(639)
State taxes and other	<u>509</u>	<u>(614)</u>	<u>(163)</u>
Total income tax	\$ 31	\$ 737	\$2,314

Given the historical loss position of American Safety RRG, which is not part of the consolidated tax return it has established a 100% valuation allowance on its net deferred tax assets totaling \$1,133 and \$1,559 at December 31, 2008 and 2007, respectively. In addition, the Company established a 100%, \$2,566 valuation allowance on a deferred tax asset resulting from realized losses on securities held at December 31, 2008.

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

	December 31, (dollars in thousands)	
	<u>2008</u>	<u>2007</u>
Deferred tax assets:		
Loss reserve discounting	\$ 10,190	\$ 9,572
Unearned premium reserves	3,110	2,625
Warranty reserve	147	26
Unrealized loss on securities	173	-
Allowance for doubtful accounts	1,575	448
Realized capital loss carry forward	2,566	-
NOL carry forward	758	1,243
Other	<u>256</u>	<u>-</u>
Gross deferred tax assets	18,775	13,914
Valuation allowance	<u>(3,699)</u>	<u>(1,559)</u>
Gross deferred tax assets after valuation allowance	15,076	12,355
Deferred tax liabilities:		
Deferred acquisition costs	2,813	2,183
Unrealized gain on securities	479	168
Other	<u>-</u>	<u>236</u>
Gross deferred tax liabilities	<u>3,292</u>	<u>2,587</u>
Net deferred tax assets	\$ 11,784	\$ 9,768

During the year ended December 31, 2008, the Company established a valuation allowance of \$2,566 as it determined that it is not more likely than not that all of the deferred tax asset related to realized losses on securities held will be realized.

(7) Fair Value Measurements

Effective January 1, 2008 on a prospective basis, we determined the fair values of certain financial instruments based on the fair value hierarchy established in Statement of Financial Accounting Standard 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value.

Level 1: quoted price (unadjusted) in active markets for identical assets

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Level 2: inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the instrument

Level 3: inputs to the valuation methodology are unobservable for the asset or liability

SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

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Our Level 1 instruments are primarily U.S. Treasuries, money market funds and equity securities listed on stock exchanges. We use quoted prices for identical instruments to measure fair value.

Our Level 2 instruments include most of our fixed maturity securities, which consist of U.S. government agency securities, municipal bonds, certain corporate debt securities, and certain mortgage and asset-backed securities. We measure fair value of our Level 2 instruments using quoted prices of securities with similar characteristics.

Our Level 3 instruments include certain fixed maturity securities and an investment in an unrelated third party insurance entity. Fair value is based on internally developed criteria that use assumptions or other data that are not readily observable from objective sources.

As management is ultimately responsible for determining the fair value measurements for all securities, we validate prices received by comparing the fair value estimates to our knowledge of the current market and investigate any prices deemed not to be representative of fair value.

Assets measured at fair value on a recurring basis are summarized below:

As of December 31, 2008

Fair Value Measurements Using

(dollars in thousands)

<u>December 31, 2008</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>	<u>Total</u>
Fixed maturities	\$ 38,621	\$ 523,882	\$ 7,407	\$569,910
Equities securities	18,742	-	5,082	23,824
Short term investments	<u>80,005</u>	<u>-</u>	<u>-</u>	<u>80,005</u>
Total	\$137,368	\$ 523,882	\$ 12,489	\$673,739

Fair Value Measurements
Using Significant
Unobservable Inputs (Level 3)
Fixed

Maturities
(dollars in thousands)

Equities

Level 3 Financial Instruments

Balance at January 1, 2008

\$ -

\$ 2,611

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Total gains (losses) (realized/unrealized)		
Included in earnings	-	-
Included in other comprehensive income	211	-
Net purchases	6,986	2,471
Net transfers in Level 3	<u>210</u>	<u>-</u>
Balance at December 31, 2008	\$ 7,407	\$ 5,082
Change in net unrealized gains relating to assets still held at reporting date	\$ 211	\$ -

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On a quarterly basis, we evaluate whether the fair values of the Company's individual securities are other-than-temporarily impaired when the fair value is below amortized cost. To make this assessment we consider several factors including (i) our intent and ability to hold the security, (ii) the potential for the security to recover in value, (iii) an analysis of the financial condition of the issuer, (iv) an analysis of the collateral structure and credit support of the security, if applicable, (v) the time during which there has been a decline below cost, and (vi) the extent of the decline below cost. If we conclude a security is other-than-temporarily impaired, we write down the amortized cost of the security to fair value, with a charge to net realized investment losses in the Consolidated Statements of Operations.

