AMERICAN SAFETY INSURANCE HOLDINGS LTD
Form 10-K
March 29, 2005

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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**FORM 10-K**

ANNUAL REPORT PURSUANT TO SECTIONS 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2004 Commission file number 1-14795

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

| | |
|---|---|
| Bermuda<br>(State of incorporation<br>or organization) | Not applicable<br>(I.R.S. Employer<br>Identification No.) |
| 44 Church Street<br>P.O. Box HM 2064<br>Hamilton, Bermuda<br>(Address of principal executive offices) | HM HX<br>(Zip Code) |

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

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

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

Securities to be registered pursuant to Section 12(g) of the Act: None Indicate by check mark whether Registrant: (1) has filed all Reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months 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. __

Indicate by check mark whether the Registrant is an accelerated filer. Yes __ No X

The aggregate market value of Registrant s voting common stock held by non-affiliates on December 31, 2004 was $60,371,986. For the purposes of this calculation, shares of common stock of the Registrant held by directors, executive officers and persons who hold more than 5% of the outstanding shares have been excluded.

The number of shares of Registrant s common stock outstanding on March 18, 2004 was 6,797,254.

Documents Incorporated by Reference: Part III of this Form 10-K incorporates by reference certain information from Registrant s Proxy Statement for the 2005 Annual General Meeting of the Shareholders (the 2005 Proxy Statement ).

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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.

We maintain a web site at *www.americansafetyinsurance.com* that contains additional information regarding the Company. We have filed as exhibits to this Report copies of the charters of our Board committees and our code of business conduct and ethics. Under the caption SEC Filings on our website, we provide access, free of charge, to our SEC filings, 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.

***Who We Are***

We are a specialty insurance holding company which, through our subsidiaries, develops, underwrites, manages and markets property and casualty insurance and reinsurance to targeted niche markets for environmental remediation, contracting and other specialty risks. We have demonstrated expertise in developing specialty insurance coverages and custom designed risk management programs not generally available in the standard insurance market.

We were formed in 1986 as a group captive insurance company in Bermuda to provide stable, long term insurance protection for the asbestos abatement and environmental remediation industries in the United States, which had suffered from disruptive market cycles in the standard insurance market. In March 2000, we acquired American Safety Indemnity Company ( American Safety Indemnity ) to target additional underserved specialty or alternative niche insurance risks. We now provide a broad range of specialty insurance coverages and services in all 50 states through approximately 230 independent insurance brokers and agencies.

***Our Market***

We provide insurance primarily to three markets in which standard insurers do not actively participate:

Our environmental insurance coverages provide insurance programs primarily for the environmental risks of environmental contractors, consultants, storage tank owners, commercial real estate owners, manufacturing facilities, hazardous waste facilities and dry cleaner operators.

Our excess and surplus coverages consist primarily of general liability for construction risks and a mix of habitational and products liability risks.

Our specialty programs include customized insurance for varying specialty niche and homogeneous groups of risks, including commercial business packages for small businesses, pest control operators, lawyers professional liability, Hawaii taxicab operators and bail bonds.

We insure and place risks primarily through our two U.S. insurance subsidiaries, American Safety Casualty Insurance Company ( American Safety Casualty ) and American Safety Indemnity, and our U.S. non-subsidiary risk retention group affiliate, American Safety Risk Retention Group, Inc. ( American Safety RRG ). We reinsure a portion of these risks through our Bermuda reinsurance subsidiaries, American Safety Reinsurance, Ltd. ( American Safety Reinsurance ), American Safety Assurance Ltd., ( ASA ), and other third party reinsurers. Our Bermuda reinsurance subsidiaries facilitate the allocation of risk among our insurance subsidiaries and generally provides us with greater flexibility in managing our business. Substantially all of the reinsurance business that we currently assume is for insurance programs that we have developed and underwritten.

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We also provide specialized insurance program development, underwriting, reinsurance, program management, brokerage, loss control, claims administration and marketing services through American Safety Insurance Services, Inc. ( ASI Services ), our principal U.S. program development, underwriting, brokerage and administrative services subsidiary. We select our roles as program developer, primary underwriter, reinsurer or program manager. After determining our roles, we utilize our insurance and reinsurance subsidiaries, our insurance brokerage and management services subsidiaries, and our non-subsidiary risk retention group affiliate to generate risk premium revenues, program management fees, insurance and reinsurance commissions and investment income.

***Our Strengths***

We have succeeded in our business through identifying insurable risks not served adequately in the standard insurance market. For these markets, we are able to offer a broad array of innovative insurance products and services. Our strategy has been to enter underserved markets where our abilities provide us with competitive advantages, and we have the ability to quickly reduce our coverages or exit these markets when results do not meet our expectations as a result of pricing, claims experience or other factors. Management has demonstrated its ability to execute on opportunities and at the same time exercise underwriting judgment and discipline. This strategy is most clearly demonstrated through our willingness to exit or reduce certain business lines such as surety or workers compensation when they generate unacceptable claims experience or do not meet our profitability goals. A significant portion of our new business comes through independent brokers and agencies who are aware of our interest and ability to offer insurance to underserved markets and who have identified a market that they believe provides both them and us with a potentially profitable opportunity. We plan to continue to expand our insurance lines and services. We believe that we are well positioned for continued success as we continue to implement our business and growth strategies. A component of these strategies includes pursuing acquisitions that can expand our written premiums or our ability to issue new insurance products and services.

***Our Strategy***

We have succeeded through identifying insurable risks not identified in the standard insurance market. Typically, we target niche insurance markets that are underserved because:

For these markets, we are able to offer a broad array of innovative insurance products and services. A significant portion of our new business comes through insurance agencies and brokers who are aware of our interest and ability to offer insurance to underserved markets and who have identified a market that they believe provides both them and us a potentially profitable opportunity.

Depending upon the needs of the particular market, we have the ability to combine (i) disciplined underwriting, (ii) value-added services, including customized coverages, professional risk management, dedicated loss control and claims management, and (iii) a commitment to superior service in order to fashion the product offering that maximizes our profit opportunity and, at the same time, fulfills the needs of the insurance brokers, agents and insureds.

We continue to offer insurance programs to the environmental remediation industry and the contracting industry that provided the impetus for our formation in 1986. As we have grown, however, we also have diversified into other specialty insurance areas. We intend to continue this diversification in the future.

