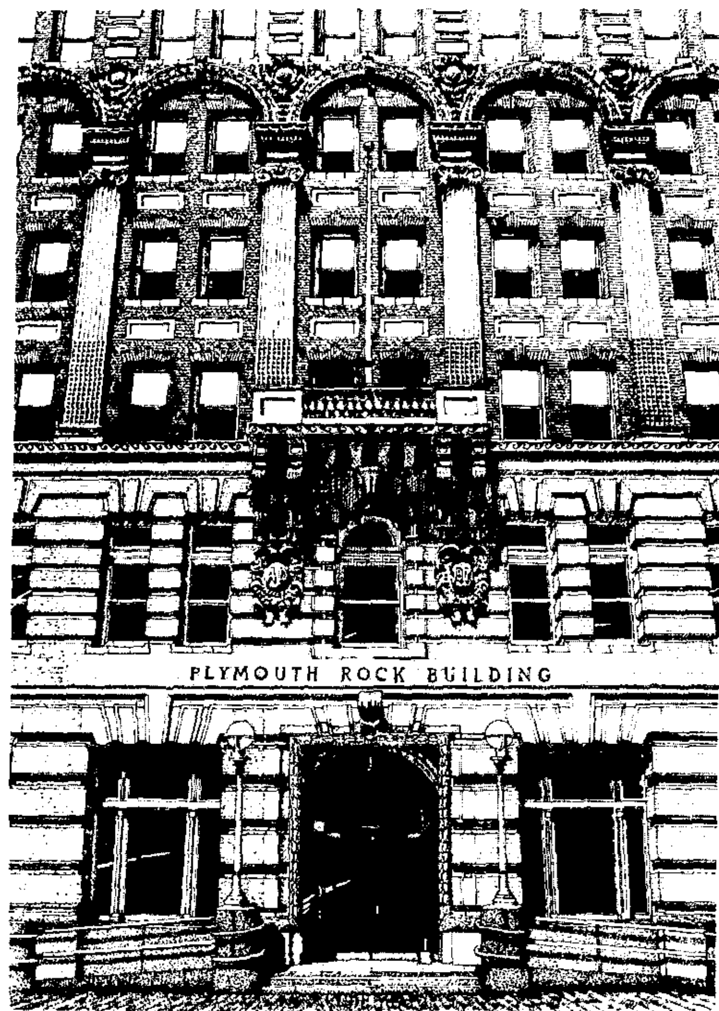
The Plymouth Rock Company



1989 Annual Report

The Plymouth Rock Company

INCORPORATED
695 Atlantic Avenue
Boston, Massachusetts 02111

Chairman's Letter

March 1, 1990

To Our Shareholders:

This was a year of transitions. Two beloved Directors of Plymouth Rock Assurance Corporation died in 1989. Maurice Saval, who was close to ninety, died in February as the consequence of an automobile accident. He had lived a long life, but he was not yet ready to quit. Mr. Saval knew more about insurance than just about anyone. He successfully established an insurance brokerage practice over fifty years ago, and later created a successful family of insurance companies in the United States and Canada. When he sold the businesses and then retired in 1982, he devoted his legendary energies to the promotion and support of education. Plymouth Rock, in fact, was his only continuing business activity. He advised us wisely and often. If there are mercies in the nature of his death, they are these. He never had to be anyone's dependent, a role he would have hated. He was also spared witnessing the continued distress of his former flagship company. The company to which he gave so much of himself cannot at present serve as his monument. He will live on instead in the grateful memories of the many he helped to educate and advise.

Sandy Ellis died of a stroke just after Christmas. He was my first boss and inspiration in the business of insurance. Had I not known him, I doubt there would be a Plymouth Rock. I was a Harvard graduate student in 1972 when he and Leon Newman, the powers of the era at Fairfield & Ellis, hired me to serve as the Boston brokerage firm's economist. Sandy had a vision that insurance brokers would have to go beyond purchasing more and more insurance for their corporate clients. They must be prepared to recommend less insurance, self-insurance, or other alternative risk management vehicles, he insisted, even if the result was a reduction in traditional commission income. In this he was ahead of his time, and we were quite successful together at our mission for the firm.