(8) Insurance Accounting

The consolidated financial statements have been prepared in conformity with GAAP which vary in certain respects, for the Company, American Safety Casualty, American Safety Indemnity and American Safety RRG, from statutory accounting practices prescribed or permitted by regulatory authorities. Statutory accounting practices include state laws, regulations, and general administrative rules, as well as a variety of publications of the National Association of Insurance Commissioners (the "NAIC"). The NAIC membership adopted the Codification of Statutory Accounting Principles Project (the "Codification") as the NAIC-supported basis of accounting. The Codification was approved with a provision allowing for commissioner discretion in determining appropriate statutory accounting for insurers. Accordingly, such discretion will continue to allow prescribed or permitted accounting practices that may differ from state to state.

The maximum amount of dividends the Company's insurance subsidiaries can pay out without prior written approval from the subsidiaries' domicile state insurance commissioners, is limited to the greater of 10% of surplus as regards to policyholders or net income, excluding realized capital gains of the preceding year. Dividends are also limited to the amount of unassigned surplus. Based on the 2008 statutory results of the U.S. insurance subsidiaries, no dividend distributions are available to the parent.

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

American Safety Casualty's statutory capital and surplus as of December 31, 2008, 2007 and 2006 was \$73,190, \$82,367 and \$70,484, respectively, and the amounts required to be maintained by the American Safety Casualty were \$31,862, \$27,651 and \$25,248, respectively. American Safety Indemnity's statutory capital and surplus as of December 31, 2008, 2007 and 2006 was \$57,414, \$65,576 and \$62,648, respectively, and the amounts required to be maintained by American Safety Indemnity were \$24,099, \$21,234 and \$19,106, respectively. American Safety RRG's statutory capital and surplus as of December 31, 2008, 2007 and 2006 was \$5,099, \$3,987 and \$5,175, respectively, and the amounts required to be maintained by American Safety RRG were \$2,016, \$1,668 and \$1,445, respectively.

The Bermuda Insurance Act of 1978 and related regulations (the "Act") requires American Safety Re to meet a minimum solvency margin. American Safety Re's statutory capital and surplus as of December 31, 2008, 2007 and 2006 was \$110,081, \$100,772 and \$76,447, respectively, and the amounts required to be maintained by the Company were \$32,380, \$26,339 and \$21,633, respectively. American Safety Assurance, Ltd (ASA) capital and surplus as of December 31, 2008 and 2007 was \$4,645 and \$1,624 respectively. ASA is required to maintain a minimum of \$1,103 and \$120 in capital for December 31, 2008 and 2007, respectively. In addition, a minimum liquidity ratio must be maintained whereby relevant

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assets, as defined by the Act, must exceed 75% of relevant liabilities. Once these requirements have been met, there is no restriction on the remaining retained earnings available for distribution.

(9) Loans Payable

Trust Preferred Offerings

In 2003, American Safety Capital and American Safety Capital II, both non-consolidated, wholly-owned subsidiaries of the Company, issued \$8 million and \$5 million, respectively, of variable rate 30-year trust preferred securities. The proceeds were used by the Company to support the growth of its insurance business. The securities require interest payments on a quarterly basis calculated at a floating rate of LIBOR + 4.2% and LIBOR + 3.95% for American Safety Capital and American Safety Capital II, respectively. The securities can be redeemed at the Company's option after five years from the date of original issuance.

In 2005, the American Safety Capital Trust III, a non-consolidated wholly-owned subsidiary of the Company, issued a 30-year trust preferred obligation in the amount of \$25 million. This obligation bears a fixed interest rate of 8.31% for the first five years and LIBOR plus 3.4% thereafter. Interest is payable on a quarterly basis and the securities may be redeemed at the Company's option after five years from the date of original issuance.

(10) Related Party and Affiliate Transactions

ASI Services, American Safety's underwriting and administrative services subsidiary leased office from an entity which was owned by certain directors, officers and shareholders of the Company. The lease commenced on March 1, 2001 with an original term through August 31, 2007. This lease was terminated in 2006. The Company paid rent associated with the former space of \$520 in 2006. See Part I, Item 2. Properties, for more information about the Company's offices.

(11) Segment Information

We segregate our business into insurance operations and other, with the insurance operations segment being further classified into four segments: excess and surplus lines (E&S), alternative risk transfer (ART), assumed reinsurance (Assumed Re) and runoff. E&S is further classified into seven business lines: property, environmental, construction, products liability, excess surety and healthcare. ART is further classified into two business lines: specialty programs and fully funded. Run-off includes lines of business that we no longer write.

Within the E&S segment, our property coverage encompasses non-standard, surplus lines commercial property business and commercial multi-peril (CMP) policies. The casualty focus of our CMP products is premises liability. Our environmental insurance group provides general, professional and pollution liability to contractors, consultants and property owners. Construction provides commercial casualty insurance coverages, generally for residential and commercial contractors. Products liability offers general liability and product liability coverages for smaller manufacturers and distributors, non-habitational real estate and certain real property owner, landlord and tenant risks. Excess provides excess and umbrella liability coverages over our own and other carriers' primary casualty policies, with a focus on construction risks. Surety provides payment and performance bonds primarily to the environmental remediation and construction industries. Our healthcare line provides customized liability insurance solutions for long-term care facilities.