***Our Market***

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

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

***Our Competition***

The casualty insurance and reinsurance business is highly competitive with respect to a number of factors, including overall financial strength of the insurer or reinsurer, ratings by rating agencies, premium rates, policy terms and conditions, services offered, reputation and commission rates. We face competition from a number of insurers who have greater financial and marketing resources and greater name recognition than we do. Although our business strategy is to develop insurance coverages for specialty niche markets (such as the environmental remediation industry and the contracting industry) where our expertise is required and where competition is limited, we nevertheless encounter competition from other insurance companies engaged in insuring risks in broader business lines which encompass our niche markets and specialty coverages, and such competition is expected to increase as we expand our operations.

***Ratings***

In September 2004, A.M. Best, an independent, nationally recognized insurance industry rating service and publisher, reaffirmed its rating of A (Excellent) with a stable outlook on a group basis to American Safety Insurance, including our two U.S. insurance subsidiaries, our Bermuda reinsurance subsidiary and our non-subsidiary risk retention group affiliate, American Safety RRG. The rating of A (Excellent) is the third highest of A.M. Best s 16 letter ratings. A.M. Best s rating represents an independent opinion of an insurer s ability to meet its obligations to policyholders. This rating is of concern primarily to policyholders, insurance brokers and agents and should not be considered an investment recommendation. A.M. Best assigned a financial size rating (VII) on a group basis to American Safety Insurance representing capital and surplus in excess of $50 million. We expect to be assigned a financial size rating (VIII) on a group basis during 2005, based on capital and surplus in excess of $100 million.

***Our Products and Services***

Through our two U.S. insurance subsidiaries and our U.S. non-subsidiary risk retention group affiliate, we provide property and casualty insurance to targeted niche markets in all 50 states for environmental remediation, contracting and other specialty risks. Our specialty insurance lines include coverages for general liability, pollution liability, professional liability, surety, as well as custom designed risk management programs (including captive and rent-a-captive facilities) for contractors, consultants and other businesses and property owners who are involved with environmental remediation, contracting and other specialty risks.

*Environmental Insurance Products.*

We have developed specialty insurance programs for a broad range of environmental concerns and believe that our disciplined underwriting, dedicated loss control and claims management, and committed service to brokers, agents and insureds will enable us to expand our insurance program base to other environmental coverages not currently being provided. Since 1986, our insurance programs have helped asbestos abatement and other environmental remediation contractors and consultants, as well as property owners, perform remediation work in schools, hospitals, and commercial, industrial and other project sites.

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

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

We provide insurance coverage for a broad range of environmental risks, including:

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

Lead Abatement.
We provide general, pollution and professional liability coverages workers for lead paint abatement contractors, consultants and property owners in connection with the abatement of lead paint from both public and private facilities, including housing authority sites.

Underground Storage Tank Removal and Installation.
We provide general liability,pollution liability and professional liability coverages as well as workers compensation coverage to contractors and consultants for the removal and installation of underground storage tanks, including associated soil remediation activities attributed to leaking underground storage tanks.

*Other Hazardous Substances.*
We provide general liability, pollution liability and professional liability coverages, in connection with the removal and remediation of other hazardous substances, including hazardous waste, polychlorinated biphenyls (PCBs) and various petroleum products.

*Excess and Surplus Lines.*
Our U.S. insurance subsidiary, American Safety Indemnity, a licensed and approved excess and surplus lines insurer in 40 states and the District of Columbia, provides excess and surplus lines insurance products through certain surplus lines brokers for commercial casualty risks, general construction and products liability. These risks are typically of a specialized or unique nature that is not served by the standard insurance market. We are generally able to use more restrictive policy terms with less price competition for these risks. By writing this business through our excess and surplus lines insurer, we are less restricted by the rate and form filing regulations to which standard insurers must adhere, thereby giving us more freedom over the pricing we can charge for a risk as well as for the policy terms and conditions we offer. We utilize the services of independent insurance brokers and agencies to attract new business and retain existing clients. Currently, our excess and surplus business line is concentrated among the five brokers below:

| Name of Broker | Percentage of Total E&S Written Premiums (through December 31, 2004) |
|---|---|
| Sterling West Insurance Services, Inc. | 29.3% |
| International E&S Insurance Brokers, Inc. | 26.3 |
| Cooney, Rikard & Curtain of Illinois, Inc. | 13.3 |
| Lemac & Associates Inc. | 9.4 |
| Brown & Riding Insurance Services Inc. | 7.7 |
| | 86.0% |

We have been working with these brokers for approximately six years.

*Program Business.*

Working with program managers, brokers, reinsurance intermediaries, our two U.S. insurance company subsidiaries and our non-subsidiary risk retention group affiliate, we target small and middle-market specialty niche and homogeneous groups of risks where the principal insurance requirements are general liability, professional liability or pollution liability. We seek to capitalize on program business opportunities, arising in large part from shrinking reinsurance availability and a decrease in the number of acceptable insurance companies willing to act as the policy-issuing insurer for a program. In 2004, the Company organized American Safety Assurance, a Bermuda segregated accounts company, which reinsurers certain general and professional liability risks written by our domestic affiliates on a fully-funded basis whereby the insured s post 100% collateral and the Company receives fees.

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We differentiate ourselves from our competitors through the writing of program business in three ways:

- we assume risk on programs where we anticipate that underwriting profits can be realized (as contrasted with traditional "fronting" arrangements);
- we have the originators of the business share in the risk; and
- we utilize a due diligence and audit team consisting of experienced insurance professionals to periodically monitor the management and administration of insurance programs.

We combine our insurance and loss control expertise with our insurance and reinsurance programs. We work with brokers, reinsurance intermediaries and reinsurance companies to design profitable, customized insurance programs. Some examples of programs currently written include commercial packages for small businesses, dry cleaning operators, pest control operators, lawyers professional liability program, and bail bonds. We look for programs where we can take and assume a portion of the risk in addition to generating income from fees and commissions.

*Other Lines.*

Our U.S. insurance subsidiary, American Safety Casualty, is licensed to write surety bonds in 47 states and the District of Columbia, primarily providing contract performance and payment bonds to general construction and environmental contractors. Surety is a contract under which an insurer guarantees certain obligations of a second party to a third party. American Safety Casualty is listed as an acceptable surety on federal bonds, commonly known as a Treasury Listed or T-listed surety.

During 2003, we made the decision to exit the environmental workers compensation line of business and the assumed liability program when its results were not meeting our expectations. We continue to manage the run-off from this business line.