I was paid fairly, but the real benefit of the job was time with Sandy. Never have I known anyone with more generosity of spirit, more ability to take pleasure from the successes of his many friends, and more just-plain decency. That he taught me the nuts and bolts of insurance is incidental compared to his lesson by example that both intellect and

moral force could be fully employed in this industry. I set out to learn the insurance business under Sandy Ellis's tutelage. A decade later, when I told him that Keith Rodney, Jim Bailey and I were founding a new insurance company, he was genuinely excited. He offered me interim office space in his executive suite and a small stipend to help get me through our initial year of planning. He honored us by serving as a Director of both the holding company and the insurance company, but he would never accept compensation. He died untimely, the holder of a great debt owed and uncollected.

This year was transitional in less personal respects as well. I have written repeatedly in past letters about the tenuous state of the auto insurance residual market rules, which have such a powerful impact on our performance. The residual market, Commonwealth Automobile Reinsurers or C.A.R., has since 1984 provided a monetary punishment for companies trying to exit the state and a concomitant reward for companies willing to grow. There has also been a sizeable reward for writing urban business. Since auto insurance rates were inadequate for most of this period, the economics of profitability depended on reaching for C.A.R.'s rewards. A shrinking insurer, especially if it deserted the cities, would be hit twice, by inadequate rates and by a C.A.R. penalty. A stable and balanced insurer would be neutral with respect to C.A.R. but squeezed by the rates. Only a growing company, with a healthy share of urban business, could prosper. We met this standard but constantly worried that the growth rewards would be removed before the rates became adequate.

Now the picture looks vastly different. In 1988, Governor Dukakis submitted to the state legislature a major law reform bill, which took effect in 1989. Unlike those states where there has been an assault on insurance premium levels coupled with no attempt at all to remove unnecessary costs from the system, Massachusetts tied a mandated rate reduction to meaningful reforms. Massachusetts may have a poor reputation in national insurance circles, but insurers who pay attention to the facts should use our Governor and our Legislature in this instance as models of responsible leadership. A rate reduction averaging over 7 percent was ordered for 1989, and it appears from preliminary observations that the savings from the new law will cover the entire reduction. Combining the law impact with the 8 percent overall increase announced for 1990, automobile insurance rates should now be adequate for the first time in a decade.

The law reform having been put in place, attention was quickly focused on the C.A.R. rules. Seeing no need to provide growth incentives in an environment of adequate rates, and assessing that there might be future systemic savings from depopulating the overstuffed residual market pool, Commissioner Gailey took it upon himself to redesign virtually all of the important C.A.R. rules. The principal thrust of his initiative was to phase out the growth incentive over a three year transition period and substitute a powerful incentive for companies to shift business out of the C.A.R. pool and into their voluntary books of business. Excessive pooling, here representing over two-thirds of the state's overall auto insurance volume, almost certainly takes the sharp edge out of insurance company cost containment efforts. When business moves back to the voluntary market,

the invisible hand will be ready to slap any carrier that becomes inattentive with respect to claims. That can only be good for the public.

Rule changes of this magnitude had not been forced by the Division of Insurance in over a decade, and a host of complex side effects of the new proposals threatened to slow down the process, but the Commissioner was adamant. It looked in October as though there would be a three-way feud among the Commissioner, the Legislative Joint Committee on Insurance, and various factions of the business. By December, a compromise had been forged that virtually everyone accepted. An overwhelming majority of the C.A.R. board, myself included, voted concurrence with the Commissioner's rules, and they took effect on January 1, 1990.

Though the impact on Plymouth Rock in the short run is attenuated by its transition provisions, the new plan has profound longer-term implications for us. Under the old rules, a company's bottom line was influenced as much by growth as by underwriting quality. Our underwriting was very good, so we were doubly blessed. Now there will be no reward for growth, but instead an incentive to keep business out of the pool. The urban credits have been retained and, in fact, increased. The company that does best in the future will be the one with the most flexible geographical mix, the most control over underwriting and, consequently, the least need for C.A.R.'s reinsurance. This system will prove stable only if independent agency companies can find strategies that produce low loss ratios without withdrawal of capacity from voluntary agents. We are thankful that Plymouth Rock begins, at least, with a strong book and a carefully selected geographical balance.

Plymouth Rock Assurance Corporation finished the year a $69 million company measured by its gross writings. This is 14 percent growth from the close of 1988, the smallest increment in our six year history. The slow growth in premiums is largely due to the auto insurance rate decrease ordered for 1989. If our policy unit count had been coupled with a more typical 8 percent rate increase in 1989, the gross volume would have been up about 30 percent. We are in no way disappointed by the top line performance. Since the rate decrease appears to have been justified by the law reforms, there was no damage to our bottom line. And we are a company driven by quality and the bottom line. Net income for 1989 was $3.84 million, up 28 percent from 1988.