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In our ART segment, specialty programs facilitate the offering of insurance to homogeneous niche groups of risks. Fully funded provides a mechanism for insureds to post collateral so as to fully self-insure their risks. We are paid a fee for arranging this type of transaction and, in the case of partially funded business, we may assume some underwriting risks.

In our Assumed Re segment, the Company assumes specialty property and casualty business from affiliated and unaffiliated insurers and reinsurers.

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Our run-off segment includes lines of business that we have placed in run-off, such as workers' compensation, excess liability insurance for municipalities and commercial lines.

The other segment consists of amounts associated with realized gains and losses on investments and the Company's investment in real estate.

The Company measures all segments using net income, total assets and total equity. The reportable insurance operations segments are measured by net premiums earned, incurred losses and loss adjustment expenses and acquisition expenses. Assets are not allocated to the reportable insurance operations segments.

The following table presents key financial data by segment for years ended December 31, 2008, 2007 and 2006 (dollars in thousands):

December 31, 2008	Insurance E & S							Assumed Re	ART	Other		Total
	Environ-mental	Products Liability							Specialty Programs	Fully Funded		
		Construction	Excess	Property	Surety	Healthcare						
Gross premiums written	\$48,275	\$34,575	\$6,780	\$7,235	\$7,752	\$11,248	\$12,238	\$ 53,032	\$ 79,249	\$ -	\$ -	\$ 260,384
Net premiums written	34,372	26,649	5,549	1,088	5,900	8,333	7,955	45,913	43,849	-	257	179,865
Fee income written -	-	-	-	-	-	-	-	-	-	2,490	957	3,447
Net premiums earned	34,026	37,358	4,954	789	4,905	7,355	3,588	42,544	38,695	-	257	174,471
Fee income earned	-	-	-	-	-	-	-	-	-	1,675	957	2,632
Losses & loss adjustment expenses	26,132	22,582	2,984	471	3,105	2,593	1,866	28,765	19,572	-	2,076	110,146
Acquisition expenses	9,566	7,655	950	(505)	1,076	2,169	482	11,792	10,299	-	-	43,484
Gross underwriting (loss) profit	(1,672)	7,121	1,020	823	724	2,593	1,240	1,987	8,824	1,675	(862)	23,473
Income tax expense (benefit)					\$ 495						\$ (464)	\$ 31
Net (loss) earnings					\$ 12,309						\$(11,999)	\$ 310
Assets					\$1,026,364						\$ -	\$1,026,364
Equity					\$ 217,131						\$ (101)	\$ 217,030

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December 31, 2007	Insurance								Assumed Re	Runoff	Other	Total
	E&S				ART							
	Products											
	Environmental	Const-ru	Liability	Excess	Property	Surety	Specialty Programs	Fully Funded				
Gross premiums written	\$47,891	\$59,533	\$5,730	\$6,322	\$3,117	\$6,438	\$68,097	\$ -	\$21,242	\$ -	\$ -	\$218,370
Net premiums written	31,444	50,502	3,746	578	2,145	6,084	34,260	-	21,242	-	-	150,001
Fee income written	-	-	-	-	-	-	-	1,987	-	-	-	1,987
Net premiums earned	36,356	66,450	2,382	527	520	5,469	27,737	-	9,352	-	-	148,793
Fee income earned	-	-	-	-	-	-	-	2,145	-	-	-	2,145
Losses & loss adjustment expenses	26,739	39,340	2,369	444	293	981	15,701	-	6,463	(1,145)	-	91,185
Acquisition expenses	9,623	13,166	125	(481)	104	1,440	2,468	-	2,427	-	-	28,872
Underwriting profit	(6)	13,944	(112)	564	123	3,048	9,568	2,145	462	1,145	-	30,881
Income tax expense (benefit)						\$ 933					\$(196)	737
Net earnings (loss)						\$ 28,634					\$(442)	\$ 28,192
Assets						\$933,826					\$ 183	\$934,009
Equity						\$230,453					\$ (53)	\$230,400