*Insurance Services.*

ASI Services provides insurance program development, underwriting, reinsurance placement, program management, brokerage, loss control, claims administration, marketing and administrative services to our U.S. insurance operations, our non-subsidiary risk retention group affiliate, and other third parties.

ASI Services identifies and evaluates potential new program business and also receives submissions for new programs from insurance brokers and other intermediaries throughout the United States. When a submission for a new program is received, ASI Services identifies the resources needed to evaluate and develop the program. In evaluating and developing a new program, ASI Services considers the following factors:

- whether the submitting party will bear risk and the collateral security required;
- the analysis of historic loss data;
- the integrity and experience of the submitting party;
- the availability of reinsurance; and
- the potential profitability of the program to us.

If the prospects for a new program appear favorable, ASI Services designs the structure for the new program and determines what additional services, such as program management, brokerage, reinsurance, loss control, claims administration, marketing, or other services will be required. ASI Services determines which entities, both affiliated and unaffiliated, are best able to provide such services in a cost-effective manner and implements the program.

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

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

- program management services for the overall management and administration of a program;
- underwriting services for evaluating individual risks or classes of risk;

brokerage services for placing risks with affiliated or unaffiliated insurers;

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;

claims administration services for the prompt reporting and handling of claims, and the supervision of claims adjusters and third party administrators;

marketing services for designing and placing advertisements and other marketing materials, as well as marketing insurance programs to independent agents and brokers; and

administrative services, including data processing, billing, collecting and reporting primary and reinsurance premiums, producing financial Reports on programs and paying claims.

We have four other U.S. subsidiaries under the direction of ASI Services which provide various administrative and insurance agency services.

**Underwriting**

ASI Services underwriting staff handles all insurance underwriting functions for programs on which we assume risk, with specific underwriting authority related to the experience and knowledge level of each underwriter. Risks that are perceived to be more difficult and complex are underwritten by experienced staff and reviewed by management. ASI Services uses management information reports to measure risk selection and pricing in order to control underwriting performance. The principal factors used by ASI Services for underwriting such risks include the financial stability of the business, its operating history, its loss histories and its demonstrated commitment to loss control practices.

**Claims Management**

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

**Reinsurance**

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

*Reinsurance Ceded.*

We obtain reinsurance for our primary insurance operations from unaffiliated reinsurers to protect and mitigate our risk exposure. Our reinsurance program for general liability, pollution liability and professional liability, and excess and surplus lines risks operates on an excess of loss basis, with our current maximum exposure, on a per occurrence basis, limited to $500,000 for general liability, pollution liability and professional liability risks and $350,000 for excess and surplus lines risks with a 3% annual aggregate deductible. For workers compensation business previously written by us, our maximum exposure was $500,000 per occurrence. Some of the reinsurance treaties that we maintain have aggregate limits of liability, swing rates or retrospective commissions.

We purchase reinsurance for our primary insurance business lines and our reinsurance business. Gross reinsurance premiums ceded in 2004 were $89.7 million, which constituted 40.5% of the gross premiums written, and in 2003 were $81.2 million, which constituted 38% of the gross premiums written. The amount of reinsurance obtained by us varies with the line of business insured or reinsured. We experienced increased reinsurance costs in 2003 and 2004, and expect such increased reinsurance costs to continue.

We evaluate the credit quality of our U.S. reinsurers to which we cede business and the retrocessionaires which our U.S. reinsurers, in turn, cede business. The following table sets forth certain information relating to our unaffiliated reinsurers and retrocessionaires as of December 31, 2004, with recoverables in excess of 5% of our total shareholders equity including the amount of collateral that we hold or control:

| Reinsurers | A.M. Best Rating | Total Recoverables at December 31, 2004(1) | Collateral at December 31, 2004 |
|---|---|---|---|
| | | (In thousands) | |
| Berkley Insurance Company | A | $ 21,013 | $ 118 |
| American Constantine | N/A | 19,532 | 21,351 |
| Alea North America | A- | 12,233 | 294 |
| Folksamerica Reinsurance Company | A | 11,067 | 746 |
| Partner Reinsurance Company | A+ | 8,541 | 902 |
| Louisiana Pest Control Insurance Company | N/A | 8,392 | 8,524 |
| QBE Reinsurance Corporation | A | 8,047 | 780 |
| Daimler Chrysler Insurance Company | A | 6,708 | 1,868 |
| Transatlantic Reinsurance Company | A+ | 6,537 | 511 |
| American Re-insurance Company | A | 6,332 | 83 |
| Alea London Limited | N/A | 5,518 | 5,878 |
| Other | | 57,059 | 19,115 |
| Total | | $ 170,979 | $ 60,170 |

(1) Total recoverables includes recoverable amounts for paid losses, case reserves, incurred but not reported reserves and ceded unearned premiums.

**Selected Operating Information**

*Gross Premiums Written.*

As a result of our roles in connection with insurance program development, risk bearing on a primary and reinsurance basis, insurance and reinsurance brokerage, and production and administration, we are involved in a number of insurance and reinsurance premium and fee-generating activities. We place insurance and reinsurance with our insurance and reinsurance subsidiaries and our non-subsidiary risk retention group affiliate. For the year ended December 31, 2004, we were involved with the placement of approximately $221.6 million of gross premiums written through our various programs and subsidiaries.

Significant fluctuations in demand for and supply of various casualty insurance and reinsurance business lines have led to substantial premium rate fluctuations over time. Our management seeks to expand and contract various business lines based on the relative favorability of the premium pricing environment for our insurance products. As a writer of both primary insurance and reinsurance, we have additional flexibility to adjust our business mix in response to price differences in these markets and to utilize our knowledge of primary insurance markets to guide our assumption of insurance and reinsurance risks.

*Net Premiums Written.*

The following table sets forth our net premiums written by specialty industry for the years ended December 31, 2003 and December 31, 2004:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2003 | | 2004 | |
| | (Dollars in thousands) | | | |
| Excess & surplus lines | $ 73,572 | 56.0% | $ 77,894 | 59.0% |
| Environmental | 27,233 | 20.7 | 35,024 | 26.5 |
| Program business | 15,152 | 11.5 | 17,530 | 13.2 |
| Other | 15,521 | 11.8 | 1,473 | 1.3 |
| Total | $131,478 | 100.0% | $131,921 | 100.0% |

*Combined Ratio.*

The combined ratio is a standard measure of a property and casualty insurer s performance in managing its losses and expenses. Underwriting results are generally considered profitable when the combined ratio is less than 100%. The combined ratio of American Safety Insurance was 102.7% in 2004, 96.8% in 2003 and 101.3% in 2002.