The pure loss ratio declined since last year. The expense ratio rose. The first fact is good news, reflecting the continued success of our agency plant and our mathematical underwriting techniques. The second fact is bad news. We want to bring our expense ratio down over the years, and we must do so if we are ever to compete successfully with the direct writers in less regulated states. In 1988, we ran our business for 38.4 percent of gross premium, including every category of operational, investment and claims expense. This year, it cost us 40.3 percent of premium for everything other than a one-time insolvency fund assessment which is matched by a direct recoupment provision in the 1990 rates.

The two point expense ratio deterioration has several causes. The first is the impact of the rate decrease. Policy counts in 1989 continued to rise while the premium income per policy fell. Claims went down with the rates, but the costs of policy services, accounting and underwriting continued upward in their normal manner. The ratio of expenses to premiums was accordingly pushed higher. This is a one-time effect and not much cause for concern. The second reason for the expense increase was our conversion to Policy Management Systems Corporation software. We are as convinced as ever that PMSC is the best and the most economical alternative for us, but no one had pretended a conversion could be free. So far, the change is costing less than we budgeted and it is reasonably on schedule. This contribution to the 1989 expense ratio will not be repeated in future years.

The third cause of the expense ratio increase, however, can not be discounted as unique to 1989 and does represent a continuing concern. We simply have not figured out how to settle claims as efficiently as we must. Keith and I have both devoted considerable time in recent months to a series of experiments in this area. One involves the way we handle the incoming telephone load. Too many calls go to busy adjusters when others could handle them; too many calls require call-backs; too many calls are initiated by agents or policyholders when better communication on our part might have answered them in advance. Our methods for addressing this problem are still in the development stage.

The other thrust is a major overhaul of our field operations in claims. We have always been unhappy about the dominance of a three-party payment mechanism in the handling of automobile damage claims. The economy is replete with examples of how easily the costs of three-party mechanisms spin out of control. To our way of thinking, the body shop, the customer and the company form a dangerous triangle when all are involved in a simultaneous negotiation. So we now offer our policyholders, in keeping with a provision of the reform law, a choice of two-party mechanisms as optional alternatives to the traditional approach.

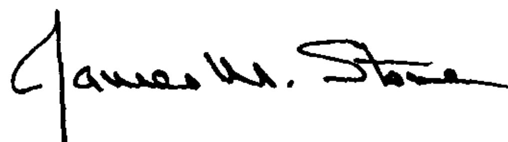
Our "Crashbusters" program promptly sends a Plymouth Rock van to the location of the damaged vehicle, allows our appraiser to perform a computer-aided evaluation of the loss, and usually results in a settlement with the customer which we promise will be honored by a list of recommended bodyshops. We can usually cut a check the same day. The customer is then free to conduct the final negotiations. If the cost is lower than our appraisal, the customer can keep the savings. Our "Door-to-Door" plan will provide a different two-party process, with even less work for the customer. If the policyholder wants us to, we will pick up the damaged vehicle and leave a rental car in its place. We will then negotiate with the body shop, effect the necessary repairs and return the vehicle. The repair is guaranteed by Plymouth Rock. Policyholders and agents seem to like these innovations. Their impact on cost remains to be discovered.

I am not yet confident we know how to do our business cheaply enough and still maintain our standards of excellence in service. We will continue to ponder and experiment until we find a way. I hope to report a resumption of our downward expense ratio trend this time next year.

Plymouth Rock's investments remain as conservative as ever. At $44 million, the portfolio is too small to produce a meaningful return on the costs of top-flight research. We are growing so quickly, moreover, and earning enough on the underwriting side of the business that there would be a high cost to capital erosion from potential investment losses. As a consequence, we knowingly sacrifice some of the available return for the security of relatively passive management and safe holdings. Our current portfolio is entirely in top-grade, fixed income securities and has an average duration of less than three years. Eventually the economics must change, and the trade-offs will favor taking risk. In the near future, we may put a toe in that water but it will be some time before we want to swim with the high performance investors of our industry.

Last year's letter noted our search for a new senior executive and our interest in states other than Massachusetts. I am thrilled to report that Edward W. Ford, formerly the Chief Actuary of Progressive Casualty, will be joining us soon as Senior Vice President for marketing, underwriting and policy services. Ed brings with him an established reputation for brilliance and a humanistic philosophy. After the founders he will be our highest ranking officer. The exploration for opportunities in additional jurisdictions is in progress. It remains for some future report to announce the birth of our first infant company in a new state.