December 31, 2006	Insurance								Assumed Re	Runoff	Other	Total
	E&S				ART							
	Product											
	Environ-mental	Const-ruction	Liability	Excess	Property	Surety	Specialty Programs	Fully Funded				
Gross premiums written	\$51,805	\$96,918	\$2,344	\$3,946	\$ -	\$4,004	\$80,590	\$ -	\$ -	\$ -	\$ -	\$239,607
Net premiums written	37,746	92,530	1,524	670	-	3,042	21,756	-	-	-	-	157,268
Fee income written	-	-	-	-	-	-	-	2,124	-	-	-	2,124
Net premiums earned	35,138	88,612	653	532	-	2,566	19,255	-	-	-	-	146,756
Fee income earned	-	-	-	-	-	-	-	1,685	-	-	-	1,685
Losses & loss adjustment expenses	20,221	58,824	456	319	-	674	12,135	-	-	(300)	-	92,329
Acquisition expenses	10,390	16,555	122	(130)	-	569	(128)	-	-	-	-	27,378
Underwriting profit	4,527	13,233	75	343	-	1,323	7,248	1,685	-	300	-	28,734
Income tax expense (benefit)						\$ 1,922					\$392	\$ 2,314
Net earnings (loss)						\$ 20,117					\$415	\$ 20,532
Assets						\$846,213					\$918	\$847,131
Equity						\$196,001					\$149	\$196,150

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Additionally, the Company conducts business in the following geographic segments: United States and Bermuda. Significant differences exist in the regulatory environment in each country. Those differences include laws regarding the measurable information about the insurance operations. Geographic segments for the years ended December 31, 2008, December 31, 2007 and December 31, 2006 (dollars in thousands):

December 31, 2008	United States	Bermuda	Total
Income tax	\$ 31	\$ -	\$ 31
Net earnings	\$ (6,920)	\$ 7,230	\$ 310
Assets	\$ 597,725	\$ 428,639	\$1,026,364
Equity	\$ 80,422	\$ 136,608	\$ 217,030

December 31, 2007	United States	Bermuda	Total
Income tax	\$ 737	\$ -	\$ 737
Net earnings	\$ 2,009	\$ 26,183	\$ 28,192
Assets	\$ 550,485	\$ 383,524	\$ 934,009
Equity	\$ 72,900	\$ 157,500	\$ 230,400

December 31, 2006	United States	Bermuda	Total
Income tax	\$ 2,314	\$ -	\$ 2,314
Net earnings	\$ 3,491	\$ 17,041	\$ 20,532
Assets	\$ 509,552	\$ 337,579	\$ 847,131
Equity	\$ 66,896	\$ 129,254	\$ 196,150

(12) Commitments and Contingencies

At December 31, 2008 and 2007, the Company had aggregate outstanding irrevocable letters of credit which had not been drawn amounting to \$2,000 for the benefit of the Vermont Department of Banking, Insurance, Securities and Health Care Administration. Investments in the amount of \$2,000 have been pledged as collateral to the issuing bank.

The Company entered into a lease for approximately 47,000 rentable square feet for its primary U.S. operations. The term of the lease is eighty-six months, commencing on February 1, 2007 and extending through March 31, 2014.

The yearly minimum base rent for all operating leases is payable according to the following schedule:

2009	\$ 1,507
2010	1,441
2011	1,339
2012	1,376
2013	1,162
Thereafter	<u>275</u>
Total	\$ 7,100

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(13) Liability for Unpaid Loss and Loss Adjustment Expenses

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

	Years Ended December 31,		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
	(dollars in thousands)		
Unpaid loss and loss adjustment expenses, January 1	\$504,779	\$ 439,670	\$ 393,493
Reinsurance recoverable on unpaid losses and loss adjustment expenses January 1	<u>175,481</u>	<u>161,146</u>	<u>159,515</u>
Net unpaid loss and loss adjustment expenses, January 1	<u>329,298</u>	<u>278,524</u>	<u>233,978</u>
Incurred related to:			
Current year	104,752	88,973	89,731
Prior years	<u>5,394</u>	<u>2,212</u>	<u>2,598</u>
Total incurred	110,146	91,185	92,329
Paid related to:			
Current year ⁽¹⁾	1,011	4,008	5,959
Prior years	<u>45,124</u>	<u>36,403</u>	<u>41,824</u>
Total paid	46,135	40,411	47,783
Net unpaid loss and loss adjustment expenses,			
December 31	393,309	329,298	278,524
Reinsurance recoverable on unpaid loss and loss			
adjustment expenses, December 31	<u>193,338</u>	<u>175,481</u>	<u>161,146</u>
Unpaid loss and loss adjustment expenses,			
December 31	\$586,647	\$504,779	\$439,670

⁽¹⁾ 2008 activity is reduced by \$8,377 related to an assumed loss portfolio transfer completed during 2008.

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The net prior year reserve development for 2008, 2007 and 2006 occurred in the following business lines:

Year Ended December 31,

2008

2007

2006

(dollars in thousands)

Excess and Surplus Lines

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Environmental	\$ 5,202	\$ 4,066	\$ 56
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Construction

-

(728)

2,425

Surety

-

(267)

(224)

5,202

3,071

2,257

Programs

(1,913)

(115)

641

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Runoff	<u>2,105</u>	<u>(744)</u>	<u>(300)</u>
Total	\$ 5,394	\$ 2,212	\$ 2,598

The 2008 prior year adverse reserve development is primarily due to increased paid and case reserves related to accident years 2002 through 2006 for environmental contractor business written in New York. In 2008, the Company decided to exit the New York contractor business by non-renewing policies. The adverse development in the runoff line relates to increased estimates of workers' compensation claims related to site cleanup activities following the terrorist attack in New York on 9/11. The adverse development is partially offset by reserve decreases in specialty programs primarily related to the pest control program.