The combined ratio of an insurance company measures only the underwriting results of insurance operations and not the profitability of the overall company. Our reported combined ratio for our insurance operations may not provide an accurate indication of our overall profitability. For instance, depending on our mix of business the combined ratio may fluctuate from time to time and may not reflect the overall profitability of our insurance operations.

Loss 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 claims. A full actuarial analysis is performed to provide this estimate of all unpaid loss and loss adjustment expense obligations of the Company under the terms of its contracts and agreements. In evaluating whether the reserves make a reasonable provision for unpaid loss and loss adjustment expense, it is necessary to project future loss and loss adjustment expense payments. It is certain that the actual future losses and loss adjustment expenses will not develop exactly as projected and may, in fact, vary significantly 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.

As of December 31, 2004, approximately 18% of our net reserves relate to liability associated with environmental insurance products, 11% of such reserves are attributable to the program business, 58% of such reserves relate to excess and surplus lines, and the balance of 13% of such reserves is allocated among surety, workers compensation and our other run-off lines of insurance business.

In establishing reserves, several methods are employed in determining ultimate losses: the expected loss ratio method; the Bornhuetter-Ferguson method based on expected loss ratios, paid losses and reported losses; and the loss development method based on paid and reported losses. The first method uses industry expected losses adjusted for our experience while the last method relies on industry payment and reporting patterns to develop our actual 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 the expected losses to produce the expected IBNR. We review the ultimate projections from all three methods and, based on the merits of each method, determine our estimated ultimate losses. In response to the adverse loss development experienced in the first two quarters of 2004 in the Company s excess and surplus segment and management s concern that existing reserves for this segment might be inadequate, the Company commenced an actuarial reserve evaluation. Following completion of this evaluation, the Company changed actuarial reserving methodologies to reflect risk categories and recorded additional reserves.

All the methods used are generally accepted actuarial methods and rely in part on loss reporting and payment patterns while considering the long tail nature of the coverages and inherent variability in projection results from year-to-year. The patterns used are generally based on industry data with supplemental consideration given to our experience as deemed warranted. Industry data is also relied upon during the actuarial analysis 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 loss, without any discount to reflect the time value of money. Reserve calculations are reviewed regularly by management and periodically by regulators. A full actuarial analysis is performed annually, assessing the adequacy of statutory reserves established by management. A statutory actuarial opinion is filed with the various jurisdictions 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 practices and procedures employed by us, without regard to independent actuarial opinions, management believes that our reserves are adequate.

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2002 | 2003 | 2004 |
| | (In thousands) | | |
| Gross reserves, beginning of year | $137,391 | $ 179,164 | $230,104 |
| Ceded reserves, beginning of year | 89,657 | 109,543 | 115,061 |
| Net reserves, beginning of year | 47,734 | 69,621 | 115,043 |
| Incurred related to: | | | |
| Current accident year | 40,297 | 60,598 | 79,101 |
| Prior accident years | 1,734 | 5,236 | 14,402 |
| Total incurred | 42,031 | 65,834 | 93,503 |
| Claim payments related to: | | | |
| Current accident year | 4,739 | 2,490 | 2,567 |
| Prior accident years | 15,405 | 17,922 | 21,939 |
| Total claim payments | 20,144 | 20,412 | 24,506 |
| Net reserves, end of year | 69,621 | 115,043 | 184,040 |
| Ceded reserves, end of year | 109,543 | 115,061 | 137,583 |
| Gross reserves, end of year | $ 179,164 | $ 230,104 | $ 321,623 |

The negative development for prior years for 2002, 2003 and 2004 occurred in the followi

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2002 | 2003 | 2004 |
| | (In thousands) | | |
| Environmental | $ 66 | $ (457) | $ 94 |
| Excess and Surplus | - | 1,602 | 7,700 |
| Programs | 279 | 191 | 1,496 |
| Other Lines | 1,389 | 3,900 | 5,112 |
| Total | $ 1,734 | $ 5,236 | $ 14,402 |

Excess and surplus lines negative development in 2004 was attributable to developing losses on (i) certain New York contractor risks written in 2001 and (ii) a change in actuarial reserving methodologies to reflect risk categories. Exposure to New York contractor risks was significantly reduced during 2002 and 2003. The other lines development was primarily due to $2.9 million of increases in workers compensation reserves and $1.6 million of increases on the Company s assumed liability program. The workers compensation business and the assumed liability program are currently in run-off.

Excess and surplus lines 2003 negative development was attributable to developing losses on (i) contractor s liability business written in New York City during 1999 and 2000 and (ii) products liability on certain types of risk. The other lines development in 2003 was primarily due to $3.6 million of increases in workers compensation reserves reflecting claim development trends that exceeded actuarial modeling expectations. In response to this, we have changed the assumptions in our workers compensation valuation model to better reflect historical loss development patterns.

In other lines development for 2002, premium increased on our assumed workers compensation business (which has been terminated) for prior years which resulted in a negative development.

The following table shows the gross, ceded and net development of the reserves for unpaid losses and loss adjustment expenses from 1994 through 2004 for our primary insurance and reinsurance subsidiaries and our non-subsidiary risk retention group affiliate on a GAAP basis. The top line of the table shows the liabilities at the balance sheet date for each of the indicated years and reflects the estimated amounts for losses and loss adjustment expenses for claims arising in that year and all prior years that are unpaid at the balance sheet date, including losses incurred but not yet reported to us. In the gross and ceded sections of the table, the second line shows the re-estimated amount of previously recorded liability based on experience as of the end of each succeeding year. The lower portion of the table in the net section shows the cumulative amounts subsequently paid as of successive years with respect to the liability. The estimates change as more information becomes known about the frequency and severity of claims for individual years. A redundancy (deficiency) exists when the re-estimated liability at each December 31 is less (greater) than the prior liability estimate. The cumulative redundancy(deficiency) depicted in the table, for any particular calendar year, represents the aggregate change in the initial estimates over all subsequent calendar years.