Whenever we operate in a next state, some aspects of our business may differ from the Massachusetts model. The most important features, however, we expect to hold constant. We are committed to hiring first-rate people, providing them an unusually happy and stable office environment, and expecting them to give us hard work, integrity and loyalty in return. The result is the sine qua non of our business: better service to the customer. We are committed to sophistication in automation, both operationally and in risk selection. We try to use cutting edge technologies and statistical methods a university professor would be proud of. We fight hard against any tendency to intellectual closed-mindedness or lack of respect for all we do not know. We are committed to good citizenship. We view the public as our primary constituency. The public, and its government officials, should never be made our adversaries. These principles have worked well for us in Massachusetts. I will be disappointed if their applicability proves other than universal.



James M. Stone

Coopers
&Lybrand

certified public accountants

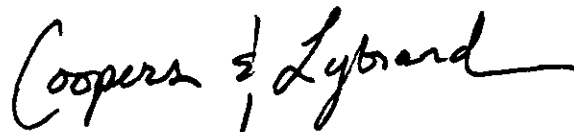
REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of
The Plymouth Rock Company:

We have audited the accompanying consolidated balance sheets of The Plymouth Rock Company and Subsidiary as of December 31, 1989 and 1988, and the related statements of income and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Plymouth Rock Company and Subsidiary at December 31, 1989 and 1988, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with generally accepted accounting principles.



Boston, Massachusetts
March 6, 1990

THE PLYMOUTH ROCK COMPANY

CONSOLIDATED BALANCE SHEETS

December 31, 1989 and 1988

ASSETS	1989	1988
Marketable securities	$37,743,999	$34,115,711
Cash and short-term investments	6,174,109	9,861,759
Premiums receivable	1,755,604	1,400,171
Accrued investment income	774,858	691,782
Deferred acquisition costs	1,624,607	1,060,797
Fixed assets	3,852,956	3,454,593
Total assets	$51,926,133	$50,584,813

LIABILITIES		
Losses and loss adjustment expenses	$16,389,638	$10,834,079
Unearned premiums	4,070,891	3,498,835
Commissions	2,670,095	1,585,322
Amounts payable to reinsurers	5,162,766	10,625,456
Other liabilities	4,446,336	8,695,272
Total liabilities	32,739,726	35,238,964

STOCKHOLDERS' EQUITY		
Common stock	17,357	17,357
Additional paid-in capital	9,787,643	9,787,643
Retained earnings	9,381,407	5,540,849
Total stockholders' equity	19,186,407	15,345,849
Total liabilities and stockholders' equity	$51,926,133	$50,584,813

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

THE PLYMOUTH ROCK COMPANY

CONSOLIDATED STATEMENTS OF CASH FLOWS

for the years ended December 31, 1989 and 1988

	1989	1988
Cash flows from operating activities:		
Net income	$ 3,840,558	$ 3,008,544
Depreciation and amortization	629,490	537,057
Changes in:		
Premiums receivable	(355,433)	(797,666)
Losses and loss adjustment expenses	5,555,559	4,341,569
Unearned premiums	572,056	1,330,801
Amounts payable to reinsurers	(5,462,690)	2,517,513
Other liabilities	(4,248,936)	2,572,329
Other, net	336,998	(160,611)
Net cash provided by operating activities	867,602	13,349,536
Cash flows from investment activities:		
Purchase of marketable securities	(23,029,080)	(27,593,432)
Sale or maturity of marketable securities	19,470,493	12,488,012
Purchase of fixed assets	(996,665)	(2,547,342)
Net cash used in investment activities	(4,555,252)	(17,652,762)
Cash flows from financing activities:		
Stock options exercised	-0-	325,000
Net cash provided by financing activities	-0-	325,000
Net increase (decrease) in cash and short-term investments	$(3,687,650)	$(3,978,226)

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

THE PLYMOUTH ROCK COMPANY

CONSOLIDATED STATEMENTS OF INCOME

for the years ended December 31, 1989 and 1988

	1989	1988
Premiums earned	$23,492,246	$15,854,054
Losses and loss expenses incurred	15,182,557	10,665,567
Underwriting, general and administrative expenses	6,162,853	3,672,192
Underwriting income	2,146,836	1,516,295
Net investment income	3,818,119	2,918,086
Income from insurance operations	5,964,955	4,434,381
Special insolvency fund assessment	537,330	-0-
Holding company expenses	180,340	125,837
Income from operations before federal income taxes	5,247,285	4,308,544
Federal income taxes	1,406,727	1,300,000
Net income	$ 3,840,558	$ 3,008,544

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

THE PLYMOUTH ROCK COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

A. Principles of Consolidation

The consolidated financial statements include the accounts of The Plymouth Rock Company and its subsidiary, Plymouth Rock Assurance Corporation. All significant intercompany accounts and transactions have been eliminated in consolidation.