The 2007 prior year adverse reserve development for the environmental line primarily relates to increased case reserves on 2004 action over claims written in New York and 2006 development on two large claims. This development was partially offset by decreases in construction, surety and the municipality business placed in runoff. Programs prior year benefit is reduced by \$436 of prior year reserve development related to a commutation of a reinsurance treaty with a former program manager.

The 2006 prior year development in the construction line primarily relates to development in layers where the reinsurance provided by one of the participants in these layers was commuted in 2005. The development in the programs primarily relates to an increase in certain case reserves on policies written in 2004 and 2005. This development is partially offset by reductions in our surety and run-off lines.

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

Management recognizes the higher variability associated with certain exposures and books of business and considers this factor when establishing liabilities for losses. Management currently believes the Company's gross and net liabilities are adequate.

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

(14) Stock Compensation

The Company's incentive stock plan grants incentive stock options to employees. Option awards are generally granted with an exercise price equal to the market price of the Company's stock at the date of grant. The Company's options vest over a period of three to five years and expire ten years from the date of the grant. The 2007 Incentive Stock Plan was approved by the shareholders at the 2007 annual shareholders' meeting on July 24, 2007 at which time the 1998 Incentive Stock Plan was terminated.

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While options remain outstanding under the 1998 Incentive Stock Plan no new options will be granted pursuant to such plan. At December 31, 2008, 1,808,847 shares were available for future grants under the 2007 Incentive Stock Plan.

In addition to stock options discussed above, the Company may grant restricted shares to employees under the incentive stock plan. During 2008, the Company granted 47,850 shares of restricted stock at a weighted average grant price of \$17.78. The restricted shares vest on the grant date anniversary ratably over three years at 25%, 25% and 50%, respectively. Stock based compensation expense related to the restricted shares was \$324 for the year ended December 31, 2008, and is reflected in net earnings under payroll and related expenses. There was no expense incurred during 2007 or 2006.

The Company applied the recognition and measurement principles of SFAS No. 123R, Share Based Payments, commencing in the first quarter of 2006. Compensation expense related to stock options of \$779, \$518 and \$615 is reflected in earnings for the twelve months ended December 31, 2008, 2007 and 2006, respectively.

A summary of options activity for the year ended December 31, 2008 is as follows:

			Weighted		
			Average	Remaining	Aggregate
			Exercise	Contractual	Intrinsic
<u>Options</u>	<u>Options</u>	<u>Price</u>	<u>Term</u>	<u>Value</u>	
Outstanding at January 1, 2008	727,150	\$10.02			
Granted	143,303	17.99			
Exercised	(46,700)	10.03			
Forfeited	(28,200)	15.80			
Outstanding at December 31, 2008	795,553	\$11.25	4.80		\$2,788
Exercisable at December 31, 2008	566,083	\$8.56	3.27		\$2,788

The weighted average fair market value of options granted during 2008, 2007 and 2006 was \$10.07, \$10.81 and \$9.43 respectively. The total intrinsic value of options exercised during the years ended December 31, 2008, 2007 and 2006, was \$382, \$2,030 and \$874, respectively.

A summary of the status of the Company's non-vested share activity for the year ended December 31, 2008 is as follows:

<u>Nonvested Options</u>	Options	Weighted Average
		Grant Date
		Fair Value

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Nonvested at January 1, 2008	279,166	\$ 7.21
Granted	143,303	10.07
Vested	(176,934)	5.56
Forfeited	<u>(16,065)</u>	10.34
Nonvested at December 31, 2008	229,470	\$10.05

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The fair value of each option granted during 2008, 2007 and 2006 was estimated on the grant date using the Black-Scholes multiple option approach with the following assumptions:

	2008	2007	2006
Expected volatility	36.36%	37.37%	37.97%
Expected dividends	0.00%	0.00%	0.00%
Expected term (in years)	10.00	10.00	10.00
Risk-free rate	4.50%	4.50%	3.50%

At December 31, 2008, there was \$1,457 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Plan. That cost is expected to be recognized over a weighted-average period of 2.4 years. The total fair value of shares vested during the years ended December 31, 2008, 2007 and 2006 was \$984, \$339 and \$414, respectively.