| | | | | | Year Ended December 31,(1) | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 20 |
| | | | | | (In thousands) | | | | |
| Gross reserves | $ 6,048 | $ 8,294 | $ 8,914 | $11,572 | $14,701 | $20,413 | $50,509 | $137,391 | $179 |
| Re-estimated at 12/31/04 | 2,834 | 5,813 | 9,430 | 11,470 | 13,217 | 27,153 | 75,650 | 189,906 | 221 |
| Cumulative redundancy (deficiency) on gross reserves | 3,214 | 2,481 | (516) | 102 | 1,484 | (6,740) | (25,141) | (52,515) | (42 |
| Ceded reserves | -- | 6 | 45 | 779 | 1,841 | 6,065 | 27,189 | 89,697 | 109 |
| Re-estimated at 12/31/04 | -- | -- | 1,568 | 1,167 | 1,520 | 10,945 | 46,942 | 122,834 | 127 |
| Cumulative redundancy (deficiency) on ceded reserves | -- | 6 | (1,523) | (388) | 321 | (4,880) | (19,753) | (33,177) | (18 |
| Net reserves for unpaid losses and loss adjustment expenses | 6,048 | 8,288 | 8,869 | 10,793 | 12,860 | 14,348 | 23,320 | 47,734 | 69 |
| Net Reserves re-estimated at December 31: | | | | | | | | | |
| 1 year later | 5,854 | 7,482 | 9,850 | 11,460 | 12,298 | 15,498 | 24,837 | 49,469 | 74 |
| 2 years later | 5,381 | 7,518 | 9,926 | 12,244 | 12,967 | 15,541 | 26,853 | 53,912 | 93 |
| 3 years later | 4,823 | 7,398 | 9,606 | 12,550 | 12,677 | 16,452 | 29,242 | 67,072 | |
| 4 years later | 4,373 | 7,027 | 9,767 | 11,556 | 13,054 | 16,510 | 28,708 | -- | |
| 5 years later | 3,941 | 7,251 | 8,677 | 11,558 | 11,995 | 16,208 | -- | -- | |
| 6 years later | 4,062 | 6,261 | 8,646 | 10,505 | 11,697 | -- | -- | -- | |
| 7 years later | 3,324 | 6,329 | 7,952 | 10,303 | -- | -- | -- | -- | |
| 8 years later | 3,005 | 5,767 | 7,862 | -- | -- | -- | -- | -- | |
| 9 years later | 2,661 | 5,813 | -- | -- | -- | -- | -- | -- | |
| 10 years later | 2,834 | -- | -- | -- | -- | -- | -- | -- | |
| Cumulative redundancy (deficiency) on net reserves | 3,214 | 2,475 | 1,007 | 490 | 1,163 | (1,860) | (5,388) | (19,337) | (24 |
| Cumulative amount of net liability paid through December 31: | | | | | | | | | |
| 1 year later | 501 | 931 | 1,827 | 2,880 | 3,612 | 5,243 | 10,514 | 15,406 | 17 |
| 2 years later | 997 | 2,056 | 3,506 | 6,057 | 6,565 | 9,616 | 15,865 | 28,577 | 35 |
| 3 years later | 1,552 | 2,906 | 4,918 | 7,443 | 9,058 | 11,060 | 22,750 | 38,290 | |
| 4 years later | 1,899 | 3,656 | 6,034 | 8,991 | 9,086 | 13,558 | 24,131 | -- | |
| 5 years later | 2,162 | 4,619 | 6,638 | 8,479 | 9,895 | 13,646 | -- | -- | |
| 6 years later | 2,428 | 4,906 | 6,362 | 9,320 | 9,816 | -- | -- | -- | |
| 7 years later | 2,617 | 4,793 | 7,017 | 9,073 | -- | -- | -- | -- | |
| 8 years later | 2,259 | 5,266 | 7,016 | -- | -- | -- | -- | -- | |
| 9 years later | 2,559 | 5,266 | -- | -- | -- | -- | -- | -- | |
| 10 years later | 2,559 | -- | -- | -- | -- | -- | -- | -- | |
| Net reserves December 31 | 6,048 | 8,288 | 8,869 | 10,793 | 12,860 | 14,348 | 23,320 | 47,734 | 69 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Ceded Reserves | -- | 6 | 45 | 779 | 1,841 | 6,065 | 27,189 | 89,657 | 109 |
| Gross Reserves | $ 6,048 | $ 8,294 | $ 8,914 | $11,572 | $14,701 | $20,413 | $50,509 | $137,391 | $179 |

(1) Only years ended December 31, 2001, 2002, 2003 and 2004 include the consolidated values of American Safety RRG.

**Investments**

We employ an independent, nationally recognized investment management company to provide investment advisory services to us, subject to the investment policies and guidelines established by our board of directors. We have consistently invested primarily in investment grade fixed income securities, with the objective of providing reasonable returns while limiting liquidity risk and credit risk. Our investment portfolio consists primarily of government and governmental agency securities and high quality marketable corporate securities which are rated at investment grade level.

At December 31, 2004 our total assets of $584.2 million consisted of the following: cash, investments 60.6%; premiums receivable and agent s balances 3.6%; reinsurance recoverables 29.3%; and other assets 6.5%. At December 31, 2003, our total assets of $514.3 million consisted of the following: cash, investments and notes receivable 57%; premiums receivable and agent s balances 5%; reinsurance recoverables 30%; and other assets 8%.

Our cash and investments at December 31, 2004 totaled approximately $351.7 million, and were classified as follows:

| Type of Investment | Amortized Cost | Percent Portfol |
|---|---|---|
| | (In thousands) | |
| Cash and short-term investments | $ 50,742 | 14.4 |
| U.S. government securities | 65,887 | 18.7 |
| States of the U.S. and political subdivisions of the states | 31,067 | 8.8 |
| Mortgage-backed securities | 97,244 | 27.7 |
| Corporate bonds | 90,742 | 25.8 |
| Equities | 14,002 | 4.0 |
| Real estate | 2,005 | 0.6 |
| Total | $ 351,689 | 100.0 |

The fair values of our bond portfolio, classified by rating, as of December 31, 2004 wer

| S&P's/Moody's Rating(1) | Fair Value | Percent Total |
|---|---|---|
| AAA/Aaa (including U.S. Treasuries of $40,056) | $ 190,476 | 66.6% |
| AA/Aa | 15,083 | 5.3 |
| A/A | 69,487 | 24.3 |
| BBB/Baa | 11,011 | 3.8 |
| Total | $ 286,057 | 100.0% |

(1) Ratings are assigned by Standard & Poor s, a division of The McGraw-Hill Companies, Inc. or, if no such rating is available, by Moody s Investors Service Inc.