B. Cash and Short-term Investments

Cash and short-term investments consist of cash and investments purchased with maturities of less than three months.

C. Marketable Securities

Marketable securities are comprised primarily of fixed income investments carried at amortized cost. The cost of marketable securities sold is based on specific identification of each security held at the time of sale.

D. Fixed Assets

Fixed assets are carried at cost less accumulated depreciation. The Company provides for depreciation and amortization principally on the straight-line method over the estimated useful lives or the applicable lease terms.

E. Income Taxes

The Company files its federal income tax return on a consolidated basis. Deferred taxes are provided to reflect the income tax effect of timing differences between book and taxable income.

F. Premiums

Premium revenues are earned on a daily basis over the terms of the policies. Unearned premiums represent billed amounts which are applicable to the unexpired terms of policies in force. Unearned premiums are presented net of reinsurance. Premiums are recorded when billed.

Continued

1. Summary of Significant Accounting Policies, continued

G. Losses and Loss Adjustment Expenses

Loss reserves represent the estimated liability for claims reported to the Company, plus reserves for losses incurred but not yet reported. Loss adjustment expense reserves represent the estimated expenses related to these claims and losses. Such estimates are presented net of amounts recoverable from reinsurance. The methods of making such estimates and establishing the resulting reserves are reviewed regularly and resulting adjustments are reflected in income currently.

H. Deferred Acquisition Costs

Commissions and premium taxes are deferred and amortized pro rata over the contract periods in which the related premiums are earned. All amounts deferred at December 31 are charged to operations in the following year as the related premiums are earned. Deferred acquisition costs are presented net of commission income on ceded reinsurance.

I. Reclassification

Certain 1988 balance sheet items have been reclassified to conform with the 1989 presentation.

2. Treaty Reinsurance

Treaty reinsurance ceded is used to reduce exposure to large losses. The Company ceded earned premiums under such treaties of $9,033,000 and $10,158,000 in 1989 and 1988, respectively. The liability for losses and loss adjustment expenses is reflected net of treaty reinsurance recoverable of $4,781,000 and $3,896,000 for 1989 and 1988, respectively. The Company recovered $1,170,000 and $921,000 from reinsurers in 1989 and 1988, respectively. The Company remains primarily liable as the direct insurer on all voluntary risks.

Continued

3. Net Investment Income

The components of net investment income before federal income taxes during 1989 and 1988 are as follows:

	1989	1988
Interest income from securities	$2,930,415	$2,357,278
Interest income from accounts receivable	1,231,828	927,127
Gross interest income	4,162,243	3,284,405
Investment expenses	375,336	326,585
Net investment income	3,786,907	2,957,820
Realized capital gains (losses)	31,212	(39,734)
Net investment income and capital gains	$3,818,119	$2,918,086

At December 31, 1989 and 1988, unrealized capital losses are as follows:

	1989	1988
Carrying value of securities:		
Marketable securities	$37,743,999	$34,115,711
Cash and short-term investments	6,174,109	9,861,759
Total	43,918,108	43,977,470
Market value of securities	43,665,687	43,386,680
Unrealized losses	$ (252,421)	$ (590,790)

Continued

THE PLYMOUTH ROCK COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(CONTINUED)

4. Fixed Assets

At December 31, 1989 and 1988, fixed assets are:

	Estimated Useful Lives	1989	1988
Furniture and fixtures	10 years	$1,470,790	$1,265,439
Computers	3-5 years	2,165,335	1,849,139
Leasehold improvements	5-10 years	1,149,218	1,301,837
Automobiles	3 years	201,956	106,244
		4,987,299	4,522,659
Less accumulated depreciation and amortization		1,134,343	1,068,066
		$3,852,956	$3,454,593

Depreciation and amortization charged to income were $629,000 and $537,000 in 1989 and 1988, respectively.