(15) Litigation

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

Griggs et al. v. American Safety Reinsurance, Ltd. et al., Case No. 2003-31509, Circuit Court, Seventh Judicial District, Volusia County, Florida. Seven plaintiffs filed suit against us and three of our subsidiaries seeking to recover a \$2.1 million loan made by the plaintiffs in 1986 to Ponce Marina, Inc., the former owner of the Harbour Village property. The plaintiffs claimed that we were responsible for the repayment of the loan, with interest. The plaintiffs propounded four theories of liability and the court granted summary judgment for us on three of the theories. However, the court entered judgment on August 10, 2005 against us for approximately \$3.4 million, which includes interest, on the remaining theory. The court held that we, as a condition of our loan, required Ponce Marina, Inc. to demand that the plaintiffs enter into an agreement with Ponce Marina, Inc., to the detriment of their loans and to our benefit, and thus, we had entered into a quasi-contract with the plaintiffs to repay their loan with interest.

On May 18, 2007, the District Court of Appeals of the State of Florida, Fifth District, reversed the judgment against the Company. The Plaintiffs' filed a motion for rehearing with the Appeals Court, which was denied by the Court on July 6, 2007. The Plaintiffs' filed a motion for leave to amend their complaint with the trial court. On September 14, 2007, the trial court issued an order vacating its judgment against the Company, dismissing the Plaintiffs' claims with prejudice and denying Plaintiffs' motion for leave to amend. On October 9, 2007, the Plaintiffs' appealed the denial of their motion for leave to amend. On February 7, 2008, the Plaintiffs filed their initial brief in support of their appeal and an oral argument was held in front of the Fifth District Court of Appeals on October 7, 2008. In November 2008, the Court of Appeals upheld the trial court's denial of Plaintiff's motion for leave to amend. This case is now concluded with no liability on the part of the Company.

AMERICAN SAFETY INSURANCE HOLDINGS, LTD.

SELECTED QUARTERLY FINANCIAL DATA

(UNAUDITED)

The following table presents the quarterly results of consolidated operations for 2008 and 2007

(dollars in thousands except per share amounts):

2008	Mar. 31	June 30	Sept. 30	Dec. 31
Total revenues	\$ 46,622	\$ 56,556	\$ 40,498	\$ 48,646
Income (loss) before taxes	6,169	6,885	(4,116)	(8,597)
Net earnings (loss)	6,021	6,789	(4,295)	(8,205)
Comprehensive income (loss)	5,857	(2,971)	(16,379)	5,720
Net earnings per share:				
Basic	\$ 0.56	\$ 0.64	\$ (0.42)	\$ (0.80)
Diluted	0.55	0.63	(0.42)	(0.80)
Common stock price ranges:				
High	\$21.06	\$18.54	\$16.97	\$15.17
Low	16.00	14.38	12.58	6.10
2007	Mar. 31	June 30	Sept. 30	Dec. 31
Total revenues	\$46,134	\$47,629	\$44,712	\$42,488
Income before taxes	7,552	7,921	7,855	5,602
Net earnings	7,092	7,272	7,046	6,782
Comprehensive income	8,199	2,137	11,364	10,824
Net earnings per share:				
Basic	\$0.67	\$0.69	\$0.66	\$0.63
Diluted	0.65	0.66	0.64	0.61
Common stock price ranges:				
High	\$19.44	\$23.96	\$24.21	\$20.85
Low	17.82	18.95	18.21	17.45

AMERICAN SAFETY INSURANCE HOLDINGS, LTD. (PARENT ONLY)

SCHEDULE II – CONDENSED BALANCE SHEETS

(dollars in thousands)

	December 31,	
	<u>2008</u>	<u>2007</u>
Assets		
Investment in subsidiaries	\$ 205,765	\$ 191,364
Other investments:		
Fixed maturity securities available-for-sale at fair value	6,422	18,611
Common stock at fair value	6,424	15,451
Short term investments	3,134	1,907
Secured note receivable from affiliate	<u>2,500</u>	<u>2,500</u>
Total other investments	18,480	38,469
Cash and cash equivalents	27	8
Accrued investment income	125	268
Other assets	<u>111</u>	<u>954</u>
Total assets	\$ 224,508	\$ 231,063
 Liability and shareholders' equity		
Accounts payable and accrued expenses	<u>\$ 7,378</u>	<u>\$ 594</u>
Total liabilities	<u>7,378</u>	<u>594</u>
 Preferred stock	 <u>100</u>	 <u>100</u>
 Common stock	 103	 107
Additional paid in capital	100,645	106,208
Accumulated other comprehensive earnings, net	(3,209)	4,874
Retained earnings	<u>119,491</u>	<u>119,180</u>
Total shareholders' equity	<u>217,030</u>	<u>230,369</u>
Total liabilities and shareholders' equity	\$ 224,508	\$ 231,063

See accompanying independent auditors' report.