The National Association of Insurance Commissioners 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, 2004, all of our portfolio was 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, 2004, was 4.09 years. The maturity distribution of our bond portfolio, as of December 31, 2004, based on stated maturity dates with no prepayment assumptions, was as follows:

| Maturity | Amortized Cost | Fair Value |
|---|---|---|
| | (In thousands) | |
| Due in one year or less | $ 21,006 | $ 21,005 |
| Due from one to five years | 85,053 | 85,038 |
| Due from five to ten years | 65,634 | 66,646 |
| Due after ten years | 16,003 | 16,566 |
| Mortgage-backed securities | 97,244 | 96,802 |
| Total | $ 284,940 | $ 286,057 |

Our mortgage-backed securities are subject to risks associated with the variable prepayments of the underlying mortgage loans.

***Our Non-Subsidiary Affiliate***

Following the enactment of the Risk Retention Act, 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. American Safety RRG is not owned by us but is managed by ASI Services, our principal U.S. program development, underwriting and administrative services subsidiary. 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 Health Care Administration (the Vermont Department ) under the Vermont Captive Act as a stock captive insurance company. Presently, five of the directors of American Safety RRG, David V. Brueggen, William O. Mauldin, Jr., Thomas W. Mueller, Cody W. Birdwell and Stephen R. Crim, are also directors of American Safety Insurance. The directors of American Safety RRG are elected annually by the insureds/shareholders of American Safety RRG.

American Safety Insurance transferred its book of primary insurance business to American Safety RRG in 1988 and American Safety RRG replaced American Safety Insurance as the policy issuing carrier insuring general liability, pollution liability and professional liability risks for contractors, consultants and other businesses and property owners who are involved with environmental remediation or related activities. We then became the quota share reinsurer of the risks transferred and subsequently underwritten by American Safety RRG. All reinsurers of American Safety RRG are required to be approved as reinsurers by the Vermont Department, and we have been an authorized reinsurer of American Safety RRG since 1988. Our insurance subsidiaries participate in the on-going business of American Safety RRG through a pooling agreement whereby we retain 75% of the premiums and risk from the insurance business of American Safety RRG.

In December 2003, the FASB revised Interpretation No. 46 revised December 2003, Consolidation of Variable Interest Entities which requires the financial statements of American Safety RRG be consolidated in our financial statements. See Note 1(n) of our financial statements for more information relating to this matter. As a result, the financial information presented herein, unless specifically noted, includes balances of American Safety RRG.

***Regulatory Environment***

*Insurance Regulation Generally.*

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

The nature and extent of state regulation varies from jurisdiction to jurisdiction, but typically involves prior approval of the acquisition of control of an insurance company or of any company controlling an insurance company, regulation of certain transactions entered into by an insurance company with an affiliate, approval of premium rates for lines of insurance, standards of solvency and minimum amounts of capital and surplus which must be maintained, limitations on types and amounts of investments, restrictions on the size of risks which may be insured by a single company, deposits of securities for the benefit of policyholders, and reports with respect to financial condition and other matters. In addition, state regulatory examiners perform periodic examinations of insurance companies.

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 determined in accordance with SAP.

*Bermuda Regulation.*

Our Bermuda reinsurance subsidiaries, American Safety Reinsurance and American Safety Assurance, are subject to regulation under The Insurance Act 1978, as amended, 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 ).

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

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

*U.S. Regulation.*

As a Bermuda insurance holding company, we do not do business ourselves in the United States. We do business in the United States through our U.S. subsidiaries. Our two 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. insurance subsidiary domiciled in Delaware, in 1993. American Safety Casualty is currently licensed as a casualty insurer in 48 states and the District of Columbia. The insurer is subject to regulation and examination by the Delaware Insurance Department and the other states in which it is an admitted insurer. The Delaware Insurance Department examines American Safety Casualty on a triennial basis. The insurance laws of Delaware place restrictions on a change of control of American Safety Insurance as result of our ownership of American Safety Casualty. Under Delaware law, no person may obtain 10% or more of our voting securities without the prior approval of the Delaware Insurance Department.

American Safety Casualty, as a licensed insurer, is subject to state regulation of rates and policy forms in the various states in which direct premiums are written for its general liability and workers compensation business lines. Under such 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 of insurers which become unable to pay claims due to an insurer s insolvency. Assessments made against insurers participating in such funds are based on direct premiums written by participating insurers, as a percentage of total direct written premiums of all participating insurers. Written premiums are those premiums written, whether or not earned, during a time period.

We acquired American Safety Indemnity, a U.S. insurance subsidiary domiciled in Oklahoma, in 2000. American Safety Indemnity is currently licensed or approved as an excess and surplus lines insurer in 40 states and the District of Columbia. American Safety Indemnity is subject to examination by the Oklahoma Insurance Department and the other states in which it is approved as an excess and surplus lines insurer. The Oklahoma Insurance Department examines American Safety Indemnity on a triennial basis. The insurance laws of Oklahoma place restrictions on a change of control of American Safety Insurance. 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 restrictions 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.

*Regulation of Our Non-Subsidiary Affiliate.*

The Risk Retention Act facilitates the establishment of risk retention groups to insure certain liability risks of its members. The statute applies only to liability insurance and does not permit coverage of personal risk liability or workers compensation.

The Risk Retention Act and the Vermont Captive Act require that each insured of American Safety RRG be a shareholder. Each insured is required to purchase one share of American Safety RRG s common stock upon the acceptance of the applicant 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, such person s share of common stock is automatically canceled and such person is no longer a shareholder of American Safety RRG. The ownership interests of members in a risk retention group are considered to be exempt securities for purposes of the registration provisions of the Securities Act and the Securities Exchange Act 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 is doing business. The Risk Retention Act requires a risk retention group to provide a notice on each insurance policy which it issues to the effect that (i) the policy is issued by a risk retention group; (ii) the risk retention group may not be subject to all of the insurance laws and regulations of the state in which the policy is being issued; and (iii) no state insurance insolvency guaranty fund is available to the policies issued by the risk retention group.

**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. The Harbour Village property (comprising 173 acres) was acquired by us through foreclosure in April 1999. Development of Harbour Village is substantially complete. We do not plan to engage in any additional real estate development activities. See Exhibit 99 for further information regarding Harbour Village.

**Employees**

At December 31, 2004, we employed 113 persons, none of whom was represented by a labor union. ASI Services employs all but one of our employees and manages our U.S. business operations. The Company believes its relations with its employees are good.