5. Stockholders' Equity

Stockholders' equity is comprised of the following:

	1989	1988
Common Stock:		
Class A, $.10 par value - voting; authorized 300,000 shares, issued and outstanding - 128,572 shares	$ 12,857	$ 12,857
Class B, $.10 par value - voting; authorized 90,000 shares, issued and outstanding - 45,000 shares	4,500	4,500
Common stock	17,357	17,357
Additional paid-in capital	9,787,643	9,787,643
Retained earnings	9,381,407	5,540,849
Total stockholders' equity	$19,186,407	$15,345,849

Continued

5. Stockholders' Equity, continued

The changes in retained earnings are as follows:

	1989	1988
Retained earnings beginning of year	$5,540,849	$2,532,305
Net income	3,840,558	3,008,544
Retained earnings end of year	$9,381,407	$5,540,849

The Class A common shares are fully transferable and have the right to elect 20 percent of the Board of Directors. The Class B common shares are not transferable, but may be converted to Class A common shares on a one for one basis at any time at the option of the holder, or automatically upon the occurrence of certain events. The Class B common shares elect 80 percent of the Board of Directors.

The Company has an option to purchase all of the common shares of SRB Corporation in exchange for shares of Class B Common Stock of the Company in amounts based on the performance of the Company and SRB Corporation taken together through 1992.

Under the Company's incentive stock option plan, 10,000 shares of Class B Common Stock were reserved for issuance upon exercise of options granted to certain key employees for the purchase of 5,000 shares at $25 per share and 5,000 shares at $40 per share. All options were exercised during 1988.

Continued

6. Income Taxes

The Company's reported provision for federal income taxes of $1,406,727 and $1,300,000 for 1989 and 1988 is less than that computed by applying the federal income tax rate for these years to income from operations before federal income taxes. This is because the Company has significant non-taxable interest and has recognized the benefit of the fresh start provision in the Tax Reform Act of 1986 in 1989 and 1988.

The Company's federal income tax returns reflect taxes of approximately $850,000 and $1,600,000 for 1989 and 1988. These amounts are not the same as federal income taxes as shown in the Consolidated Statements of Income. This is because the rules of the Internal Revenue Code and those of generally accepted accounting principles differ with respect to the time periods in which premium income and loss expense are recognized for tax purposes.

7. Savings and Investment Plan

The Company has a Savings and Investment Plan under Section 401K of the Internal Revenue Code. The Plan covers all employees 21 years or older with at least one year of service. The Company made discretionary contributions of $330,000 and $218,000 in 1989 and 1988, respectively.

8. Lease Commitments

Rental expenses for 1989 and 1988 (net of sublease rental income of $95,000 and $54,000) aggregated $614,000 and $588,000, respectively.

The Company leases approximately 37,500 square feet of space for its home office building. The future lease obligations of the Company under the lease are summarized in the table below. The Company was required to deposit an escrow fund at the inception of the lease. The escrow balance, which declines over time, was $500,000 at the end of 1989.

Continued

8. Lease Commitments, continued

Future minimum lease payments are as follows:

Year ending December 31,	Minimum Lease Payments
1990	$ 754,000
1991	786,000
1992	818,000
1993	1,018,000
1994	1,062,000
Later years	4,130,000

In connection with the above lease, the Company receives sublease income of $95,000 per year, which is expected to continue through June 1993.

9. Related Party Transactions

During 1989 and 1988, certain services, principally consulting and data processing services, were provided to the Company by the SRB Corporation, an affiliate of the Company which specializes in the provision of insurance services. The Company paid to SRB Corporation for these services during 1989 and 1988 a total of $766,000 and $426,000, respectively. The Company has the option to acquire 100% of the common stock of SRB Corporation. SRB Corporation paid the Company $36,000 in 1989 and $18,000 in 1988 for services provided to it by the Company.

Directors and Officers of The Plymouth Rock Company

Directors

James M. Stone, *Chairman*

James N. Bailey

Michael J. Johnston

Wilmot H. Kidd, III

Keith R. Rodney

Benno C. Schmidt

Officers

James M. Stone
President and Chief Executive Officer

Keith R. Rodney
Executive Vice President and Clerk

James N. Bailey
Treasurer

Edward W. Ford
Senior Vice President

Directors and Officers of Plymouth Rock Assurance Corporation

Directors

James M. Stone, *Chairman*

James N. Bailey

Wilmot H. Kidd, III

Keith R. Rodney

Officers

James M. Stone
President and Chief Executive Officer

Keith R. Rodney
Executive Vice President and Secretary

Edward W. Ford
Senior Vice President — Underwriting

William M. Kelley
Vice President — Claims

Stewart W. Kemp
Vice President — Counsel

Myron S. Steere, III
Vice President — Finance

William J. Whitebone
Vice President — Underwriting

COUNSEL:
Ropes & Gray, Boston

AUDITORS:
Coopers & Lybrand, Boston