AMERICAN SAFETY INSURANCE HOLDINGS, LTD. (PARENT ONLY)

SCHEDULE II – CONDENSED STATEMENTS OF OPERATIONS

(dollars in thousands)

	Years Ended December 31,		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Revenues:			
Investment income	\$ 853	\$1,769	\$1,754
Realized (losses) gains on sales of investments	<u>(823)</u>	<u>124</u>	<u>91</u>
Total Revenues	<u>30</u>	<u>1,893</u>	<u>1,845</u>
Expenses:			
Operating expenses	<u>2,866</u>	<u>2,572</u>	<u>1,942</u>
Total Expenses	<u>2,866</u>	<u>2,572</u>	<u>1,942</u>
Net loss before equity in net earnings of subsidiaries	(2,836)	(679)	(97)
Equity in net earnings of subsidiaries	<u>3,146</u>	<u>28,871</u>	<u>20,629</u>
Net earnings	\$ 310	\$28,192	\$ 20,532

See accompanying independent auditors' report.

AMERICAN SAFETY INSURANCE HOLDINGS, LTD. (PARENT ONLY)

SCHEDULE II – STATEMENTS OF CASH FLOW

(dollars in thousands)

	Years Ended December 31,		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Cash flow from operating activities:			
Net loss before equity in earnings of subsidiary	\$ (2,836)	\$ (679)	\$ (97)
Adjustments to reconcile net earnings (loss) to net cash provided by (used in) operating activities:			
Change in operating assets and liabilities:			
Accrued investment income	143	12	(232)
Due from/to affiliate	7,143	-	(2,108)
Accounts payable and accrued expenses	(52)	128	842
Other, net	<u>2,029</u>	<u>(983)</u>	<u>399</u>
Net cash provided by (used in) operating activities	6,427	(1,522)	(1,196)
Cash flow from investing activities:			
Decrease (increase) in investments	16,797	4,046	(22,309)
Investment in subsidiary	(14,873)	(2,350)	(30,000)
Increase in short term investments	<u>(1,227)</u>	<u>(1,177)</u>	<u>(619)</u>
Net cash provided by (used in) investing activities	697	519	(52,928)
Cash flow from financing activities:			
Proceeds from secondary offering of common stock	-	-	53,277
Proceeds from exercised stock options	460	1,450	918
Stock repurchase payments	<u>(7,565)</u>	<u>(512)</u>	<u>-</u>
Net cash (used in) provided by financing activities	<u>(7,105)</u>	<u>938</u>	<u>54,195</u>
Net increase (decrease) in cash	19	(65)	71
Cash and cash equivalents, beginning of year	<u>8</u>	<u>73</u>	<u>2</u>
Cash and cash equivalents, end of year	\$ 27	\$ 8	\$ 73

See accompanying independent auditors' report.

AMERICAN SAFETY INSURANCE HOLDINGS, LTD. (PARENT ONLY)

SCHEDULE II – CONDENSED STATEMENTS OF COMPREHENSIVE INCOME

(dollars in thousands)

	Years Ended December 31,		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Net earnings	\$ 310	\$ 28,192	\$ 20,532
Other comprehensive (loss) income:			
Unrealized (losses) gains on securities available-for-sale	(21,967)	4,817	3,617
Unrealized losses on hedging transactions	(94)	(292)	(103)
Reclassification adjustment for realized losses (gains) included in net earnings.	<u>14,074</u>	<u>307</u>	<u>(1,216)</u>
Total other comprehensive (loss) income before income taxes.	(7,987)	4,832	2,298
Income tax expense related to items of other comprehensive income	<u>96</u>	<u>499</u>	<u>207</u>
Other comprehensive (loss) income	<u>(8,083)</u>	<u>4,333</u>	<u>2,091</u>
Total comprehensive (loss) income	\$ (7,773)	\$32,525	\$ 22,623

See accompanying independent auditors' report.

AMERICAN SAFETY INSURANCE HOLDINGS, LTD.

SCHEDULE III – SUPPLEMENTAL INFORMATION CONCERNING

PROPERTY-CASUALTY INSURANCE OPERATIONS

(dollars in thousands)