**Risk Factors**

Our insurance operations are subject to the following risk factors, among others, in addition to the information (including disclosures relating to forward-looking statements) set forth elsewhere in this Report:

Industry Cyclicality; Potential Fluctuations in Financial Results.

The financial results of casualty insurance companies historically have been subject to significant fluctuations and may vary significantly in the future. Operating results may fluctuate due to a variety of factors, including competitive conditions in the industry, levels of new and renewal insurance business, unpredictable developments in loss trends, adequacy and changes in liabilities established by insurance and reinsurance to reflect the estimated costs of claims payments (known as loss reserves) according to their insurance or reinsurance contracts, collectibility of reinsurance receivables, market acceptance of new coverages or enhancements, legal interpretations of policy provisions, changes in operating expenses, fluctuations in interest rates and other changes in investment markets which affect market prices of investments and income from such investments, and changes in levels of general business activity and economic conditions. We have experienced increased competitive pricing pressures in almost all of our insurance business lines in recent years. Recently, however, the insurance industry has progressed from a soft market (wherein insurers could not charge higher premiums) to a hard market (wherein insurers can charge higher premiums). These markets are cyclical and may change at any time.

In addition, insureds are eligible for renewal of their policies on different anniversary dates, subject to underwriting and loss control criteria that we develop. If a large number of insureds were to decline to renew their policies or if their policies were not renewed in a given calendar quarter, our results of operations could be materially adversely affected in the renewal quarter and subsequent quarters.

Significant Industry Concentration; Specialty Industry Risks.

Due to our focus on insuring specialty risks, such as the environmental remediation and contracting, our operations could be more exposed than our more diversified competitors to the effects of changes in economic conditions, regulations and legal precedents affecting such specialty industries. These changes may include, but are not limited to, economic downturns that may adversely impact the building and real estate development industry, and the degree of enactment and enforcement of federal and state environmental regulations that encourage or require environmental remediation efforts.

*Dependence and Availability of Reinsurance.*

The availability, amount and cost of reinsurance are subject to prevailing market conditions that are beyond our control and that affect our business, financial condition and operating results. Our business depends significantly upon our ability to limit risk exposure by ceding (i.e., transferring to others) significant amounts of the potential liability arising from risks insured or reinsured by us. As a result of these factors, it is unclear if such reinsurance will continue to be available or available at an affordable cost. If we were unable to maintain or replace reinsurance treaties upon their expiration, either exposures would increase or, if unwilling to bear such increase in exposures, we would be required to reduce the level of our underwriting commitments. Furthermore, we are subject to credit risk with respect to our reinsurers, as the ceding of risk to reinsurers does not relieve us of our primary liability to our insureds. Although we place our reinsurance with reinsurers we believe to be financially stable, a significant reinsurer s inability or unwillingness to make payment under the terms of a reinsurance treaty could have a material adverse effect on our business, financial condition and/or operating results.

*Possible Inadequacy of Loss Reserves.*

The establishment of appropriate loss reserves is an inherently uncertain process, particularly in the environmental remediation industry, contracting industry, other specialty and excess and surplus lines risks where claims that have occurred may not be reported to an insurer until future periods of time. Due to the uncertainties inherent in our business lines, the possibility exists that ultimate losses could exceed the current loss reserves. Insurers are required to maintain reserves to cover their estimated ultimate liability for losses and loss adjustment expenses with respect to reported and unreported claims incurred. Reserves are estimates at a given time involving actuarial and statistical projections of what is expected to be the cost of the ultimate settlement and administration of claims. These estimates are based on facts and circumstances then known, predictions of future events, estimates of future trends, claims frequency and severity, potential judicial expansion of liability precedents, legislative activity and other factors, such as inflation. We engage an internationally recognized actuarial consulting firm to provide reserve studies and rate studies. To the extent that loss reserves prove to be inadequate in the future, we would have to increase our reserves and incur charges to earnings in the periods such reserves are increased, which would cause fluctuations in operating results and could have a material adverse effect on our business, financial condition and/or operating results.

Reliance on Independent Insurance Agencies and Brokers.

The failure or inability of independent insurance agencies and brokers to market our insurance programs successfully could have a material adverse effect on our business, financial condition and/or operating results. We market our insurance programs primarily through approximately 230 independent insurance agencies and brokerage firms. Agencies and brokers are not obligated to promote the Company s insurance programs and may sell competitors insurance programs. As a result, our business depends in part on the marketing efforts of these agencies and brokers and on our ability to offer insurance programs and services that meet the requirements of the clients and customers of these agencies and brokers.

*Risks Associated with Growth Strategy.*

Our growth strategy includes potential strategic acquisitions, as well as continued internal growth, particularly of our specialty business lines, and development of new insurance lines. If we are unable to implement the growth strategy effectively, our business, financial condition and/or operating results could be materially adversely affected. Although the Company is not engaged in negotiations with respect to any acquisition, any future acquisition would be accompanied by risks commonly encountered in acquisitions of companies. Such risks include, among other things, the difficulty in assimilating the operations and personnel of an acquired company; potential disruption to ongoing business; inability to successfully integrate acquired systems and insurance programs into existing operations; maintenance of uniform standards, controls and procedures; and possible impairment of relationships with employees and insureds of an acquired business as a result of changes in management. Due to these risks and other unforeseen factors, we may not be able to successfully implement our strategy for continued internal growth and may not be successful in overcoming the risks or any other problems customarily encountered in connection with an acquisition or development of new insurance lines.

*Importance of Industry Ratings.*

Increased public and regulatory scrutiny of the financial stability of insurance companies have resulted in greater emphasis by policyholders upon insurance company ratings, with a resultant potential competitive advantage for insurance companies with higher ratings. In September 2004, A.M. Best, an independent nationally recognized insurance industry rating service and publisher, reaffirmed a rating of A (Excellent)", with a stable outlook, for the American Safety group of companies, including our Bermuda reinsurance companies, our U.S. insurance subsidiaries and our non-subsidiary risk retention group affiliate. Because A.M. Best continually monitors insurance companies with regard to their ratings, that group rating could change at any time, and any downgrade of such rating could adversely affect the business, financial condition and/or results of operations. A.M. Best s ratings represent an independent opinion of an insurer s ability to meet its obligations to policyholders which opinion is of concern primarily to policyholders, insurance agents and brokers and should not be considered an investment recommendation.

*Regulation.*

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. Such regulation may limit the ability or the speed with which we could 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 or insurance holding companies. Insurance regulation relates to authorized lines of business, capital and surplus requirements, types and amounts of investments, underwriting limitations, trade practices, policy forms, claims practices, mandated participation in shared markets, reserve adequacy, insurer solvency, transactions with related parties, changes in control, payment of dividends and a variety of other financial and nonfinancial components of an insurance company s business. Any changes in insurance laws and regulations could materially adversely affect our business, financial conditions and/or 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.

Environmental Regulation. Environmental remediation activities and other environmental risks are highly regulated by both federal and state governments. Environmental regulation continually is evolving and changes in the regulatory patterns at federal and state levels may have a significant effect upon potential claims against us. Such changes may also affect the demand for the types of insurance we offer and the availability or cost 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 or how they might be interpreted.

The Potential Risk of United States Taxation of Bermuda Operations.

Bermuda s tax laws are more favorable to American Safety Insurance, a Bermuda company, and our Bermuda reinsurance subsidiaries, American Safety Re and American Safety Assurance, than the United States tax laws because these Bermuda companies are not obligated to pay any taxes in Bermuda based upon income or capital gains. If our Bermuda-based operations were determined to be subject to United States taxation, our results of operations could be materially adversely affected. The United States Internal Revenue Code of 1986, as amended, does not contain a definitive identification of activities that constitute being engaged in a United States trade or business, and the possibility exists that the Internal Revenue Service will take the position that our Bermuda-based operations are engaged in a United States trade or business and therefore are subject to United States income taxation. Exclusive of our U.S. subsidiaries, American Safety Insurance does not consider itself to be engaged in a trade or business in the United States and accordingly do not expect to be subject to United States income taxation. Our U.S.

subsidiaries are subject to United States taxation.

**Item 2. Properties**

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

**Item 3. Legal Proceedings**

The Company, through its subsidiaries, is routinely a party to pending or threatened litigation 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 the Company s subsidiaries, management does not believe that any pending or threatened litigation or arbitration disputes will have any material adverse effect on the Company s financial condition or operating results, except for the following matters.

*Acquisition Rescission Litigation.* In April 2000, we filed a lawsuit in the U.S. District Court for the Northern District of Georgia for damages and, alternatively, to rescind the stock purchase of a Michigan insurance agency and two related insurance companies specializing in insurance program business based upon the sellers breach of the representations and warranties made in the definitive agreements concerning the business affairs and financial condition of the acquired companies. The defendants filed several motions for summary judgment opposing our claims. In September 2002, the Court entered an order granting the defendants motions for summary judgment. However, the Court did not rule that the representations and warranties of the defendant in the definitive agreements were correct. The Court also granted our motions on various counterclaims. We filed a motion for reconsideration with respect to the Court s order which the Court denied in November 2002. In August 2003, we filed a motion requesting the Court certify its previous order granting the defendants motion for summary judgment as final so that we could appeal the adverse rulings, however the Court denied our motion in December 2003. In 2004 the Company accrued $1.4 million of additional expense as a result of an adverse ruling in March 2005. It is anticipated that the remaining issues (i.e. disposition of escrowed shares and defendants claim for attorneys fees) in the case will be determined by the Court, without a trial, in 2005. Thereafter, we will have the right to appeal all adverse prior rulings in the case.

*Assumed Reinsurance Litigation.* The Company is a defendant in four lawsuits arising from certain reinsurance agreements, for the years 2002 and 2003, with an automobile warranty insurer which is now in liquidation. The insurer provided coverage to dealerships and other providers who sold extended automobile warranty contracts to consumer purchasers. In these lawsuits, the consumer purchasers and automobile dealers have alleged various theories of liability against the Company. The Company believes it has several valid defenses and intends to vigorously contest these lawsuits.

## 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, 2004.

**Management of the Company**

The following table provides information regarding the management of the Company. Biog persons is set forth immediately following the table.

| Name | Age | Position |
|---|---|---|
| Stephen R. Crim ............. | 41 | President, Chief Executive Officer |
| Joseph D. Scollo, Jr......... | 41 | Executive Vice President |
| Steven B. Mathis ............ | 37 | Chief Financial Officer |
| Fred J. Pinckney ............ | 57 | General Counsel and Secretary |
| J. Jeffrey Hood ............. | 41 | Senior Vice President-Technical Se |

*Stephen R. Crim* became President and Chief Executive Officer of the Company on January 1, 2003 and he became President of the Company s insurance and reinsurance operations effective January 1, 2002. Previously, Mr. Crim had been responsible for all underwriting functions since joining the Company in 1990. Previously, Mr. Crim was employed in the underwriting department of Aetna Casualty and Surety and The Hartford Insurance Co. between 1986 and 1990. Mr. Crim has 19 years experience in the insurance industry. Mr. Crim received a bachelors degree in mathematics from Indiana University in 1986.

*Joseph D. Scollo*, Jr. became Executive Vice President of the Company on January 1, 2003 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 since 1989. Mr. Scollo has 16 years experience in the insurance industry. Mr. Scollo received a Bachelor of Science degree in business from Western New England College in 1985 and is a certified public accountant.

*Steven B. Mathis* became Chief Financial Officer of the Company in August 1998. Previously, he was the Company s controller since 1992 and he is currently responsible for all accounting and treasury functions of the Company. Mr. Mathis has 16 years accounting experience in the insurance industry having held accounting positions with American Insurance Managers, Inc. and American Security Group. Mr. Mathis received a bachelor of business administration degree in accounting from the University of Georgia in 1989.

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

*J. Jeffrey Hood* is Senior Vice President-Technical Services of ASI Services and is responsible for loss control, claims, regulatory and information technology matters. Prior to joining the Company in 1990, Mr. Hood served as a consultant for a national technical engineering firm for four years. Mr. Hood has 18 years of experience relating to risk management in the environmental remediation industry. Mr. Hood received a Bachelor of Science degree in petroleum engineering from Mississippi State University in 1985.

**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 December 31, 2004, there were approximately 2,200 holders of the Company s common shares.

The following table sets forth the high and low prices per share of the Company's common

| Fiscal Year Ended December 31, 2003 | High | Low |
|---|---|---|
| First Quarter | $ 7.33 | $ 6.69 |
| Second Quarter | 9.15 | 6.18 |
| Third Quarter | 13.60 | 9.03 |
| Fourth Quarter | 14.00 | |