	Column B	Column C Reserves for Unpaid Deferred Policy Acquisition Costs	Column D Claims and Adjustment Expenses	Column E Net Earned Premiums	Column F Net Investment Income (1)	Column G Claims and Claim Adjustment Expenses Incurred Related to Current Year	Column H Prior Years	Column I Amortization of Deferred Policy Acquisition Costs	Column J Other operating expenses (1)	Column K Net Premiums Written
2008										
E&S:										
Environmental	\$ 5,083	\$ 72,983	\$ 20,818	\$ 34,026	\$ -	\$ 20,930	\$5,202	\$ 9,423	\$ -	\$ 34,372
	3,065	200,156	14,631	37,358	-	22,582	-	8,195	-	26,649
	(324)	1,642	630	789	-	471	-	(498)	-	5,549
Construction	590	5,015	2,831	4,954	-	2,984	-	936	-	1,088
	597	2,228	2,620	4,905	-	3,105	-	1,060	-	5,900
	741	3,320	2,461	7,355	-	2,593	-	1,885	-	8,333
Excess	<u>306</u>	<u>1,863</u>	<u>4,607</u>	<u>3,588</u>	<u>-</u>	<u>1,866</u>	<u>-</u>	<u>475</u>	<u>-</u>	<u>7,955</u>
	10,058	287,207	48,598	92,975	-	54,531	5,202	21,476	-	89,846
Products Liability										
Property										
Surety										
Healthcare										
ART										
Programs	4,994	51,163	22,283	38,695	-	21,485	(1,913)	10,393	-	43,849
Assumed Re	3,119	40,913	15,260	42,544	-	28,765	-	11,615	-	45,913
	<u>-</u>	<u>14,026</u>	<u>-</u>	<u>257</u>	<u>-</u>	<u>(29)</u>	<u>2,105</u>	<u>-</u>	<u>-</u>	<u>257</u>
Runoff	\$ 18,171	\$393,309	\$ 86,145	\$174,471	\$ 29,591	\$ 104,752	\$5,394	\$ 43,484	\$ -	\$ 179,865
Total									39,946	
2007										
E&S										
Environmental	\$4,839	\$62,930	\$20,472	\$36,356	\$ -	\$22,673	\$ 4,066	\$9,623	\$ -	\$31,444

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Construction	4,739	197,974	25,342	66,450	-	40,068	(728)	13,166	-	50,502
Excess	85	1,170	329	527	-	444	-	(481)	-	578
Products Liability	395	2,583	2,236	2,382	-	2,369	-	125	-	3,746
Property	359	268	1,625	520	-	293	(267)	104	-	2,145
Surety	<u>390</u>	<u>914</u>	<u>1,482</u>	<u>5,469</u>	-	<u>1,248</u>	<u>-</u>	<u>1,440</u>	-	<u>6,084</u>
	10,807	265,839	51,486	111,704		67,095	3,071	23,977		94,499
ART										
Programs	2,907	41,719	17,132	27,737	-	15,816	(115)	2,468	-	34,260
Assumed Re	3,117	6,453	11,890	9,352	-	6,463	-	2,427	-	21,242
Runoff	<u>-</u>	<u>15,287</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(401)</u>	<u>(744)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total	\$16,831	\$329,298	\$80,508	\$148,793	\$30,269	\$88,973	\$2,212	\$28,872	\$32,894	\$150,001
2006										
E&S										
Environmental	\$5,117	\$51,316	\$22,579	\$35,235	\$-	\$20,165	\$56	\$10,398	\$-	\$37,746
Construction	7,544	179,282	41,288	88,612	-	56,398	2,425	16,555	-	92,530
Excess	(181)	726	278	532	-	319	-	(130)	-	670
Products Liability	(15)	424	871	653	-	456	-	122	-	1,524
Surety	<u>213</u>	<u>174</u>	<u>867</u>	<u>2,566</u>	<u>-</u>	<u>898</u>	<u>(224)</u>	<u>569</u>	<u>-</u>	<u>3,042</u>
Total	12,678	231,922	65,883	127,598	-	78,236	2,257	27,514	-	135,512
ART										
Programs	(275)	27,269	13,417	19,255	-	11,495	641	(52)	-	21,756
Runoff	<u>-</u>	<u>19,336</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(300)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total	\$12,403	\$278,527	\$79,300	\$146,853	\$21,767	\$89,731	\$2,598	\$27,462	\$30,377	\$157,268

(1) The Company does not allocate net investment income or other operating expenses to the various business segments.

See accompanying independent auditors' report.

AMERICAN SAFETY INSURANCE HOLDINGS, LTD.

SCHEDULE IV – REINSURANCE

Years Ended December 31,

(dollars in thousands)

Property-Liability	Gross	Ceded to		Net	Percentage of
		Other	Assumed from		Amount
Insurance Premiums Earned	Amount	Companies	Other Companies	Amount	Assumed to Net
United States					
December 31, 2008	\$ 201,735	\$ 69,808	\$ -	\$ 131,927	-%
December 31, 2007	\$ 212,757	\$ 73,316	\$ -	\$ 139,441	-
December 31, 2006	\$ 222,257	\$ 75,636	\$ 135	\$ 146,756	0.1
Bermuda					
December 31, 2008	\$ -	\$ 5,545	\$ 48,089	\$ 42,544	113.0
December 31, 2007	\$ -	\$ -	\$ 9,352	\$ 9,352	100.0
December 31, 2006	\$ -	\$ -	\$ -	\$ -	-
Combined Total					
December 31, 2008	\$ 201,735	\$ 75,353	\$ 48,089	\$ 174,471	27.6
December 31, 2007	\$ 212,757	\$ 73,316	\$ 9,352	\$ 148,793	6.3
December 31, 2006	\$ 222,257	\$ 75,636	\$ 135	\$ 146,756	0.1

See accompanying independent auditors' report.